

**THE DETERIORATION IN THE TERMS OF  
TRADE OF LDC S AND UNEQUAL EXCHANGE**

**A DISSERTATION  
SUBMITTED TO THE  
UNIVERSITY OF POONA  
IN PARTIAL FULFILMENT  
FOR THE DEGREE OF  
MASTER OF PHILOSOPHY  
IN ECONOMICS**

**BY**

**RAJANI GUPTA**

**GOKHALE INSTITUTE OF POLITICS AND ECONOMICS  
PUNE 411 004**

**1983**

(11)

ACKNOWLEDGEMENT

I am extremely grateful to Prof. P. Venkatramaiah for his guidance in the writing of this dissertation.

I would also like to thank Dr. B.G. Bapat and Dr. S.V. Bokil for their valuable comments.

Finally, Shri K.P. Limbore deserves praise for the prompt and efficient typing of the manuscript.

Rajani Gupte.

CONTENTS

	<b>Page</b>
<b>ACKNOWLEDGEMENT</b> .. .. .	(11)
<b>CONTENTS</b> .. .. .	(111)
<b>INTRODUCTION</b> .. .. .	1
<b><u>CHAPTER I</u> - TRADE AND DEVELOPMENT</b> ..	3
1.1 Introduction .. .. .	3
1.2 Foreign Trade as an Engine of Growth	4
1.3 The Ricardian Comparative Cost Doctrine .. .. .	5
1.4 The secular trend in the Terms of Trade - A Statistical Debate ..	9
<b><u>CHAPTER II</u> - SOME EXPLANATIONS FOR THE DETERIORATION OF TERMS OF TRADE IN LDC'S</b> ..	20
2.1 Introduction .. .. .	20
2.2 The Prebisch - Singer Thesis ..	21
2.3 Variable returns to scale ..	28
2.4 The Dependency Thesis ..	30
2.5 The Unequal Exchange Thesis ..	34
<b><u>CHAPTER III</u> - THE UNEQUAL EXCHANGE HYPOTHESIS</b>	38
3.1 Introduction .. .. .	38
3.2 Objectives .. .. .	39
3.2.1 On the Theoretical Plane ..	39
3.2.2 On the Practical Plane ..	41
3.3 Methodology .. .. .	43
3.3.1 Determination of Internal Equilibrium Prices .. .. .	44
3.3.2 Formation of External Equilibrium Prices .. .. .	45
3.3.3 Unequal Exchange .. .. .	48



					Page
<b>CHAPTER IV - (contd.)</b>					
4.10	The Modifications suggested by				
	the critics	..	..		91
CONCLUSION	..	..	..	..	93
APPENDIX	..	..	..	..	95
LIST OF ABBREVIATIONS	..	..	..	..	108
BIBLIOGRAPHY	..	..	..	..	109

## INTRODUCTION

Discussions regarding the impact of international trade on development date back to the mercantilist writings of the 17th century, which focussed attention on the beneficial effects of a surplus in the trade account. Later, the classical and neo-classical economists extolled the virtues of foreign trade and advocated a free trade policy, on the grounds that free trade resulted in a gain for all the participants. In fact, Lewis (1952) was convinced that, "..... historically, the beginnings of economic development in every country are associated with increased foreign trade ....."

This view was regarded with increasing scepticism around the 1950's when Prebisch, Singer and others observed a persistent downward trend in the terms of trade of primary-product-exporting countries. This was interpreted as an indication that trade between two countries did not necessarily benefit both partners. This set off a long drawn out controversy. Both these hypotheses form the subject matter of Chapter I.

Besides investigating the decline in terms of trade (TOT) as a statistical phenomenon, several attempts have been made to explain theoretically the malfunctioning of trade as an "engine of growth" and we deal with these explanations in Chapter II.

In Chapter III, we pursue one of these explanations viz. Emmanuel's "Unequal Exchange" hypothesis, in some detail, before we present a critique of this theory in Chapter IV.