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BA Economics Honours | Semester 3 | Calicut University

Foundations of Global Economics

Course Code: ECO3MN205 • Module 3

Module III: International Trade and Economic Development

The relationship between international trade openness and long-run economic development is one of the most vigorously debated subjects in development economics. While classical economists hailed trade as an "engine of growth," structuralist and dependency theorists warned that primary commodity exporters face systemic structural disadvantages in the global division of labor.

Unit 13 & 14: Trade as an Engine of Growth versus Structural Critique

British economist D.H. Robertson famously termed trade an **"Engine of Growth"** in the nineteenth century, when European industrial demand fueled rapid capital accumulation and infrastructure expansion in newly settled regions (Australia, Canada, Argentina). Trade contributes to development through:

- Direct capital goods imports embodying state-of-the-art technological advances.
- Vent-for-surplus: mobilizing underutilized domestic labor and natural resources to produce agricultural and mineral exports.
- Enlarging market size, enabling domestic firms to reap internal and external economies of scale.

The Singer-Prebisch Thesis (1950)

Argentine economist Raúl Prebisch and British economist Hans Singer formulated a devastating empirical critique of classical trade optimism. They demonstrated that developing nations that export primary agricultural commodities and minerals to advanced industrial nations in exchange for manufactured capital goods suffer from a **secular, long-run deterioration in their Net Barter Terms of Trade (**$NBT = P_x/P_m$**)**.

The thesis identifies two structural economic mechanisms:

1. **Disparities in Income Elasticity of Demand:** Manufactured goods have an income elasticity of demand greater than unity ($e_y > 1$), while food and primary agricultural raw materials have an income elasticity below unity ($e_y < 1$, following Engel's Law). As global GDP rises, global demand for manufactured goods expands much faster than demand for agricultural commodities.
2. **Asymmetry in Labor Market Power:** In advanced nations, strong labor unions and oligopolistic corporate cartels capture productivity gains in the form of higher wages and firm profits, preventing manufactured prices from falling. In developing nations, surplus rural labor keeps agricultural wages at subsistence, passing all agricultural productivity gains to Western consumers via declining export prices.

Development Strategies: Import Substitution versus Export Orientation

- **Import Substituting Industrialization (ISI):** Popular in Latin America and India during 1950–1980. Replaced imported manufactured consumer goods with domestic production behind high tariff walls and import quotas. While successfully establishing basic heavy industries, prolonged ISI led to high-cost, inefficient monopolies and severe foreign exchange shortages.
- **Export-Oriented Industrialization (EOI):** Pursued by the "East Asian Tigers" (South Korea, Taiwan, Singapore, Hong Kong). Focused on manufacturing labor-intensive manufactured goods for competitive global export markets, achieving unprecedented rates of sustained economic growth and poverty eradication.

Advanced Theoretical Formulations and Empirical Frameworks (Analytical Division 1)

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Empirical Methodology, Identification Strategies, and Econometric Estimation

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Consider the structural estimation of policy impacts across decentralized economic agents. When evaluating macroeconomic interventions or microeconomic regulatory changes, parameters estimated from observational datasets must account for expectations formation and structural parameter stability in accordance with the Lucas Critique. Consequently, contemporary applied economics bridges micro-foundations with aggregate macroeconomic phenomena through dynamic stochastic general equilibrium (DSGE) modeling and micro-econometric panel estimations.

Comparative Institutional Analysis, Market Failures, and Policy Governance

Economic outcomes are fundamentally mediated by institutional architectures, legal property rights regimes, and regulatory governance. In emerging market economies such as India, market imperfections—including asymmetric information, transaction costs, infrastructural bottlenecks, and credit constraints—often necessitate nuanced policy interventions that differ substantially from textbook laissez-faire predictions.

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Market Efficiency	Markets clear instantaneously; price mechanism allocates resources optimally without systemic friction.	Markets are prone to structural failures, information asymmetry, and coordination coordination failures.	Targeted regulatory oversight, public investment in infrastructure, and social safety nets.
Behavioral Motivation	Hyper-rational agents maximizing expected utility with complete cognitive computational capacity.	Bounded rationality, behavioral heuristics, loss aversion, and institutional anchoring effects.	Choice architecture, behavioral nudges (NITI Aayog initiatives), and consumer financial protection mandates.
State Intervention	State role restricted to core public goods, contract enforcement, and national defense (minimalist state).	State acts as developmental catalyst, risk-absorber of last resort, and promoter of equitable distribution.	Strategic industrial policy (PLI schemes), counter-cyclical fiscal intervention, and universal public services.
Distributional Equity	Factor rewards reflect marginal productivity;	Power asymmetries, bargaining power, and	Progressive fiscal transfers, land reforms, and affirmative

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	distribution is secondary to allocative efficiency.	historical wealth accumulation shape distribution.	human capital investments.
Technological Progress	Exogenous technological shocks arriving randomly (Solow neoclassical growth model).	Endogenous technological innovation driven by R&D, human capital, and intellectual property institutions.	National Innovation Foundation, Startup India, and public digital infrastructure (India Stack / UPI).

Comprehensive Empirical Analysis: The Kerala Model and Sub-National Development

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However, contemporary economic analysis also highlights structural challenges confronting this development paradigm: high educated unemployment, fiscal constraints stemming from escalating public debt servicing and pension obligations, and heavy reliance on external remittance inflows from migrant workers in the Persian Gulf. Sustaining this high-welfare equilibrium necessitates transitioning toward a knowledge-driven economy, incentivizing high-tech manufacturing, and mobilizing sustainable sub-national fiscal resources.

Policy Synthesis and Analytical Evaluation

Policy formulation in dynamic economic environments must therefore synthesize foundational deductive reasoning with robust inductive empirical inquiry. Economists must continuously evaluate the balance between market incentives and regulatory governance, ensuring that institutional frameworks promote both productive efficiency and distributive social justice.

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