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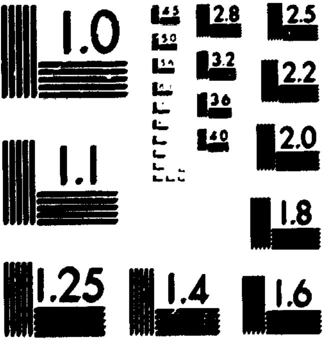

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SOME REFLECTIONS ON EAST-SOUTH TRADE AND THE DIVISION OF LABOUR *

by

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PREFACE

This short study was submitted to the Research Seminar on Structural Changes in Industry in European CMEA Countries, held in Budapest, Hungary, from 22 to 26 March 1982 as detailed view on the subject of Mr. Deepak Nayyar, Professor of the Indian Institute of Management, Calcutta. It attempts to analyse the mutual interests and emerging conflicts in trade between European CMEA countries and developing countries, and problems and prospects of division of labour between the two groups of countries.

The study fits in the framework of the research programme of UNIDO on industrial redeployment and structural change. This programme constitutes a surveillance of the international industrial restructuring process, aiming at highlighting pertinent trends in industrial development nationally and internationally. By identifying the factors that determine structural changes and indicating the likely direction and possible implications of this process, uncertainties and rigidities in this process might be reduced and a basis created for a forward-looking conception of industrial co-operation between the developed and the developing countries.

I. INTRODUCTION

The process of economic growth is inevitably associated with structural change. Even in closed economies, technological developments and changes in demand would require a responsive system. In open economies, the need for adaptability is far greater. The rigidities in the structure of economies which give rise to problems of adjustment constitute an important aspect of the current debate on the new international economic order. Much of the literature on the subject, however, tends to focus attention on the problems of structural change in the developed market economies, with reference to the international relocation of production and the changing pattern of trade between the West and the South. A research seminar on structural change in the industrial sector of centrally planned economies is, therefore, a welcome attempt to redress the balance.

In the context of this subject, the similarities between the industrialised economies of the East and the West are, at one level, more important than the differences. Yet, the factors underlying problems of structural change in the two sets of countries probably differ to a significant extent. Thus, for the analyst interested in examining the prospects of developing countries in the contemporary world economy, it is important to distinguish between East and West in the industrialised world. It need hardly be stressed that for both the East and the South, interaction with the West is an overwhelmingly important part of the same picture.

The discussion at this seminar is meant to examine the process of structural change in the centrally planned economies of Europe and its implications for trade and industrialisation in the developing countries. The object of my note is a very limited one. First, I shall consider the past experience of economic interaction between the industrialised CMEA countries and the developing countries to highlight the convergence and divergence of their interests. Second, I shall explore briefly the problems and prospects of the division of labour between the European CMEA and the developing countries. I should make it clear, however, that these are some reflections based on my perception of East-South issues, which would require further investigation. The aim is to stimulate discussion rather than to provide a complete or systematic analysis.

II. EAST-SOUTH TRADE : MUTUAL INTERESTS AND EMERGING CONFLICTS

In my view, the implications of structural change in the centrally planned economies of Europe for the developing countries can be analysed only if the economic interaction between the two sets of countries is placed in historical perspective. Such a view would not only highlight the convergence and divergence of economic interests, but would also shed some light on the future prospects of a division of labour between the East and the South.

Consider first, the past experience, which, in my perception, reflects the mutual interests insofar as the interests of the industrialised CMEA countries coincided with the needs of industrialisation and development in the Third World. From the late 1950s to the early 1970s, there was a remarkable expansion of trade and economic relations between the centrally planned economies of Europe on the one hand and the developing market economies on the other. From 1955 to 1970, East-South trade was the most dynamic component of world trade.

The growth rate exceeded that of both intra-CMEA trade and East-West trade, though in the 1970s East-West trade increased faster than East-South trade. There were two basic factors underlying this remarkable trade expansion.

First, in a situation where scarcities of foreign exchange were a constraint on international trade, bilateralism made possible a much higher turnover of trade. Multilateral trade might have been superior in principle but, during the period 1955 - 1970, it was not an option available to the centrally planned economies nor was it a feasible option for many developing countries. Although one cannot be certain, it is extremely unlikely that the European CMEA countries would have increased their trade with the developing world to the extent that they did in the absence of special payment arrangements which eliminated the use of convertible currencies in trade. For the South too, without bilateralism the East might not have emerged as an alternative source of imports and as an alternative outlet for its traditional exports.

Second, complementarities of demand between the two sets of countries were fundamental to the expansion in trade. In the East the relative isolation from the world economy, and the prevalent level of consumption, meant that the income elasticities of demand for primary commodities exported by the South were high : a sharp contrast with the near saturated markets in the West. At the same time, in the developing world, the needs of industrialisation meant high income elasticities of demand for intermediate and capital goods exported by the centrally planned economies of Europe. During the 1960s, therefore, trade expansion was indeed remarkable; the growth began to taper off in the mid-1970s and a threshold was reached when the existing complementarities were exhausted.

These two factors were also the principal sources of mutual benefit, for the scarcity of foreign exchange and the constraints on exports in both sets of countries meant that gains from trade were ensured. The principle of bilateralism, which governed a substantial proportion of such trade flows, had several virtues in this phase. Most important, given the extreme shortage of foreign exchange, it enabled both the centrally planned economies and the developing countries to avail themselves of international trade opportunities which might not have been possible otherwise. For the industrialised CMEA countries, the South was a useful source of imports and an obvious market outlet for exports; the USSR and Eastern Europe sold machinery and other manufactured goods which were probably difficult to sell in Western markets, in exchange for primary products which would otherwise have involved an expenditure of hard currencies. For the developing countries, the East provided welcome new markets for a large number of traditional commodity exports which faced near saturated markets and rather low income elasticities of demand in the West. At the same time, imports from the CMEA were constituted by capital goods and intermediate products which were essential to the industrialisation programmes in the South.

It is worthnoting that both factors ran out of steam by the mid-1970s. The modus operandi of East-South trade shifted steadily from bilateral payments arrangements to transactions in convertible currencies. Available evidence suggests that, during the 1970s, the share of trade conducted through clearing agreements declined sharply for both the USSR and Eastern Europe, although the decline was much more pronounced in the latter. There was, of course, a corresponding increase in the share of convertible currency transactions. By the mid-1970s, the growth potential of the complementary trade patterns was also nearly exhausted. The import requirements, and the export prospects, of both sets of economies changed rapidly in the late 1970s, and are likely to change even further in the future. I shall elaborate on this point in a moment when I consider the division of labour between centrally planned economies of Europe and the developing countries.

Mutual interests were probably rather important in the first phase of the relationship between the East and the South. However, the potential sources of conflict, some of which have existed all the time, are beginning to surface and might indeed be accentuated in the near future. It is usual for discussion in international forums to search for harmony which must be mobilised to realise mutual interests. Obviously it is important, as well as constructive, to discuss possible mechanisms for extending East-South economic co-operation. But it would be a serious mistake to ignore the potential sources of conflict for, at present, the interests of nation states in the world economy are characterised as much by contradiction as by harmony.

The conflict of economic interests between the industrialised CMEA countries on the one hand and the developing world on the other, might stem from a wide range of factors : it appears that the main points at issue would relate to trade, joint ventures or international relations. Given the constraint on time and space, it is not possible to explore these emerging conflicts in depth, but it is essential to make them explicit.

First, in the sphere of trade, the likely points of contention are the distribution of gains which would depend _inter alia_ on the terms trade, and the need for a diversification in the pattern of trade which would depend largely on market access for manufactured exports from developing countries. Structural forces in the centrally planned economies, such as the nature and pace of technical progress, are bound to push in the direction of more East-West trade in the 1980s, rather than East-South trade, as there is a growing need in the industrialised CMEA countries to import Western technology and thereby increase productivity. The worsening trade balance and the increasing international indebtedness of the centrally planned economies would only squeeze the prospects of convertible currency trade with the developing countries further. Faced with a sharp deterioration in their terms of trade, the smaller CMEA countries in particular, are likely to drive harder bargains in transactions with developing countries. The stipulated objectives of reducing raw material intensity and increasing value added in industrial production within CMEA economies would also adversely affect the prospects of exports from the South to the East, whether primary commodities or processed products. In the circumstances, the difficulties faced by attempts to diversify the composition of trade with the South are likely to be compounded. At the same time, the centrally planned economies of Europe might compete with the more industrialised developing countries in Western markets for manufactured goods.

Second, joint ventures in the developing world are a possible source of conflict. While the USSR government does not share in equity or profits some East European countries do, and in any case, the distribution of benefits might introduce contradictions between partners. This problem might be even more acute where the USSR, or Eastern Europe, in collaboration with industrialised developing countries establish joint ventures in other underdeveloped economies, on account of conflict with the host countries; economic disparities between countries in the South are, after all, a sensitive issue.

Third, on international matters, the self-interest of the centrally planned economies might create problems. For instance, in several international negotiations at UNCTAD, UNIDO or at the Law of the Sea Conference, the industrialised CMEA countries have, in effect, opposed the position of the developing countries. Moreover, the political compulsions of international relations might also bring conflict to the surface. In particular, the objective of detente, and the desire not merely to preserve but to develop the East-West relationship, might supersede the prospects of East-South cooperation.

III. DIVISION OF LABOUR BETWEEN EAST AND SOUTH : PROBLEMS AND PROSPECTS

As a first step, it is essential to obtain a clear picture of the past and present division of labour between the centrally planned economies of Europe and the developing countries. For that purpose, we have to consider the composition of East-South trade and the changes in it over time. Available evidence suggests that at least 85 per cent, if not more, of exports from the developing countries to the European CMEA countries – USSR as well as Eastern Europe – were constituted by primary products and raw materials throughout the period from the mid-1950s to the late 1970s. The share of manufactures (defined as SITC categories 5 to 8 less division 68) in total exports, however, increased steadily from 1955 to the early 1970s; from less than 1 per cent to more 16 per cent in the case of USSR, and from about 3 per cent to a little over 13 per cent in the case of Eastern Europe, but by 1978 this share had decreased to less than 10 per cent for the USSR as well as Eastern Europe.[1] On the other hand, a very large proportion of exports from the industrialised CMEA countries to the developing countries were constituted by manufactured goods. During the same period, the share of manufactures in East European exports to the developing market economies was nearly 80 per cent, but for the USSR this proportion was a little higher than 50 per cent; it would

1. It is necessary to point out that this declining trend during the mid-1970s, to some extent, reflects the impact of the oil price rise on the value of international trade flows; in particular on the value of exports from oil producing developing countries which boosted the total value of exports from developing countries.

have been larger if petroleum and petroleum products are included in the category of manufactures.

This division of labour between East and South provides a sharp contrast with other aspects of European CMEA participation in world trade. For instance, the commodity composition of trade between the centrally planned economies of Europe and the centrally planned economies of Asia was notably less traditional. While manufactured goods accounted for 75 per cent of Soviet and East European exports to the Asian socialist countries, approximately 50 per cent of the exports from the latter to the former were also manufactured goods.[2] As a contrast, it is also worth noting that almost two-thirds of total world exports to the European CMEA countries were constituted by manufactured goods.

Clearly, the composition of East-South trade, at least as far as the developing market economies are concerned, is not significantly different from that of North-South trade. The developing world exports primary commodities and raw materials to the industrialised countries, both East and West, in exchange for manufactured goods. Indeed, it has been observed that in terms of trade patterns, developing countries are to the European CMEA countries what the latter are to the developed market economies. Such traditional patterns of trade, however, can neither transform the structure of production in the South nor make for a new international division of labour. Admittedly, the patterns of production and trade that have evolved in the developing world over a long period of time could not have been changed overnight and during the 1960s there was a discernible increase in the share of manufactures in exports from the South to the East, but distinctly less

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2. For trade with the USSR this proportion was attained as early as 1960 - it declined a little thereafter - though in the case of trade with Eastern Europe it was reached *circa* 1970.

than the diversification in trade with the West which also continued in the 1970s.

It is obvious enough that the division of labour implicit in such patterns of specialisation and trade is not consistent with the objectives of rapid industrialisation in the developing countries. What is more, it cannot facilitate structural change in the world economy which is required for the establishment of a new international economic order. But that is not all. It would also limit the pace and extent of East-South cooperation.

At the present juncture, it appears that oil imports by the smaller CMEA countries, who would have to switch sources from the USSR to OPEC, might be a new bonanza for East-South trade. In my view, however, this new complementarity might not provide a net boost to trade between the centrally planned economies of Europe and the developing countries. It would probably mean that one set of primary commodities is replaced by another, while one group of developing countries is replaced by another, in East-South trade. It would, of course, do little to change the division of labour.

There can be little doubt that the future of economic interaction between East and South depends on a successful transition from a complementary to a competitive pattern of trade; in other words, inter-sectoral trade must be replaced by intra-sectoral or intra-industry trade and specialisation. The obstacles in the path of such a transition are perhaps the greatest challenge to East-South cooperation in the 1980s. The economic constraints are familiar enough. For one thing, there is little room for radical change in the structure and volume of production capacities already determined by the planners within the CMEA, so that foreign trade is likely to remain a residual category in the near future. For another, East and South are emerging as competitors in Western markets for manufactured goods. The mechanism for the requisite structural adjustment would have to be reciprocal and simultaneous programmed, negotiated process which can emerge from planned changes in international specialisation through long term bilateral agreements. In this context two further problems are worth noting. Is it possible even in principle to plan the integration of production capacities between centrally planned economies on the one hand and developing market economies on the other ? In practice, the experience of centrally planned economies at different levels of development - say in the CMEA - attempting planned economic integration through trade and specialisation, highlights the problems which are likely to arise. The process would be all the more difficult in relations with developing market economies.

While the scope for a new international division of labour between East and South appears limited in the short run, or even the medium term, in the long run the situation has to be transformed, as part of the process of structural change in the world economy brought about by a changing international division of labour. Otherwise, East-South interaction would simply be bypassed in a rapidly changing scenario. There is, however, a silver lining to the cloud. For, in principle, centrally planned economies should be much better equipped for coping with structural change than the developed market economies. After all, in the OECD countries the ability of governments to mould the direction of trade and specialisation in accordance with their priorities is limited, as it is individuals or firms who trade and their decisions are determined by market forces rather than by planning authorities. On the other hand, the CMEA countries can plan for structural change, as indeed Japan has done in a completely different context, and thus minimise the problems or costs associated with the process.

It is obviously not sufficient to enunciate a general principle about planning for structural change in the European CMEA countries. An assessment of future prospects must go further, simply because it would be idle to pretend that the potential for change is uniform across the board. The possibility of bringing about a change in the division of labour between East and South would vary considerably across sectors and countries. For the purpose of analysis, therefore, it would be useful to identify sectors where manufactured exports from the South to the East might be developed, and to distinguish between groups of developing countries for an assessment of the prospects.

Generalisations are always difficult but sometimes essential. If the object is to change the composition of East-South trade, the main avenues for increasing manufactured exports from the developing countries are likely to be : (a) processing of natural resources, such as non-ferrous metals or petroleum products, which would increase value added before export; (b) domestic resource based manufactures, such as wood products, leather goods, textiles and processed foods; or (c) labour intensive manufactured goods, such as clothing, carpets, travel goods, footwear, toys, sports goods, simple electronic products, metal manufactures and so on.

A diversification of trade in these directions, which are by no means exhaustive, would also yield gains for the centrally planned economies of Europe. First, it would release scarce domestic resources, particularly labour, which have alternative uses. Second, it would increase the range and volume of consumer goods available, which is now a priority in CMEA economies. There would, of course, be corresponding costs, such as the absorption of convertible foreign exchange or the redundance of established production capacities, but these are an inevitable price of structural change.

In order to explore the possibility of changing the division of labour between East and South, it would also be useful to distinguish between three groups of developing countries : OPEC, NICs and other developing countries. It need hardly be stressed that there would be significant variations even within these groups of countries; but some degree of aggregation is essential for analysis. Consider each set of countries in turn.

For the oil producing and exporting countries, in the Middle East, the prospects of trade with the East are bright because of the latter's emerging need for oil imports from sources other than the USSR, but the pattern of trade would remain as traditional as ever, unless OPEC exports petroleum and petroleum products instead of crude oil. For the newly industrialising countries, in Latin America, South Asia and South East Asia, as argued earlier, the complimentarities between the East and South as a source of trade expansion are almost exhausted; if anything, there is an increasing degree of competitivoness between the two sets of economies, which poses the greatest challenge in terms of structural change. A diversification of trade patterns which leads to an absorption of labour-intensive and domestic resource based manufactured exports from the South would be absolutely essential here. For the remaining developing countries, in Africa, Asia or Latin America, the complementarities of East-South trade might remain an important force for some time to come. But the objectives of industrialisation in these economies require a change in the traditional division of labour; for this component of East-South trade, the processing of natural resources in the developing countries holds the greatest promise for diversification.

It must be stressed that the preceding comments are meant to initiate a discussion. Towards that end, I have attempted to pose some of the important questions and problems. Answers and solutions can only emerge from further research and negotiations.

Table - A

Manufactured Exports from the South as a percentage of Total Exports to the East

Year	From Developing Market Economies		From Centrally Planned Economies of Asia	
	To USSR	To Eastern Europe	To USSR	To Eastern Europe
1955	0.6	2.8	17.2	10.0
1960	3.7	6.8	49.9	5.8
1965	9.4	9.8	43.9	8.4
1970	16.1	13.9	53.7	54.2
1973	16.6	13.3	45.5	55.8
1975	12.7	11.8	43.2	54.5
1977	11.3	9.7	43.2	56.4

Table - B

Manufactured Exports from the East as a percentage of Total Exports to the South

Year	To Developing Market Economies		To Centrally Planned Economies of Asia	
	From USSR	From Eastern Europe	From USSR	From Eastern Europe
1955	30.0	62.4	80.9	75.4
1960	46.9	71.9	77.0	78.1
1965	53.2	86.4	74.9	67.4
1970	55.3	84.2	70.0	79.7
1975	55.5	79.6	79.5	76.9
1977	58.8	77.4	72.3	74.6

Source : United Nations. For 1955 - 1965, UNCTAD *Handbook of International Trade and Development Statistics*, *1972*. For subsequent years, UN *Monthly Bulletin of Statistics*, several issues.

Notes : (a) Manufactures are defined as SITC categories 5 to 8 less division 68. (b) The percentages have been computed from data on trade flows valued in US million at current prices.