Chapter 9

INTERNATIONAL TRADE THEORY AND DEVELOPMENT POLICY

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I. INTRODUCTION

The case for international specialization is firmly based on considerations of economic efficiency. The world is not rich enough to be able to despise efficiency. The optimum pattern of specialization is governed by the principle of comparative advantage. This principle remains as valid today as it was in Ricardo's time. And yet there is some question whether it alone can give all the guidance needed by countries whose dominant and deliberate aim is economic development (that is, increasing real income per capita).

Trade between countries rests on the realization of mutual gains. Objection may be raised to the uneven division of these gains. Within the range of opportunities for gainful trade, it is true that one country may be able to improve its terms of trade at the expense of another. For a single country, therefore, the logic of the classical position does not necessarily lead to a free trade recommendation, but only to one of some trade as opposed to no trade at all. Moreover, the effects of trade restriction on a country's barter terms are not necessarily offset by retaliation, since different countries have different demand and supply elasticities. It may be that primary producing countries are in a relatively favourable position for playing this kind of game. But even for them the possibilities suggested by the so-called optimum tariff argument are limited and in the long run very unreliable. These possibilities are discussed in Professor

1 Some parts of a preliminary draft of this paper were presented for discussion at a seminar of the RAND Corporation's Economics Division in Santa Monica, California, in July 1957. In addition Professor W. R. Allen of the University of California at Los Angeles was kind enough to read my manuscript and comment on it in detail. My colleague Professor J. W. Angell gave valuable help in a similar way at a later stage. The criticisms received from these sources, for which I am extremely grateful, have led me to revise or expand a number of points. It goes without saying that no one except myself is responsible for the views advanced or any errors remaining in the paper.

H. S. Ellis (ed.), Economic Development for Latin America
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Haberler’s paper on ‘The Terms of Trade and Economic Development’, and need not be dwelt upon further.

Whatever the distribution of the gain from trade, so long as some gain accrues to each party the case for trade remains. In fact, it can be argued that to under-developed countries trade is more important than to advanced countries. There is therefore a prima facie presumption in favour of promoting development by means of — or at least side by side with — foreign trade, rather than at the cost of sacrificing the economic efficiency derived from specialization.

The traditional theory of international specialization centres on the comparison of a trading situation with a no-trade situation, and on the demonstration of the superiority of the former over the latter. This is essentially the Ricardian procedure. The mental process which we perform when, starting from a state of isolation with different pre-trade ratios of exchange in each country, we let the barriers be stripped and then study the effects of trade, is still the core of international trade theory. The assumption of a fixed initial stock of factors can be relaxed by allowing factor supplies to change in response to trade itself, without altering the essential character of this demonstration of the gains from international specialization. The demonstration is conclusive. If one asks what help it offers here and now to low-income countries in search of development, the answer is not altogether clear. If these countries were each of them isolated from the rest of the world, they could indeed rise to a higher income level by simply stripping the barriers to trade. But in fact they have long been closely linked to world trade. Their export products do not in general encounter any very severe restrictions in world trade, and their import controls, as will be seen below, are mainly designed either to curb an excessive appetite for foreign wares or to modify the composition of their imports, rather than to force an actual reduction in total volume. There is undoubtedly a good deal of senseless restrictionism that hampers their trade as a whole and hence their economic growth. And yet they may also have reason to wonder what international specialization, an essential base for their existing position, can do for their development.

The present interest in growth economics has so far had little impact on the theory of international trade. In trying to give a specific focus to the discussion of the very broad topic assigned to me, it may be worth considering whether the notion of balanced growth is compatible with the principle of international specialization or whether, on the contrary, it means throwing away the benefits obtainable through trade. In many of the less developed countries today the dominant practical question is whether the available