

Subject	ECONOMICS
Paper No and Title	13: International Economics
Module No and Title	12: Secular Deterioration Hypothesis (Prebisch Singer Hypothesis)
Module Tag	ECO_P13_M12

Principal Investigator	Co- Principal Investigator	Co- Principal Investigator	Co- Principal Investigator and Technical Coordinator
Prof H C Pokhriyal Executive Director School of Open Learning University of Delhi Delhi-110007	Dr Jaswinder Singh Principal SGTB Khalsa College University of Delhi Delhi-110007	Dr Jatinder Bir Singh Principal Sri Guru Gobind Singh College of Commerce University of Delhi	Dr Vimal Rarh Deputy Director, Centre for e-Learning and Assistant Professor, Department of Chemistry, SGTB Khalsa College, University of Delhi <i>Specialised in : e-Learning and Educational Technologies</i>
Paper Coordinator	Content Writer		Reviewer
Dr Jaswinder Singh Principal SGTB Khalsa College University of Delhi Delhi-110007	Ms. Shelly Gupta Assistant Professor Gargi College University of Delhi		Dr. Poonam Bakhshi Associate Professor Department of Economics Panjab University Chandigarh
Anchor Institute : SGTB Khalsa College, University of Delhi			

ECONOMICS
Paper 13: International Economics
Module 12: Secular Deterioration Hypothesis (Prebisch Singer Hypothesis)

TABLE OF CONTENTS

1. Learning Outcomes
2. Introduction
3. The Theory
 - 3.1 The Hypothesis
 - 3.2 The Classical School of Thought
 - 3.3 Evolution of the theory
4. Various explanations: Prebisch-Singer Hypothesis
 - 4.1 Explanation by Prebisch (Supply-side argument)
 - 4.2 Explanation by Singer (Demand-side argument)
5. Empirical Evidence
6. Summary

1. Learning Outcomes

After studying this module, you shall be able to

- Know how terms of trade change over time with respect to agriculture and manufactured goods
- Learn the explanations behind the changing terms of trade
- Identify the gains from trade
- Analyse the evidence which supports and disregards the theory

2. Introduction

In this chapter, we will learn about the Prebisch-Singer theory in detail. The hypothesis developed by Raul Prebisch and Hans Singer is considered as a major part of the dependency theories developed which supports the argument that resources flow from underdeveloped to developed countries at the expense of the former. The idea of import substitution industrialisation (ISI) is also based on the grounds of this theory.

3. The theory

3.1 The Hypothesis

The Prebisch-Singer hypothesis was initially developed by Hans Singer in 1948-49 and was later developed by Raul Prebisch. It argues that the prices of primary commodities will decline over time relative to manufactured goods which leads to a decline in terms of trade for developing countries as developing countries are usually the exporter of primary products and developed nations the producer and exporter of manufactured goods. However, through this relationship, Prebisch and Singer focused on the rising per capita income gap between the developing and developed world arising due to the international trade. According to them, due to this static specialization in the production of primary commodities, developing world has been excluded from enjoying the fruits of technological progress mainly found in the industrial nations.

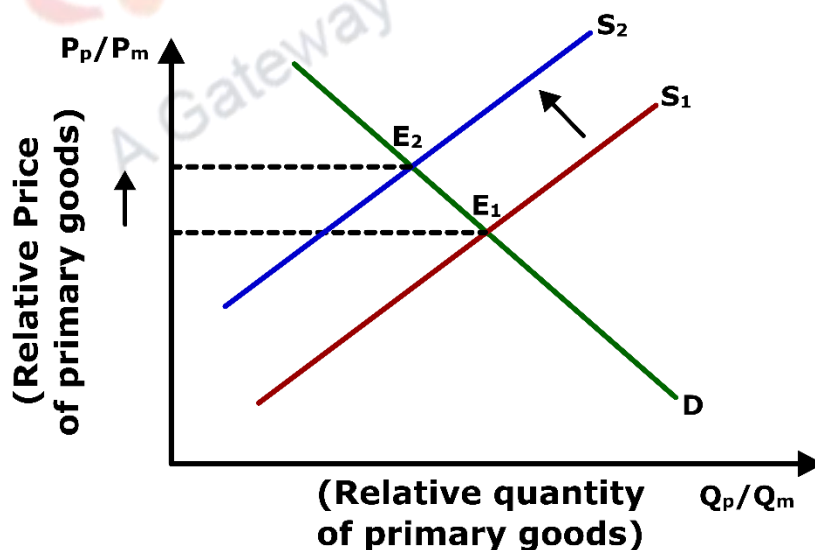
They argued this on the basis of three facts:

1. Developing countries specialize in the production and export of primary commodities and industrialized countries specializes in production of manufactures.
2. Technical progress is mainly concentrated in industry
3. Terms of trade of primary goods relative to manufactured goods has declined since 19th century.

Due to these facts, developing countries has failed to benefit from the technical progress and have suffered from the declining terms of trade.

3.2 The Classical School of Thought

The classical economists however had an exactly opposite approach to what was conceived by Prebisch and Singer. They thought that primary products will overtime experience a rise in terms of trade relative to manufactures. They based their argument on the basis that diminishing returns operate in primary products production and manufactures experience increasing returns. Also, the technical progress in manufactures will exceed that of primary products and hence supply of manufactures will grow faster than the supply of primary commodities. Also, primary products producing nations need not industrialize as trade will increase the prices of the exports of primary products relative to the prices of imports of manufactured goods. This can be better explained with the help of a diagram-



The vertical axis shows the relative price of primary products in terms of manufactures, and the horizontal axis shows the relative quantity- the quantity of primary products divided by the quantity of manufactured goods. The supply and demand curves intersection show the world equilibrium at point E.

As technical progress in manufactured goods exceed that of primary goods, the relative supply of manufacture increases while the relative supply of primary products declines. As the relative supply curve (S_1) shifts to the left, the relative price of primary products rises and the relative quantity declines. The new equilibrium is at E_2 now and the terms of trade for primary product export rises. This leads to the welfare gains from primary product exporting nations.

However, according to Prebisch and Singer, this doesn't work. The terms of trade for primary products relative to manufactures actually declines. The reason for the same is explained in the next section.

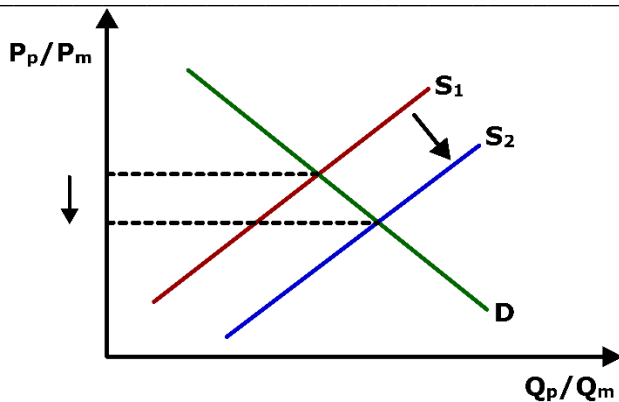
3.3 Evolution of the theory

According to Prebisch and Singer, the above mechanism doesn't work. The relative price of primary goods actually fall and this has been empirically seen in the case of United Kingdom from 1876 to 1947. This was shown by Hans Singer, then working in the United Nations Department of Economic Affairs in New York City, in his paper titled "Post-war Price Relations between Under-developed and Industrialized Countries". Its subsequent follow-up by the United Nations in 1949 led actually to the origin of the Prebisch-Singer hypothesis and the related debate. It was observed in these reports that during the sixty years preceding 1938 primary product prices had fallen relative to prices of manufactures.

4. Various explanations: Prebisch-Singer Hypothesis

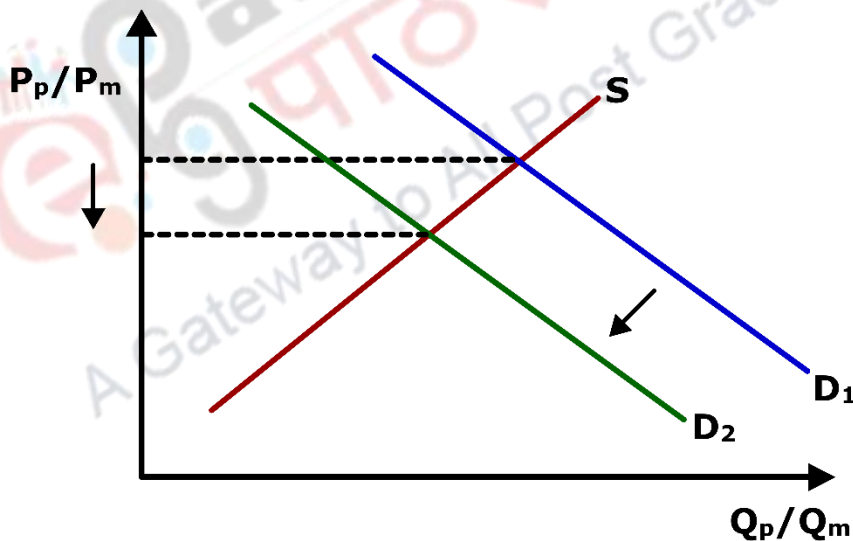
4.1 Explanation by Prebisch (Supply-side argument)

According to Prebisch, labor unions work well in industrialized nations and are weak in developing nations. Hence, workers are able to extract higher wages in industrial nations as compared to primary products producing nations. Thus cost of primary product rises by less than the cost of manufactured goods. This decline in costs increases the relative supply of primary products shifting the relative supply curve to the right and the relative price decreases leading to a decline in terms of trade.



4.2 Explanation by Singer (Demand-side argument)

Singer's argument is based on income and price elasticities. It is usually observed that primary products have low income elasticity. So as and when income rises, the demand for primary commodities decline rapidly than demand for manufactured goods leading to a decline in relative price of primary goods. This would lead to a leftward shift in relative demand curve leading to a worsening of terms of trade for developing nations.



- Both Prebisch and Singer advocated that developing countries should industrialize.

5. Empirical Evidence

The Prebisch-Singer hypothesis has generated much debate. It has been criticized by academicians such as Jacob Viner (1953), R. E. Baldwin (1955), G. M. Meier (1958), G. Haberler (1961), R. E. Lipsey (1963), Harry Johnson (1967), Paul Bairoch (1975), Ronald Findlay (1981), and hence discarded the hypothesis.

It is criticized on the grounds that if it will be reasonable to treat the relative prices of goods equivalent to terms of trade. Developing countries do not export only primary goods and developed countries do not only specialize in manufactured goods. So commodity prices cannot be treated as synonymous to terms of trade.

The fact that industrialized countries do not export only manufactures was addressed early on by Meier and Baldwin (1957), who pointed out the many primary commodities, like wheat, beef, wool, cotton and sugar, are heavily exported by industrialized countries. Indeed, Diakosavvas and Scandizo note that the developing country share of agricultural primary commodities was only 30% in 1983, down from 40% in 1955. Yet Spraos (1980) argues that this fact is immaterial, because the same trends that are observed in the broad index of primary commodity prices are found in a narrower index that includes only developing-country products.

Since the 1980s, a series of studies undertaken by John Spraos (1980), David Sapsford (1985), Prabirjit Sarkar (1986a, b, 1994, 2005), Sarkar and Singer (1991), E. R. Grilli, and M.C. Yang (1988), and many others questioned the validity of the criticism and provided strong statistical support for the Prebisch–Singer hypothesis, thereby bringing it back into the limelight.

6. Summary

- Prebisch-singer hypothesis acts as a major pillar of the dependency theory and import substituting industrialization.
- The hypothesis argues that the prices of primary commodities will decline over time relative to manufactured goods which leads to a decline in terms of trade for developing countries.
- In making this argument, it is assumed that developing countries are the exporter of primary products and developed countries are the exporter of manufactured commodities.
- The classicals thought that primary products will overtime experience a rise in terms of trade relative to manufactures. They based their argument on the higher technical progress experienced by manufactures.
- Prebisch and Singer however have a different argument to offer based on asymmetries and elasticities.
- The Prebisch-Singer hypothesis has generated much debate. It has been widely criticized and then supported by various academicians all over the globe.