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**INDUSTRY 2000
-- NEW PERSPECTIVES*
COLLECTED BACKGROUND PAPERS**

Volume 4

**INTERNATIONAL TRADE
IN INDUSTRIAL
PRODUCTS****

* Issued as document ID/CONF.4/3 for the Third General Conference of UNIDO,
New Delhi, India, 21 January-8 February 1980.

** This background paper has been prepared by the UNIDO Secretariat assisted by a number of consultants.

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UNITED NATIONS INDUSTRIAL DEVELOPMENT ORGANIZATION

INDUSTRY 2000 - NEW PERSPECTIVES
COLLECTED BACKGROUND PAPERS
VOLUME 4

1

THE ROLE OF TRADE IN INDUSTRIAL DEVELOPMENT AND CO-OPERATION

FOREWORD

This volume presents some of the background material for the study Industry 2000 - New Perspectives published by UNIDO as ID/CONF.4/3 (Vienna 1979) for the Third General Conference of UNIDO at New Delhi, India, 21 January - 8 February 1980.

The volume contains an overview of the subject area by the UNIDO secretariat, as well as some selected consultants' papers. For the latter papers the respective authors bear full responsibility for the opinions expressed as well as for the material presented. The publication of a consultant paper must not be taken as indicating support or agreement, tacit or otherwise, with its content or form by UNIDO or its secretariat. It is hoped, however, that the publication of this documentation will make a contribution towards the understanding of problems connected with the industrialisation of developing countries.

UNITED NATIONS INDUSTRIAL DEVELOPMENT ORGANIZATION
 INDUSTRY 2000 - NEW PERSPECTIVES
 COLLECTED BACKGROUND PAPERS

THE ROLE OF TRADE IN INDUSTRIAL DEVELOPMENT AND CO-OPERATION

TABLE OF CONTENTS

	<u>Page</u>	
THE ROLE OF TRADE IN INDUSTRIAL DEVELOPMENT AND CO-OPERATION Overview by the UNIDO Secretariat	1	09629
THE ROLE OF TRADE UNDER ALTERNATIVE INDUSTRIALISATION STRATEGIES Ahmad, J.	91	09630
TRADE AMONG DEVELOPING COUNTRIES AS A VEHICLE FOR INDUSTRIALISATION: PAST EXPERIENCE AND NEW POSSIBILITIES Ahmad, J.	109	09631
CO-ORDINATION OF ECONOMIC POLICIES AND THE NORTH-SOUTH TRADE Kierzkowski, H.	137	09632
PROSPECTS FOR FURTHER INDUSTRIALISATION OF DEVELOPING COUNTRIES THROUGH EXPORTS OF MANUFACTURES Lydall, H.F.	155	09633
BILATERALISM AS A POLICY OPTION Nayyar, D.	193	09634
LIMITS AND OBSTACLES TO SOUTH-SOUTH TRADE Nayyar, D.	205	09635
MARKET ACCESS FOR EXPORTS FROM DEVELOPING COUNTRIES Pugel T.A. and Walter I.	215	09636

ABBREVIATIONS

The following abbreviations have been adopted:

ACP	African Caribbean and Pacific States in association with the European Economic Community
CIEC	Conference on International Economic Co-operation
CMEA	Council for Mutual Economic Assistance
CPE	Centrally Planned Economies
DAC	Development Assistance Committee of OECD
DC	Developing Countries
DFG	Development Corporation of the Federal Republic of Germany
DPI	Direct Foreign Investment
DMEC	Developed Market Economy Countries
ECE	UN Economic Commission for Europe
EEC	European Economic Community
EFTA	European Free Trade Association
FAO	Food and Agriculture Organization
FDA	Food and Drug Administration of the U.S.
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GNP	Gross National Product
GSP	Generalised System of Preferences
IBRD	International Bank for Reconstruction and Development (The World Bank)
IC	Industrialised Countries (including DMEC and CPE)
ICC	International Chamber of Commerce
ICOR	Incremental Capital Output Ratio
ICPO	Investment Co-operative Programme Office (of UNIDO)
IDA	International Development Association
IFC	International Finance Corporation (of the World Bank)
ILC	International Labour Organisation
IMF	International Monetary Fund
INPADOC	International Patent Documentation Centre
INTAL	Instituto para la Integración de América Latina
INTIB	Industrial and Technological Information Bank (of UNIDO)
LDC	Least Developed Countries (according to UN definitions)
MNC	Third World Multinational Corporation
MSA	Most Seriously Affected (Countries)
MVA	Manufacturing Value Added
NYEO	New International Economic Order
NTB	Non Tariff Barrier to Trade
OAPI	African Intellectual Property Organisation
ODA	Official Development Assistance
OECD	Organisation for Economic Co-operation and Development

OPEC	Organisation of Petroleum Exporting Countries
R + D	Research and Development
SDR	Special Drawing Rights
SEC	Servicio Latinoamericano de Cooperación Empresarial
SITC	Standard International Trade Classification
TCDC	Technical Co-operation among Developing Countries
TIES	Technical Information Exchange System (of UNIDO)
TNC	Transnational Corporation
UNCITRAL	United Nations Commission on International Trade Law
UNCSTD	United Nations Conference on Science and Technology for Development
UNCTAD	United Nations Conference on Trade and Development
UNCTC	United Nations Centre on Transnational Corporations
UNDP	United Nations Development Programme
UNESCO	United Nations Educational, Scientific and Cultural Organisation
UNIDO	United Nations Industrial Development Organisation
UNITAR	United Nations Institute for Training and Research
WIPO	World Intellectual Property Organisation

09629

THE ROLE OF TRADE IN INDUSTRIAL DEVELOPMENT AND CO-OPERATION

Overview by the UNIDO Secretariat

TABLE OF CONTENTS

	<u>Page</u>
<u>CHAPTER 1: INTRODUCTION. SCOPE AND OBJECTIVES OF THE STUDY</u>	5
<u>CHAPTER 2: PAST TRENDS AND PRESENT STRUCTURE OF WORLD AND DC TRADE</u>	7
2.1 Past Trends and Present Structure	7
2.2 Trade in Manufactures	11
2.3 The Terms of Trade	11
<u>CHAPTER 3: TRADE UNDER IMPORT SUBSTITUTION AND EXPORT ORIENTATION POLICIES</u>	18
3.1 The Gains from Trade	18
3.2 The Experience from Export-Oriented and Import-Substitution Trade Strategies	19
3.2.1 The Early Export-Oriented Phase	19
3.2.2 The Import-Substitution Strategy	20
3.2.3 The Manufactured Export-Oriented Strategy	27
<u>CHAPTER 4: RESTRICTIONS ON THE EXPANSION OF DC MANUFACTURED EXPORTS</u>	30
4.1 Supply and Demand Restraints	30
4.2 The Supply Side	30
4.3 The Demand Side	36
4.4 Market Access for Exports from Developing Countries	46
4.4.1 Tariffs	46
4.4.2 Non-Tariff Barriers to Trade	50
<u>CHAPTER 5: BILATERAL TRADE AGREEMENTS</u>	56
5.1 Various Forms of Bilateral Trading Arrangements	56
5.1.1 Historical Bilateralism	56
5.1.2 Rubrique Bilateralism	57
5.1.3 Bilateral Trade Controls	57
5.1.4 Bilateral Agreements	58
5.2 The Rationale for Bilateral Agreements	58
5.3 The East/South Experience of Bilateral Trade	59
<u>CHAPTER 6: THE DEVELOPMENT OF SOUTH/SOUTH TRADE AS A VEHICLE FOR INDUSTRIALISATION. PAST EXPERIENCE AND NEW POSSIBILITIES</u>	61
6.1 Statistical Perspective	62
6.1.1 Growth Rates and Shares	62
6.1.2 Commodity Composition	62
6.1.3 Regional and Interregional Composition	63
6.1.4 Preferential Trade	64
6.1.5 Concluding Observations	65
6.2 Long-Run Determinants of Intra-Trade	66

	<u>Page</u>
6.3 Institutional and Policy Limits and Obstacles to South/South Trade	67
6.3.1 Institutional Obstacles	68
6.3.2 Policy-Induced Obstacles	68
6.3.3 The Case for Promotion of South/South Trade	69
6.4 Review of Policy Instruments	70
6.4.1 Regional Integration	70
6.4.2 Prospects for Interregional Trade	72
6.4.3 Other Institutional Arrangements	74
6.4.4 Impact of Intra-Trade on Traditional Trade Flows	74
<u>CHAPTER 7: SUMMARY, CONCLUSIONS AND SUGGESTIONS FOR ACTION</u>	80
7.1 Summary	80
7.2 Issues and Problems	81
7.3 Conclusions	82
7.4 Suggestions for Action	85
7.4.1 Need for Greater Availability of Marketing Information and Techniques	85
7.4.2 Technical Assistance in Bilateral Trade Negotiations	86
7.4.3 A Target for Trade in Manufactured Goods	87
7.4.4 Third World Collective Self-Reliance	88
7.4.5 Third World Multinational Corporations	88

LIST OF TABLES

	<u>Page</u>
Table 2(1): World Export Values 1948-1977: Annual Percentage Change	8
Table 2(2): Export Values, Volumes and Prices 1960-1976	9
Table 2(3): Share of World Exports of Areas now Designed as Developing Countries	10
Table 2(4): Exports and Production of Manufactured Goods in Developed Market Economies	12
Table 2(5): Selected Indicators of World and DCs Export of Primary Commodities 1880-1975	13
Table 2(6): Network of Trade in Manufactures - Rates of Growth of Value of Trade	14
Table 2(7): Network of Trade in Manufactures - Share of Totals	14
Table 2(8): The Terms of Trade against the Rest of the World for Various Country Groups 1960-1976	16
Table 2(9): The Purchasing Power of Exports for Developing Countries, 1960-1976	16
Table 3(1): Annual Rates of Change in the Gross Real Domestic Product in the Non-socialist Third World, 1900-1976	21
Table 3(2): The Share of the Labour Force Employed in the Manufacturing Industry in Latin America, Selected Years	26
Table 3(3): Annual Average Growth Rates of Total GDP at Market Prices for the Top Ten Countries, 1960-1976	28
Table 4(1): Imports of Manufactured Products into Developed Market-economy Countries from World and from Developing Countries in 1970 and 1976	31
Table 4(2): Growth of the Value of Exports and Imports in Selected Developing Countries	33
Table 4(3): Selected Indicators of DC Exports of Manufactured Goods in 1913-1975	37
Table 4(4): Imports from DCs as Percentage of Apparent Consumption in the EEC, UK, US and Japan by Commodity Groups; in 1973-74	38
Table 4(5): Shares of Regions in World Exports of Manufactured Goods	40
Table 4(6): Trade Projection for Developed Market Economies in Year 2000	41
Table 4(7): Trade Projection for Groups 1, 2, 3 and 4 in Year 2000	42
Table 4(8): Projection of DC Trade in Manufactures in 2000	44
Table 4(9): Nominal and Effective Rates of Protection in 1964 and 1972	47
Table 6(1): Annual Average Growth Rates of World Exports by Regions	77
Table 6(2): Relative Importance of Exports to Developing Countries in Total Exports of Individual Regions, 1960-1975	77
Table 6(3): Trade Matrix of Intra-Developing Country Flows by Regions	78
Table 6(4): Trade in Manufactures Among Developing Countries (SITC 5-8 less 68), 1970-1975	78
Table 6(5): Relative Importance of Exports and Imports from and to Developing Countries in Countries	79
Table 6(6): Shares of Intra-Regional Exports in Total Exports to All Developing Countries, 1960-1976	79
Table 7(1): Shares of World Exports of Manufactured Goods - 1960, 1970 and 1976	80

CHAPTER 1: INTRODUCTION. SCOPE AND OBJECTIVES OF THE STUDY

The classical gains from taking part in the international exchange of goods and services can be summarized as follows:

- by creating an export surplus a country earns foreign exchange, which can be used for internal development purposes
- by international specialisation the constraints of small domestic markets for the development of industry is relieved
- international specialisation makes it possible for countries to industrialise according to their comparative advantages which means an efficient utilisation of available resources

Another aspect of the gains from trade can be coupled to the concept of risk. By utilising the world markets risks of sudden drops of demand can be spread and minimised. On the other hand participation on the markets increase the exposure to certain types of risks, e.g. unfavourable price movements. Under certain circumstances a high degree of specialisation could also increase the risks for a drop in demand. Normally, however, specialisation should make it possible for countries to secure stable markets in the areas where their particular comparative advantages lie.

Trade necessarily implies some degree of dependence on other countries. This means that the national development to some extent is subject not only to more or less endogenous influences from the world markets but also from direct policy action of other countries. A typical example is when one country tries to reach a low rate of domestic inflation through a tight demand policy. This will directly influence the export possibilities of its supplier countries. Because of this dependence there is an inherent conflict between the integration in the international economic system and the aspirations of the domestic economic and social policy. The nature of this conflict and the instruments at hand for overcoming it will depend on the nature of the political strategy in the country concerned and on the degree of control that it can exert over the trade sector. The presence of transnational entities in the trade sector presents its particular problems in this context.

The gains from trade can be greatly enhanced if a successful international co-operation can be achieved. The evidence from experience in the industrialised countries, e.g. of the EEC, EFTA and CMEA, clearly shows this. One of the obstacles for a successful regional integration is difficulties to assess and distribute the gains from such co-operation in a manner considered to be fair by all participating countries.

There are also problems connected with the internal distribution of the gains from trade. Again the exact nature of these problems will depend on the particular economic and social policy strategy that a country follows as well as on the degree to which it can control the parameters involved. In this context it should merely be observed that

an extreme export orientation of an economy may tend to reinforce a dualistic and egalitarian character of domestic growth. A flourishing export sector with a large proportion of earnings accrued to foreigners can exist parallel with an impoverished and stagnating domestic sector.

Within the context of Industry 2000 - New Perspectives a number of consultancy papers on these and other problems in the area of international trade were assigned, the reason being the strong links between trade and the process of industrialisation. Some of these papers are reproduced in this volume. The overview article on the role of trade represents an attempt to synthesize and summarise these papers and to supplement them with some observations derived from trade theory. Part of the analysis has been endorsed and further elaborated in document ID.CONF 4/3 Industry 2000 - New Perspectives. Other parts should be seen as a general contribution to the discussion on international trade questions, derived from the contributions of the consultants and not necessarily representing an official UNIDO position.

CHAPTER 2.4 PAST TRENDS AND PRESENT STRUCTURE OF WORLD AND DC TRADE2.1 Past Trends and Present Structure

The basic trends in world and Developing Country trade in the post-war era are well known and no detailed description will be made here. A summary review will be made, however, in this chapter as a background to subsequent chapters of this document.^{1/}

Table 2 (1) shows that the expansion of world trade in current value terms has accelerated decade by decade in the post-war era. This acceleration took place in all the major groups of countries except for the Centrally Planned Economies, who experienced a slack in the 1960s. The acceleration was most pronounced for the Developed Market Economy Countries and the non-oil exporting DCs. The tremendous upsurge of trade during the first half of the 1970s was, of course, mainly due to increased inflation and the huge boost of the Organisation of Petroleum Exporting countries' foreign exchange earnings, but nominal growth was also unprecedented for the other country categories, not the least the non-oil exporting DCs.

Table 2 (2) presents the basic developments of world trade in value terms, of prices and of quantities since 1960. (The lack of data on price indices for DC exports impedes a presentation for the full period covered in Table 2 (1). During the 1960s, world export prices revealed practically no upward trend and each of the major country categories shared this development for its exports. In the 1970s, the growth of the value of world trade has been due mostly to rising prices; the increase in volume indices have actually been smaller than in the 1960s for all the major country groupings, the exception being the non-oil exporting DCs. It is also notable that while the volume expansion of DMECs slacked considerably in the 1974-76 business cycle slump, DCs exports volume kept up well, although prices did not develop as favourably.

Table 2 (3) shows the development of the share in world trade of the areas now designated as developing countries, since 1880. It reveals that up to the 1930s, a period through which most decisions regarding their trade lay in the hands of the metropolitan colonial power, their share increased notably. After 1930, when they were struck unproportionately by the world-wide recession, and when many of them commenced a more inward-oriented trade policy, their share declined steadily up to the early 1970s. Since then, the downward trend has been reversed. Inclusive of the oil-producing countries, the DC share has increased dramatically, net of the oil exporters, the share has continued to decline, but less rapidly than in the 1950s and, to a lesser extent than in the 19760s. The ten or so Newly Industrialising Countries have accounted for the major contribution to this slowdown of the decline.

^{1/} It is fully recognised that certain data and definitions - as well as time periods used - are not strictly comparable as among the various tables.

Table 2(1): World Export Values 1948-1977; Annual Percentage Change

	<u>1948-1960</u>	<u>1960-1970</u>	<u>1970-1974</u>	<u>1974-1977</u>
World	7.0	9.4	28.0	10.0
Developed Market Economies	7.3	10.1	24.7	10.3
Centrally Planned Economies	12.7	8.1	21.3	14.2
Developing Countries (Market Economies)				
Non-OPEC	2.7	7.0	27.7	10.4
OPEC	7.9	8.3	63.7	5.5

SOURCE: UN Yearbook of International Trade Statistics 1977. (See special Table A for notes and definitions.)

Table 2(2): Export Values, Volumes and Prices 1960-1976

(Annual percentage changes)

	<u>1960-1970</u>	<u>1970-1976</u>	<u>1970-1974</u>	<u>1974-1976</u>
World:				
Value	9.4	21.4	28.4	8.5
Volume	8.1	6.5	8.0	3.6
Price	1.2	13.9	18.8	4.7
Developed Market Economies:				
Value	10.2	19.1	24.6	9.0
Volume	8.6	6.9	8.8	3.2
Price	1.5	11.4	14.5	5.6
Developing Market Economies, Total:				
Value	7.4	28.9	41.4	7.1
Volume	6.8	5.6	5.9	5.0
Price	0.6	22.1	33.5	2.0
Non-Oil Developing Market Economies:				
Value	6.3	18.5	24.2	7.8
Volume	4.9	5.9	5.5	6.7
Price	1.3	11.9	17.7	1.0

SOURCE: UN Yearbook of International Statistics 1977

Note: "Prices" are unit values. "Volumes" are derived from the quantum index. "Values" have been obtained by multiplying indices for unit values and quanta. See "special table E" for more notes and definitions.

Table 2(3): Share of World Exports of Areas now Designated as Developing Countries

(Per cent)

	<u>1880</u>	<u>1913</u>	<u>1928</u>	<u>1950</u>	<u>1960</u>	<u>1970</u>	<u>1976</u>
All DCs (and corresponding)	24	23	34	31	22	18	25
Petroleum Exporters	..	..	..	6	6	5	14
Other DCs	..	..	..	25	16	13	11

SOURCES: Yates 1959; UNCTAD Handbook 1972, Table 1.8; Ibid 1977, Table 3.1.c.

2.2 Trade in Manufactures

Manufactures have accounted for an ever increasing share of world trade in the past century. Exports of manufactures also grew increasingly important for the earnings of foreign exchange by DCs. For the DMECs, for which data are available, trade in manufactures has increased considerably faster than manufacturing production, as seen from Table 2 (4). This is also true for the DCs, although statistical evidence is scarce. A few indications of the developments of world and DC trade in manufactured goods are presented in the remaining tables in this section.

Table 2 (5) shows the distribution of world and DC (or corresponding) exports between primary commodities and manufactures in one hundred years perspective. The constantly growing share of manufactured goods in world trade is notable indeed. No less striking is the predominance of primary commodities in DC exports up to the late 1960s. Since then there has been a rapid expansion of DC exports of manufactures. Today, manufactures account for more than half of the DCs' foreign exchange earnings from non-oil exports. Traditional primary commodities nowadays make up less than one-quarter of DC export proceeds.

Table 2 (6) summarises the growth rates in current values of world exports of manufactures for the 1960s and the first half of the present decade. For all the major country groupings, annual growth rates were higher in recent years than in the previous decade.

Table 2 (7) gives the distribution by destination of the main country groups' manufactured exports for selected years. DMECs have accounted for the bulk of world trade in manufactures throughout the period, although they have experienced a slight decrease in recent years. The centrally planned economies, both in Europe and in Asia, have seen their shares declining significantly. The DCs share has thus increased substantially, although it is still rather small (7% in 1974). When looking at the various country groups' exports to one another, there are a few striking changes during the period under study. One is that DMECs have increased their share of total exports to the centrally planned economies, especially those in Asia. Another is the increased importance of DCs in exports to the CPE countries. Finally, as far as the intra-trade is concerned, the shares have fallen somewhat for the developed market economies, fallen rapidly for the centrally planned economies, and increased quite substantially for the developing countries.

2.3 The Terms of Trade

The development of the terms of trade is one of the most controversial and heatedly debated issues in trade between industrialised and developing countries. This is by no means surprising; the terms of trade are integral parts of the mechanism that determines the distribution of the gains from trade between countries. Probably more than anything else, the idea of a secular deterioration of the terms of trade in the

Table 2(h): Exports and Production of Manufactured Goods in Developed Market Economies
 (Annual Percentage Changes in Quantity Indices)

	<u>1948-58</u>	<u>1958-70</u>	<u>1970-76</u>	<u>1970-74</u>	<u>1974-76</u>
Exports	7.2	10.0	8.0	9.9	4.4
Production	4.8	6.3	3.7	5.3	0.4
Exports/production	1.5	1.6	2.2	1.9	-

SOURCE: UN Yearbook of International Trade Statistics 1977
 (Derived from the "quantum index" in "special Table F".)

Table 2(5): Selected Indicators of World and DCs^{1/} Export of Primary Commodities 1880-1975

(Per cent)

	<u>1880</u>	<u>1913</u>	<u>1928</u>	<u>1937</u>	<u>1955</u>	<u>1960</u>	<u>1965</u>	<u>1970</u>	<u>1975</u>
Manufactured Goods Share in World Export	42.0	42.5	41.8	40.0	49.6	55.5	59.8	62.3	63.6
Primary Commodity Share in World Export	58.0	57.5	58.2	60.0	50.2	44.5	40.2	33.7	36.4
(a) Fuel	..	4.8	6.2	6.8	11.2	10.0	9.8	9.4	19.3
(b) Non-fuel	..	52.7	52.0	53.2	39.0	34.5	30.4	24.3	17.1
Manufactured Goods Share in DC Exports		11.5			12.5	14.4	17.6	22.5	20.6
Primary Commodity Share in DC Export	..	88.5			87.1	85.6	82.4	77.1	79.4
(a) Fuel		1.9			25.2	28.0	31.2	34.1	59.3
(b) Non-fuel		86.6			61.9	57.7	51.2	43.0	20.1

^{1/} Or corresponding areas

SOURCE: Yates, L., Forty Years of Foreign Trade, London, Allen and Unwin, 1959 (1800-1937);
 UNCTAD, Handbook of International Trade and Development Statistics, various issues (1955-1975).

Table 2(6): Network of Trade in Manufactures - Rates of Growth of Value of Trade
(Per cent per Annum)

		<u>World</u>	<u>DMEC</u>	<u>DC</u>	<u>CPE</u>	<u>CPA</u>
World	1960-70	11.46	13.56	7.67	10.53	0.95
	1970-74	24.17	23.64	26.60	22.23	29.50
DMEC	1960-70	11.65	13.46	6.99	14.55	14.53
	1970-74	23.94	22.87	26.59	29.98	39.51
DC	1960-70	13.92	15.56	10.94	20.89	-
	1970-74	33.54	34.32	33.27	20.74	35.12
CPE	1960-70	9.32	12.70	14.65	9.92	-3.93
	1970-74	19.79	27.69	16.79	18.56	14.46
CPA	1960-70	4.04	16.49	12.19	-7.11	...
	1970-74	26.70	45.12	18.92	20.25	...

Table 2(7): Network of Trade in Manufactures - Share of Totals

		<u>World</u>	<u>DMEC</u>	<u>DC</u>	<u>CPE</u>	<u>CPA</u>
World	1960	100	100	100	100	100
	1970	100	100	100	100	100
	1974	100	100	100	100	100
DMEC	1960	83.6	94.1	89.6	20.0	14.0
	1970	85.1	93.3	84.1	28.6	49.6
	1974	84.4	91.0	84.1	36.6	66.8
DC	1960	4.3	4.0	6.3	1.0	2.5
	1970	5.3	4.8	8.5	2.5	2.3
	1974	7.1	6.7	10.4	2.4	2.7
CPE	1960	11.0	1.9	3.1	71.4	82.6
	1970	9.0	1.8	5.8	67.5	50.4
	1974	7.8	2.0	4.2	59.8	30.7
CPA	1960	1.1	0.2	1.1	7.8	..
	1970	0.6	0.2	1.7	1.3	..
	1974	0.7	0.4	1.3	1.3	..

Note: Manufactured goods are defined as SITC Nos. 5 + 6 + 7 + 8 - (67 + 68).

DMEC = Developed Market Economies
 DC = Developing Countries
 CPE = Centrally Planned Economies in Europe
 CPA = Centrally Planned Economies in Asia

SOURCES: A. and B., UNCTAD, Handbook of International Trade and Development Statistics, and 1977 Supplement, United Nations, New York, as presented in Lydall, Prospects for further Industrialisation of Developing Countries through Exports of Manufacturers, Oxford, February 1979.

primary-product exporting DCs, the so-called Prebisch-Singer thesis, fostered the inward-oriented, import-substituting trade policies pursued by the majority of the DCs in the period 1930 up to the late 1960s. The evidence in support of the notion of long-run, secularly deteriorating terms of trade for the DCs is, however, ambiguous on several accounts, and the discussion of the thesis has by no means ended.^{1/}

The evidence for the post-war era is somewhat less difficult to interpret, but problems such as the choice of base and terminal years are unavoidable. Table 2 (8) suggests that for the period 1960-76, the terms of trade of the non-oil exporting DCs have developed parallel with those of the industrialised countries. The terms of trade of the oil exporting countries have, of course, improved tremendously. It is interesting to note, however, that for the non-oil exporting developing countries, the terms of trade have fallen most spectacularly for the poorest countries. There has also been a decline in terms of trade of the high-income group, whereas the middle income countries have improved their terms of trade slightly.

It should be recalled, however, that whatever the development of the DCs' terms of trade suggested by various studies, the notion of a secular deterioration is exclusively associated with exports of traditional primary commodities (i.e. non-fuels). Such commodities account for about one-fifth of the DCs' export proceeds today and they tend to become increasingly less important. For the oil and successful manufactured goods exporting DCs, deteriorating terms of trade is no problem. The problem lies with the poorest DCs, for which traditional primary products still account for the bulk of their exports; these are also the countries which have experienced falling terms of trade in the post-war era, as indicated by Table 2 (3) above. As suggested below, however, there is scope for these countries to lessen their dependence on traditional exports by shifting their resources towards an export-oriented industry sector. If this should be possible the threat from falling terms of trade for primary commodities would not create an unescapable problem for the majority of the DCs.

Table 2 (9) shows the development since 1960 of the income terms of trade, which measures the purchasing power, or import capacity, of the developing countries. As could be expected, this has increased tremendously for the oil-exporting countries. Also in other developing countries the increase has been sizeable but with decelerating growth rates over the period. Since the non-oil exporting DCs have lost market shares in world exports to the DMECs (cf. Table 2 (5) above), and the terms of trade have developed in an almost identical fashion (Table 2 (9)), the DCs' purchasing power has not developed as favourably as those of the industrialised countries. Still focussing on the non-oil exporting countries, an interesting feature is that the ones on a relatively high income level have been able to compensate an unfavourable price movement by volume increases in their exports, thus increasing the purchasing power of their exports. Also, the middle-income countries have succeeded in doing so to some extent except between 1975 and 1976. The low-income countries, on the other hand, have

^{1/} See Findlay, R., "The Fundamental Determinants of the Terms of Trade", in The Past and Prospects of the Economic World Order Grassman, S. et al (eds), London: McMillan 1979.

Table 2(8): The Terms of Trade against the Rest of the World for Various Country Groups
1960-1976 (Index 1970 = 100)

	<u>1960</u>	<u>1970</u>	<u>1974</u>	<u>1976</u>
Industrialised Countries	96	100	87	89
All Developing Countries	100	100	163	165
of which: Oil Exporting Countries	113	100	290	303
Others	95	100	96	89
GDP/capital more than \$800	100	100	96	90
\$300-800	91	100	96	101
less than \$300	103	100	85	87

SOURCE: UNCTAD Handbook of International Trade and Development Statistics Supplement 1977.

Table 2(9): The Purchasing Power of Exports for Developing Countries
1960-1976 (Index 1970 = 100)

	<u>1960</u>	<u>1970</u>	<u>1974</u>	<u>1976</u>
All Developing Countries	58	100	205	210
of which: Oil Exporting Countries	54	100	379	389
Others	59	100	119	122
GDP/capita more than \$800	62	100	128	125
\$300-800	58	100	114	105
less than \$300	74	100	81	84

SOURCE: Handbook of International Trade and Development Statistics, Supplement 1977.

Note: The purchasing power is defined as the value index of exports divided by the unit value index of imports

suffered a decline in their import capacity since 1970. They are the group where the terms of trade have developed most unfavourably and they have not been able to compensate for this through an increased volume of exports.

CHAPTER 3: TRADE UNDER IMPORT SUBSTITUTION AND EXPORT ORIENTATION POLICIES^{1/}

3.1 The Gains from Trade

In orthodox economic theory, the proposition about gains from the division of labour and, thus, from trade, is perhaps the most fundamental. It argues that if each country specialises in the production of goods in which it has a comparative advantage, the world's total product and income will be maximised. The argument for unrestricted trade can be extended beyond the static allocative efficiency criteria to stress the dynamic beneficial effects of trade. The "vent for surplus" variant suggests that trade might bring otherwise neglected resources into use. Trade, it is also argued, should enable countries to realise economies of scale, overcome the limitations of domestic market size, exploit complementary resources through specialisation and reduce the exposure to risks. Classical political economy has stressed the "learning" or "educational" effects of international trade. Also, new wants are stimulated, producers' horizons broadened, workers' skills developed and innovations encouraged, increasing productivity and promoting economic growth.

While orthodox theory prescribes free trade as the best overall strategy, it does not claim that it is the best strategy for each individual country. If a country is large enough to influence the world price of its exports or imports through taxes and tariffs, there is a case for restricting trade as export taxes and tariffs will partly be borne by other countries, and an optimal tax or tariff maximises trade gains.

Arguments for restricted trade can be made for DCs seeking 1) to enhance and change the composition of the supply of factors of production; 2) to increase technological development in the land- and unskilled labour-intensive sectors; 3) to encourage formation of skills.

While the neoclassical trade theory postulate that all participating countries benefit from trade, it does not say that all countries gain equally. The larger the country the more it can shift the gains from trade in its own favour by applying export taxes and import tariffs. In almost all commodity and goods markets, DCs are "small" countries, unable to enhance their trade gains through such mechanisms. There are also other reasons to believe that DCs gain less from trade than do the larger, more industrialised countries because of their smaller capabilities to adjust their production structure.

So far, only the static determinants for the distribution of the gains from trade have been mentioned; major factors determinating the change of the distribution of the gains are the income elasticity of demand for a country's exports and the technological progress in the export- and import-competing sectors. Both static and dynamic factors

^{1/} For an analysis of the role of trade under an endogenous industrialisation policy see ID Conf. 4/3. Industry 2000 - New Perspectives, part II, chapter 2.

seem to suggest that DCs benefit less than the advanced countries. This conclusion seems to be valid as long as the DCs' comparative advantage is associated with exportation of primary commodities rather than with unskilled labour-intensive, technology-extensive manufactured goods.

The above summary, even if brief, should make it obvious that no clear-cut theoretical argument for completely unrestricted trade exists. Neither, of course, would it be possible to give a rationale for autarky on purely economic grounds. Economic theory alone cannot provide general answers to the optimal interference in trade for individual countries with varied characteristics.

In modern times no country has pursued complete autarky: few countries have adhered to free trade proper. How countries have restricted their trade varies enormously and provides a rich source for empirical study. In the following section, a summary discussion of the major trade strategies followed by the DCs is presented.

3.2 The Experience from Export-Oriented and Import-Substitution Trade Strategies

3.2.1 The Early Export-Oriented Phase

During the heydays of colonialism, approximately between 1870 and 1930, most developments in the DCs were subordinate to the needs of the metropolitan countries. The international division of labour meant supplying raw materials to the colonial powers; imports were the inputs needed to extract the primary products and some finished manufactured goods. Around 1880, colonies accounted for about one-quarter of world exports. More than 90% was made up by primary products and the rest by semi-processed commodities.^{1/} Trade between colonies and industrialised countries was at the same time almost exclusively between colony and metropolitan powers. This monopoly meant that colonies had to pay more for their imports and receive less for their exports than they would have on the world market.

While there was rapid industrialisation in Western Europe and North America, Latin America, Asia and Africa remained underdeveloped in that their export-oriented sectors had little connection with the rest of their economy. The infrastructure served the trade interests of the metropolitan countries for half a century.

The colonial bilateralisation of trade was much manifested in the DC trade pattern even in the 1960s. The export and import share of Britain and France in their former colonies was respectively three and eight times higher than that in the average DC.^{2/ 3/}

^{1/} See Yates L., Forty Years of Foreign Trade, London: Allen and Unwin, 1959, Appendix Table 32.

^{2/} Kleinman E., "Trade and the Decline of Colonialism", Economic Journal, vol. 86, September 1976.

^{3/} The same over-representation of metropolitan countries have been found in foreign direct investment.

Another study found that this monopolisation of the colonies trade in fact meant exploitation. The prices former French colonies paid in the 1960s for imports of a selected set of homogeneous goods from France were some 10-20% higher than the prices paid by other countries for the same goods imported from France.^{1/} If these figures are representative for colonial trade in general, the resources thus transferred from the Third World to metropolitan countries would be very significant.

Other observers note that, despite the exploitation, growth took place in the colonies (Table 3 (1)). The tentative estimates available suggest that in the 1900-1929 period gross domestic product of what is now the Third World grew by some 2% per annum, a figure substantially lower than in later decades and also somewhat lower than figures for the DMECs. Some transformation occurred: although biased, an infrastructure was built; attitudes were changed. It may be argued that these developments were conducive to future growth.

3.2.2 The Import-Substitution Strategy

To colonies, the 1930s depression meant balance of payments problems due to falling demand for their exported goods, capital outflow, and deteriorating terms of trade. During World War II, it also became difficult to obtain many industrial goods on the international markets. These difficulties provided incentives for substituting domestic production of industrial goods for imports. The early import-substitution phase - especially in Latin America - was thus not primarily the outcome of a deliberate policy; as in Europe and the US, but rather the result of changing external circumstances. After the war, when the international economic order began to normalise, import-substitution became an explicitly formulated industrialisation strategy. The earlier "natural" protection of the incipient industry sector was replaced by tariffs and other import-restrictive devices.^{2/}

By now, a large number of DCs have nearly fifty years of experience in an import-substitution industrialisation strategy. These experiences have been scrutinised in many studies, the most important ones being sponsored by the OECD, NBER and the Kiel Institute.^{3/} The picture emerging from these studies is rather unambiguous

^{1/} Yeats A.J., "Monopoly Power, Barriers to Competition and the Pattern of Price Differentials in International Trade", Journal of Development Economics, June 1978.

^{2/} All developing countries did not adhere to an import-substitution strategy at the time; some countries had yet to start industrialisation and a selected few followed an export-oriented industrialisation, chiefly Hong Kong and, a little later, Taiwan, South Korea, Malaysia and Singapore.

^{3/} Each of these three projects has reported its findings from the countries studied in summarising and concluding volumes as well as in separate volumes for each individual country. The summarising studies are:

Little I., et al., Industry and Trade in Some Developing Countries, Oxford University Press, 1971.

Bhagwati, J.N., Anatomy and Consequences of Exchange Control Regimes, NBER Special Studies, Praeger, 1978;

Kruger A.D., Liberalisation Attempts and Consequences, NBER Special Studies, Praeger, 1978, The Kiel Institute Study is not yet available.

Table 3(1): Annual Rates of Change in the Gross Real Domestic Product in the
Non-socialist Third World, 1900-1976

	All DCs		Latin America		Asia		Middle East		Africa	
	Total	Per Capita	Total	Per Capita	Total	Per Capita	Total	Per Capita	Total	Per Capita
1900-1913	2.1	1.2	2.1	1.5	2.2	1.5	..	..	..	..
1913-1929	1.9	0.9	2.8	1.0	1.3	0.8	..	..	..	..
1929-1950	2.2	0.6	3.5	1.4	1.1	-0.3	..	..	..	..
1950-1960	4.7	2.4	5.2	2.3	4.1	2.0	6.9	4.1	4.5	2.3
1960-1970	5.2	2.7	5.4	2.6	4.7	2.3	7.9	4.7	4.7	2.0
1970-1976	5.3	2.8	5.7	2.8	4.8	2.4	7.8	4.7	4.1	1.4

SOURCES: The Economic Development of the Third World since 1900,
Ed. Bairoch, Paul, London, Methuen and Co., 1975, Table 51
(1900-1950);
UNCTAD Handbook 1972, Table 6.2. (1950-1960);
UNCTAD Handbook 1977, Supplement, Table 6.2. (1960-1976).

Allocative efficiency. At the heard of the so-called infant industry argument for protection lies the notion that as the infant grows up, protection is to be reduced, and finally, abolished. Several studies of the level of effective protection in countries that have pursued import-substituting policies for several decades reveal the opposite. Effective protection rates in the range of 50 to 100% or the average for DCs manufacturing industry are not unusual. The use of labour, capital and other factors of production is about 50 to 100% larger; the efficiency is about two-thirds to half that in the countries supplying the world market with similar goods.

The high costs of production are not only due to economic inefficiency. Many studies show a comparatively low level of utilisation of installed capacity in the DCs' protected industries. Critics attribute this to the balance of payments consequences of import-substituting industrialisation. Initially, import demands are lowered as some or all stages in the production are undertaken domestically. At this stage the country can achieve balance-of-payments equilibrium at a higher exchange rate, which will discourage exports. Furthermore, imports demands of machinery, intermediate goods and industrial primary products tend to grow more rapidly as the industry sector expands. To pay for these imports, foreign exchange is needed, but intrinsic in the import-substitution strategy is a discouragement of exports, especially non-traditional primary commodities. Exchange rate overvaluation, and high profitability in the import-competing sectors have discouraged the inflow of capital and talent into prospective export-oriented industries.^{1/} In the import-substituting sectors, costs have been far too high to permit exportation, at least without subsidies.

Growing import demand combined with stagnating exports are apt to produce balance of payment problems especially when 1) imports are almost exclusively essentials for which (derived) demand is very price inelastic, and 2) exports are primary commodities for which foreign demand and domestic supply are inelastic in the short run. In such situations, it may be that devaluations as balance of payments correcting instruments become almost useless. What remains is to reduce imports through quotas and licences, a practice followed by most of the import-substituting DCs.

A problem in allocating scarce foreign exchange through licenses and quotas is choosing between imports of necessary primary imports, spare parts and intermediary goods to supply already installed operations and machinery imports to expand production capacity. Many countries' clear bias for the latter explains the estimated low capacity utilisation. In some countries, unutilised capacity has even been the criterion on which import licenses have been allotted, signifying that there is an incentive for firms to install unutilised capacity in order to get import permits.

^{1/} The main analytical and empirical support of this notion is provided by several so-called market-share analyses, which show that, to a large extent, the DCs' falling share of world trade since the early 1950s is not due to an over-representation in the export of commodities for which total trade has developed unfavourably. Not a negligible part of the falling overall share is explained by the fact that DCs have lost their market share for a number of individual goods and commodities, signifying that there have been problems on the supply side.

Savings and Investments. Import-substitution policies in DCs have been considered conducive to savings and investments through regressive income distribution. Protection of the capital-intensive sector in a labour-abundant country transfers income towards capital. The higher returns to capital encourages more investment; enhanced capital incomes provide the capitalists with means to invest.

The available studies of income distribution in countries pursuing import-substituting industrialisation suggest a very uneven distribution of incomes, and in many instances, regression. But there is little evidence that regressive distribution has promoted savings.^{1/}

Empirical evidence does not support a positive effect of enforced import-substitution on savings, rather the opposite. The most straight-forward explanation is that the high income earners, whose incomes were supported, did not have the expected marginal savings propensity.^{2/}

The Technological Capacity. Perhaps the oldest argument for protection in DC countries is the so-called infant industry argument. In this perspective, short-run allocation losses can be viewed as investments in creating a technological base that will provide long-run returns. Unfortunately, little empirical work on how well the import-substituting industrialising countries have managed to break their "technological dependence" on the North by building a domestic industrial R+D capacity. The little evidence there is, however, suggests that the success has been scant, if any.

Growth. Empirical studies primarily in Latin America^{3/} suggest that import substitution strategies have not been very successful on four important growth-decisive components: 1) allocating and utilising resources efficiently; 2) stimulating exports; 3) enhancing savings and 4) fostering the development of industrial R+D capabilities. One, therefore, would expect that growth rates for the DCs, most of which have followed inward-oriented strategies, have been slow during this period; evidence indicates the opposite.

For the DCs as a whole, growth during the import-substitution era - the 1950s and 1960s - has not been low compared to DC growth rates for earlier periods or to the growth the DMECs achieved in their early stages of development. (Table 3 (1)) It is also well at par with the growth rates experienced by the DMECs during the same time, although it has been slightly lower in per capita terms.

1/ United Nations, The Measurement of the Development Effort, New York 1970.

2/ See Corden W.M., "Protection and Growth" in Di Marco (ed.) International Economics and Development, New York 1972.

3/ Herrera, A., "Social Determinants of Science in Latin America", Journal of Development Studies 9 (1972).

Growth rates have differed markedly among the DCs, however. The countries with the initially lowest income level, especially the populous countries in Asia and many of the small ones in Africa, have generally showed the lowest growth rates, signifying a gap within the Third World. Among the rapid growing countries are the oil-exporting countries in the Middle East, who have started to industrialise only in recent years. The few countries that have followed a consistent export-oriented industrialisation strategy, i.e. Hong Kong, Singapore, Taiwan and South Korea, also are among the countries showing high growth rates. It is important to note that countries like Brazil and Mexico have grown rapidly through strictly inward-oriented post-war industrialisation, but other countries, with similar basic features and using roughly the same inward-oriented policies, e.g. Argentina, have been notably less successful.

The divergent experiences among countries following the inward-looking strategy have not been studied very carefully: few well-founded explanations are available. Two important conclusions may be drawn, however. The first is that inward-oriented industrialisation policies are compatible with - although not necessary for - rapid growth, at least for some time (and when simultaneous equalisation of incomes is not a prerequisite). Second, the divergent experiences suggest that there are factors other than the ones usually focussed on - static allocation, export performance, savings rates and R&D - that have a significant influence on growth among countries following import-substitution strategies; these factors have not been identified and studied in the economic literature at large.

Despite the rather favourable growth record of many of the DCs pursuing inward-oriented policies, however, most of these countries have, more or less valiantly and successfully, tried to re-direct their economies in a more outward-oriented fashion. There seem to be at least three reasons for such a change in policy. 1) there are phases in import substitution; by now, the easy ones have been completed. 2) although growth has been high in many countries, import substitution has not had equally favourable consequences in the creation of employment and on income distribution, two closely related questions. 3) the performance of DCs following an outward-oriented industrialisation policy has been impressive indeed, not only in terms of growth, but also with respect to the distributional aspects of development.

Easy vs. Difficult Stages. The easy vs. difficult stages in import substitution have long been recognised. First there are the afore-mentioned macro-economic, balance of payments-related problems. At the initial stage, both imports and exports are discouraged, but the long-run impact of increasing imports but not exports, causes severe balance of payments constraints on development. On the micro-economic level there also seem to be phases of an increasingly problematic nature.

In most instances, the process is initiated by the substitution of the last stage of production for imports of final goods, i.e. the assembly of parts is transferred to the importing country. The next step is usually domestic production of certain inputs and components, the number and complexity of which increases over time. The final step is taken when the capital goods are also produced domestically. There are several reasons to think that these steps are increasingly more difficult to conduct efficiently in DCs.

First, the assembly of parts is usually a rather labour-intensive process requiring little of technology and skills. The production of capital goods, on the other hand, is probably in general both a capital- and a technology-/skill-intensive activity. This would mean that, as the import-substitution process evolves, the structure of the industry sector is removed further from the pattern reflecting the DCs' comparative advantage. At least this is so, when the development of technical knowledge and skills does not proceed as fast as the restructuring of the industry sector.

Secondly, one has to consider economies of scale. For a given volume of final goods, derived demand for inputs tend to be smaller the farther back in the production chain one goes. To some extent, fragmentation tendency is counterbalanced by the demand for certain inputs deriving from several final-good industries. Considering, however, the limited size of the overall market in many DCs, the scale of production must have been very low in the latest-stage processes in relation to the most-efficient-size output. In some instances, it is also likely that economies of scale become more pronounced farther back in the production process. Technological improvement has also mean that economies of scale in most activities have grown in the last few decades. It is quite conceivable that the most-efficient size of output has grown at a faster pace than has actual production in many lines of production in several inward-oriented DCs. This would signify an increasingly growing comparative disadvantage in scale-intensive activities for these countries.

Employment and Income Distribution. While the growth achievements of many DCs following an inward-oriented industrialisation strategy is impressive, the employment and income-distribution records are not. In the import-substitution era, very few jobs have been created in the non-artisan manufacturing sector. And towards the late 1960s, unemployment (open and disguised) became the most disturbing feature of development. The Latin American situation is illustrative in this respect (Table 3 (2)). The share of the labour force employed in the manufacturing industry is very low. (In addition, the share of the adult population defined to belong to the labour force is very much smaller than in the DMECs.) The most disappointing feature is that the share employed in manufacturing has not grown over time: on the contrary, it declined between 1950 and 1970, the heydays of import-substitution in Latin America.

Table 3 (2): The Share of the Labour Force Employed in the Manufacturing Industry in Latin America, Selected Years (Percentage)

	<u>1925</u>	<u>1950</u>	<u>1960</u>	<u>1970</u>
Seven largest countries	15.0	..	17.0	17.0
All Latin America	..	14.4	14.0	13.8

Sources: Griffin 1969; Turnham 1971; Morawetz 1974.

The links among import-substitution, industrialisation and low labour absorption are quite straightforward. Protection is given to the capital- and skill-intensive sectors. This is the basic objective of the whole strategy. The short-run, static effect of the re-orientation is less demand for labour, especially the un- and low-skilled. The intended long-run outcome, on the other hand, is faster growth and, thus, higher rates of labour absorption into wage employment. In countries, however, where the labour force grows by 2.5-3% per annum, and where the labour-absorption elasticity (i.e. the incremental labour/output ratio) is about 0.3 in the protected manufacturing sector, expansion of output has to be rapid indeed, if this sector is to increase its share of the labour force. In most, if not in all, countries output growth has failed to reach the requested levels.

Protection of the capital-intensive sectors may also discourage employment through its effect on relative factor prices in a non-perfect economy. In many DCs, the import-substitution promoting tariff (and non-tariff) structure is cascaded. That means that the final steps of production are heavily protected while capital goods are allowed in free of import charges (but often a licence is required) in order to boost investment. With overvalued exchange rates, duty-free importation of capital goods stimulates the application of capital-intensive production techniques. In countries where very selective labour unionisation has taken place, labour costs in the protected large-plant manufacturing sector have far exceeded the rest of the economy, aggravating the incentive for using labour-saving techniques. Econometric studies suggest a rather low elasticity of substitution, however, in modern manufacturing industries. If this conclusion is accepted, the industry-composition factor probably explains more than the use of labour-saving production techniques in respective sectors when it comes to weighing the reasons for the low labour absorption in the "modern", inward-oriented manufacturing sector in the DCs.

The other side of the coin is the effects on income distribution. The high capital-intensity of the protected manufacturing industries has not only mean low labour absorption, but also high capital incomes and relatively high wages for the selected few employed in this sector. Studies of income distribution in countries like Brazil and Mexico at the height of the import-substitution phase, reveal much higher concentration

of income than in DMECs and in DCs pursuing other development strategies. Incomes have obviously become more unequally distributed over time. The expectation held by some that the incomes generated in the highly protected segments of the economy should, at a labour stage, trickle down to the rest of the economy, has yet to materialise.

In summary, we can conclude the realisation that later stages of import-substitution industrialisation are considerably more difficult to pursue efficiently than the earlier ones is undoubtedly one of the main reasons why many DCs have tried to change their trade and industrialisation policies towards a more outward-oriented outlook in the 1970s. The second major reason probably is the insight that continued reliance on far-reaching import substitution is not compatible with a degree of labour absorption and an income distribution that is politically sustainable or warranted. A third major reason why so many countries dared undertake a re-orientation was possibly the example set by the few DCs that did choose an export-oriented strategy very early in their attempts to industrialise. The experience from these countries are summarised in the following section.

3.2.3 The Manufactured Export-Oriented Strategy

After World War II, most DCs had experienced two decades of extreme difficulties for their traditional exports, and set out on a more or less naturally protected import-substitution industrialisation. The alternative of an outward-looking industrialisation strategy was hardly considered at the time. As discussed in the economic literature, it was viewed with pessimism. On the supply side the DCs faced formidable obstacles to attaining a minimum level on efficiency. On the demand side, unfavourable commercial policies in the rich countries were insurmountable.^{1/} In fact, in the Third World, only one country/territory can be identified as having pursued an outward-oriented path all the way in the post-war era: Hong Kong.

Today, only a handful of DCs follow a truly free-trade industrialisation path: Hong Kong, Taiwan, South Korea, Singapore and, to a lesser extent, Malaysia. Only in these DCs, is there an almost complete absence of tariffs and other barriers to imports, free capital movements and the other prerequisites usually associated with "free trade".

The other so-called NICs^{2/} differ in two respects from the truly export-oriented countries.^{3/} First, they have pursued import-substitution much further than have Taiwan, South Korea and Singapore. Second, the outward reorientation has been partial

1/ Cf. Nurkse R., Equilibrium and Growth in the World Economy, G. Harberler and R.M. Stern (eds.), Cambridge, Mass. 1961.

2/ The countries considered NICs vary from source to source, but include usually the following: Brazil, Mexico, Colombia and Argentina in Latin America; Philippines, India and Pakistan in Asia; Yugoslavia, Greece, Spain and Turkey in Europe; and Tunisia in Africa.

3/ There are also a number of other countries that have adhered to the exportation of manufactures from so-called free trade zones, which are usually not linked to the rest of the economy.

Table 3(3): Annual Average Growth Rates of Total GDP at Market Prices for the
Top Ten Countries, 1960-1976

(Percentage)

	<u>Country</u>	<u>1960-1976</u>
1	Libyan Arab Republic	17.6
2	Botswana	11.2
3	Gabon	10.8
4	Hong Kong	10.7
5	Saudi Arabia	9.9
6	Republic of Korea	9.6
7	Iran	9.4
8	Singapore	9.3
9	Taiwan	9.1
10	Reunion	8.4
	Average for Hong Kong, Republic of Korea, Singapore and Taiwan	9.7
	Average for all DCs	5.2

SOURCE: UNCTAD Handbook of Trade and Development Statistics 1977,
Table 6.2; figures for Taiwan OECD Development Co-operation Review,
1974 Annex Table 110 (1960-70); Ibid, 1978, Annex Table 113 (1970-76).

and gradual, and has not yet affected the structure of their economies much. The experience on an export-oriented industrialisation strategy proper in the Third World is thus restricted to very few countries, but compared to almost any other country they show outstanding records of growth.

Growth. Looking at growth of GDP rates from 1960, Taiwan, South Korea, Singapore and Hong Kong are among the DCs having growth rates almost twice that of the average Third World country. Only a few oil-exporting countries and Botswana show higher figures (Table 3 (3)).

Studies of export and growth of GDP among DCs in general all show a positive association, although it is always difficult to establish unambiguous lines of correlation. Nevertheless, one study found a highly significant positive correlation between the rate of change in exports as a share of national product and the change in per capita product for 41 developing countries over the period 1950 to 1973.^{1/} Two other studies investigated the relationship between growth of export earnings and of GNP with a similar result for a similar set of countries.^{2/} Yet another study, prepared for Industry 2000 - New Perspectives, revealed a highly positive correlation between expansion of exports and of manufacturing output.^{3/} While all the hitherto referred to studies use a rather simplistic way of establishing the correlation (simple regression analysis), also a study of a more selected number of countries, using a fully specified model, found the same correlation between growth of exports and total product.^{4/}

None of the authors of the various studies goes as far as to say that rapidly growing export earnings is a sufficient condition for overall growth and development: it might not even be a necessary one, but the experience of the DCs in the past few decades suggests that expanding exports certainly helps in fostering growth. Trade may not be the engine of growth, but certainly helps in fostering growth. Trade may not be the engine of growth, but certainly a "handmaiden", as so succinctly put by Prof. Kravis.^{5/} This is to say that growth is only triggered by export expansion if other supplementary growth stimuli are there.

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- 1/ Michaely M., "Exports and Growth: An Empirical Investigation", Journal of Development Economics, (March 1977), pp. 44-53.
 - 2/ Cohen B., "Relative Effects of Foreign Capital and Larger Exports on Economic Development", Review of Economics and Statistics, May 1968, pp. 281-284.
Emery R.F., "The Relation of Exports and Economic Growth", Kyklos, Fasc. 2, 1967, pp. 470-486.
 - 3/ Lydall, Prospects for Further Industrialisation of Developing Countries Through Exports of Manufactures, (in this volume).
 - 4/ Balassa B., "Exports and Economic Growth: Further Evidence", Journal of Development Economics 5, 1978, pp. 181-189.
 - 5/ Kravis I., "Trade as a 'Handmaiden of Growth: Similarities between the Nineteenth and Twentieth Centuries", Economic Journal, 80, December 1970, pp. 850-872.

CHAPTER 4: RESTRICTIONS ON THE EXPANSION OF DC MANUFACTURED EXPORTS4.1 Supply and Demand Restraints

Ever since the early 1950s, there has been a wide-spread pessimism among DCs of the potentials for expanding and diversifying their exports of manufactured goods. On the supply side, lack of manufacturing experience, low-skilled labour forces, technological insufficiency, all have been quoted as obstacles for rapid expansion of manufactured goods. On the demand side, the DMECs' commercial policies discriminate against DCs on a scale that unavoidably would stifle their efforts even if the supply problems could be overcome.

4.2 The Supply Side

The hindrances on the supply side are conveniently divided into what might be called structural and policy-induced restraints.

Structural Restraints. The unfavourable developments of the DCs overall exports during the 1950s and 1960s, manifested in a rapidly falling share of world trade, has been shown to derive to a large extent from a "structural" bias in their trade. That is, world trade in the natural-resource and unskilled labour-intensive goods in which the DCs have their comparative advantage, tend to expand less rapidly than trade in general. Even if the DCs have managed to hold their share of world trade for individual commodities (which they have not in several cases), their share of total world trade would fall. At first sight, it may seem plausible that the same type of structural bias applies to the DCs' manufactured exports. In other words, that world demand for textiles and other labour-intensive manufactures, in which DCs have their relative advantage, grows more slowly than demand for all manufactures.

A look at the facts does not corroborate this hypothesis, however. Table 4 (1) depicts growth of the DMECs import of manufactured goods, by "dynamic class", i.e. the 422 products have been classified according to how fast imports have expanded. Grouped into five classes, number 1 comprises the fastest growing products. Columns A and B respectively give an index of the increase in imports of the various product groups internationally and specifically from DCs. The C column shows the ratio of B over C.

As can be seen from column C, the imports of all manufactured goods from DCs increased 1.5 times faster than from the world as a whole. The ratio, however, for the two most dynamic product groups is at par with, or even larger than, the average, signifying that the demand for products in which DCs seem to have a comparative advantage has grown especially rapidly. The notion that there should be an unfavourable structural bias on the supply side against DC manufactured exports is thus not vindicated by the facts.

**Table 4(1): Imports of Manufactured Products into Developed Market-economy Countries
from World and from Developing Countries in 1970 and 1976.**
Classified according to percentage change between 1970 and 1976 of imports
from world.

Dynamic class	No. of products in class	Percentage value of trade in each class				Increase in imports 1970 to 1976 ^{1/}		Ratio between (B) and (A)
		DMEC imports from world		DMEC imports from DC		From World	From DC	
		1970	1976	1970	1976			
I	85	15.5	22.2	22.7	32.8	(A) 3.9	(B) 5.8	(C) 1.5
II	85	30.0	35.8	26.2	33.5	3.1	5.1	1.7
III	85	18.3	17.5	16.1	15.0	2.6	3.8	1.4
IV	84	19.1	15.9	13.8	9.7	2.3	2.8	1.2
V	83	17.1	10.6	21.2	9.0	1.7	1.7	1.0
Total	422	100.0	100.0	100.0	100.0	2.7	4.0	1.5

SOURCE: Special tabulations by the UNCTAD secretariat.

^{1/} Import value in 1976 as a multiple of import value in 1970.

Policy-Induced Restraints. In assessing non-structural supply restraints, one has to differentiate between those following from policy and those that are, supposedly, inherent in underdevelopment and/or the basic structure of individual countries. As set out in the previous chapter, the import-substituting policies pursued by the vast majority of the DCs in the post-war era has not fostered exports of manufactures. On the contrary, overvalued exchange rates in the wake of high protection, expensive inputs, high profitability in the protected import-substitution industries, have meant discrimination against export-oriented manufacturing activities. These hindrances can be removed, but only through policy changes.

A re-orientation is not easily accomplished. The entire price and production structures in many countries are often shaped in accordance with the pattern of protection and bear little resemblance to the world market prices and the output mix that would be compatible with unrestricted trade. The adjustments needed to orient the manufacturing sectors outwards means drastic redistribution of incomes and assets as well as a closing down of many of the inefficient import-competing production units. In order to be politically feasible, such changes often have to take place over a period of time. Most countries that have recently started to re-orient their economies have done so in a rather partial and gradual fashion.

In many of these countries, the rapid expansion of manufactured exports has not been made possible through very systematic and far-reaching reforms of the import-substitution structure. Rather, the devices protecting the import-competing branches/firms have been left very much intact; exports have been made possible through various subsidies and partial liberations for imported inputs. Brazil and Argentina are examples of this partial and limited re-orientation,^{1/} but almost every country in Latin America has relaxed its import-substitution orientation to some extent.^{2/} This also applies to many countries in Asia, but to a lesser extent in Africa.

In summary, the policy-created obstacles on the supply side in many DCs are often both many and difficult to overcome without drastic policy changes, or, as has been the case in many countries, heavy subsidising of manufactured exports. It is important, however, to recognise that many of the difficulties some DCs may experience in expanding their exports of manufactures do not stem from inherent inelasticities embedded in underdeveloped economies, but are the consequences of policies detrimental to the cause of developing an export-oriented industry sector.

1/ A discussion of the Brazilian example is provided in Tyler, W.G., "Brazilian Industrialisation and Industrial Policies: A Survey", World Development 4, Oct.-Nov. 1976, pp. 863-82.

2/ Analyses of the "post-import-substitution" phase in the various Latin American countries are presented in a special issue of World Development 5, Jan.-Feb. 1977.

Table 4(2): Growth of the Value of Exports and Imports in Selected Developing Countries

(average annual growth rates)

	Argentina	Brazil	Chile	Colombia	India	Israel	Korea	Mexico	Singapore	Taiwan	Yugoslavia
Traditional primary products											
1953-60	0.7	-5.3	4.3	-4.5	2.4	16.8	-17.5	-0.3	-	-3.2	
1960-66	6.7	2.0	9.5	-0.5	0.3	15.2	26.5	3.8	-	8.0	11.6
1966-73	6.9	7.6	5.1	6.5	0.2	16.7	16.9	1.7	-	1.2	12.5
Non-traditional primary products											
1953-60	-3.4	5.4	-5.6	11.9	5.6	47.0	7.1	12.2	n.a.	12.7	19.6
1960-66	3.6	9.6	11.3	5.9	9.2	16.8	22.5	10.3	29.5	36.5	2.3
1966-73	14.0	26.5	7.6	25.5	10.4	16.9	35.5	6.3	19.5	25.0	11.1
Primary products together											
1953-60	0.2	-3.1	2.5	-3.5	3.7	20.5	-5.4	3.8	n.a.	-1.2	12.4
1960-66	6.3	4.7	9.7	0.3	4.5	15.5	24.0	6.9	29.3	17.3	5.7
1966-73	7.8	17.0	5.5	10.7	6.5	16.8	26.0	4.3	19.5	17.0	9.8
Of which, agricultural goods											
1953-60	0.2	-3.5	-9.0	-4.8	3.9	18.3	-3.2	5.4	n.a.	-2.1	14.5
1960-66	6.2	4.5	22.5	1.0	3.7	9.5	25.2	7.7	2.9	15.6	6.7
1966-73	7.9	16.7	2.7	11.1	9.5	11.7	29.5	5.7	19.2	16.3	9.8
Manufactured goods											
1953-60	-11.7	9.9	3.2	-	1.3	18.0	14.0	5.6	n.a.	29.5	28.0
1960-66	14.6	27.5	15.6	35.0	6.7	15.3	80.0	12.1	24.5	36.5	21.5
1966-73	33.5	38.5	-	27.5	7.7	17.5	50.0	20.0	42.0	47.0	14.9

Table 4(2) Contd.

	Argentina	Brazil	Chile	Colombia	India	Israel	Korea	Mexico	Singapore	Taiwan	Yugoslavia
Total exports											
1955-60	-0.6	-2.8	2.6	-3.4	2.6	19.6	-3.2	3.9	n.a.	2.2	17.2
1960-66	6.7	5.4	10.1	1.5	5.5	15.3	40.0	7.8	28.5	23.5	13.6
1966-73	10.8	19.9	5.3	12.7	7.0	17.0	44.0	8.1	28.5	35.5	13.8
Total imports											
1953-60	6.7	1.5	5.9	-3.6	9.8	8.5	-	5.6	n.a.	6.2	11.1
1960-66	-1.8	0.4	6.9	3.7	5.4	8.8	13.0	6.9	8.0	13.1	11.3
1966-73	10.3	24.5	5.7	6.7	-0.3	20.0	29.0	14.5	25.5	29.5	17.2
Purchasing power of exports ^{1/}											
1960-66	4.0	4.0	8.8	0.2	4.2	13.0	38.0	6.5	26.5	22.5	12.9
1966-73	4.9	13.5	-0.6	6.7	1.2	10.2	36.5	2.3	21.5	28.5	7.7

SOURCE: National and International Trade Statistics

^{1/} Export values deflated by the unit value index for the manufactured goods exports of developed countries.

Export Incentives and Export Performance. The association between export promotion and export performance has been studied in two different ways: 1) regression analysis; 2) simple comparison between countries. The most comprehensive econometrical test seems to be the one undertaken by the Kiel Institute Study; results are available for twelve countries.^{1/} The authors of the paper believe their results "provide prime facie evidence that economic policy is effective in stimulating export growth".^{2/} This is perhaps a somewhat strong conclusion, but it is reassuring that the countries that no doubt have been most consistent in promoting exports, Korea and Taiwan, show highly significant positive values. But this result also applies to a country like Turkey, where export-promotion has been both very limited and hesitant. However, even in countries which have yet to abolish most of their protection of the import-competing industries, export promotion super-imposed onto the old structure, has had its effect, i.e. in Mexico, Brazil and Spain.

The simple regression model used in the test cited is too crude to permit singling out what kind of promotion policies have been most effective. Supplementary tests, however, show a positive response of manufactured exports to exchange rate depreciation, one of the a priori important instruments to foster export expansion. More elaborate and detailed econometrical tests are difficult to apply for a number of reasons. In many instances, several export promotion policies are introduced simultaneously and many are intangible and defy quantification, e.g. the lessening of the red tape.^{3/} Other problems include the shortness of available time series, the existence of various lagged effects, and lack of information on changes in incentives to import substitution that provides an alternative to exports.^{4/} There is also the problem to sort out the demand-side induced influences on the expansion of exports.^{5/}

A simple comparison between countries is a crude but supplementary way of assessing the effectiveness of various export promotion policies. Table 4 (2) provides information on export and import performance of selected countries for different time periods.^{6/} The first observation is the outstanding export-of-manufactured-goods performance in the 1966-1973 period of the countries that have gone "all the way" in export-orientation: Taiwan, Korea and Singapore. This is in sharp contrast with the sluggish performance in the countries that at the time had not pursued export-promotion, Chile and India. The table also indicates marked effects in response to the switchovers in Columbia (1959), Brazil (1964-66) and Argentina (1968), but less so for Mexico (n.d.) It is also notable that the expansion of manufactured exports has not been at the expense of non-traditional primary products in almost any of the successful countries. (Traditional primary products, on the other hand, show a low growth rate in but a few countries.

1/ Donges, J. and Riedel, J., "The Expansion of Manufactured Exports in Developing Countries: An Empirical Assessment of Supply and Demand Issues", Weltwirtschaftliches Archiv, Band 113.

2/ Donges, J. and Riedel, J., op.cit. p. 63.

3/ Ibid.

4/ Balassa, B., op.cit., p. 33.

5/ Young, Y., "Estimation of the Manufactured Export Supply Function from Developing Countries", Weltwirtschaftliches Archiv, Heft 3, 1978, pp. 516.

6/ Balassa, B., op.cit.

4.3 The Demand Side

To the developing countries that have begun to export manufactured goods or intend to do so, several characteristics of the market facing them are of paramount interest: first of all, size; second, growth.

Size of Market. In the mid-1970s, the DCs share of the world market for all manufactured goods was about 7%. The share has grown rapidly since the mid-1960s, but is still very small. (Cf. Table 4 (3)). The low share suggests that there is plenty of room for expansion of DC exports. Even in a historical perspective, the DCs' market position seems favourable. The second-generation industrialised countries, e.g. Germany, the US, France and Scandinavia faced a much smaller market, both in absolute terms and in relation to their output capacity, than do the DCs today. Post - World War II markets have also expanded about twice as fast per annum as in the nineteenth century.^{1/} The expected future growth rate is discussed in the subsequent section.

Focussing on individual items, one finds, of course, higher DC market shares as of today, especially for the traditional DC manufactures, such as textiles and clothing, but also in new products, e.g. electronics. Even in these fields, however, it is only in selected items on a low level of aggregation that one finds a high DC share. Moreover, textiles and clothing tend to become increasingly less important in overall DC manufactured exports.

In assessing the order of magnitude of the market proper facing the DCs, world trade is not always the most relevant measure. A better indication is sometimes provided by the DCs' share of total consumption in the importing countries. Table 4 (4) reveals that the DC share in consumption of the major categories of manufactures is exceedingly small in their chief markets. Even for such hitherto important items as textiles and clothing, the share is not even 10%. Overall, for all manufactures, it is two per cent only.

Access impediments apart (analysed in section 4.4 below), it seems that market opportunities are extremely great for the DCs.

Growth of Market. Considering the DCs low share of the world market for manufactured goods, the question of the future growth of this market may seem to be of secondary importance. There is reason, however, to believe that it is easier for newcomers to capture incremental shares of an expanding market than it is to seize shares of an already established market. The main reason is, of course, that seizing shares in existing markets often means trade diversion rather than trade creation, signifying a contraction of domestic production in importing countries. This in turn often leads to, as we have witnessed for decades now, the imposition of trade barriers. The growth of the market facing the DCs therefore is of significance.

^{1/} Kravis, I., op.cit. pp. 860-864.

Table 4(3): Selected Indicators of DC Exports of Manufactured Goods in 1913-1975

	(Per Cent)							
	<u>1913</u>	<u>1928</u>	<u>1937</u>	<u>1955</u>	<u>1960</u>	<u>1965</u>	<u>1970</u>	<u>1975</u>
DC Share of World Export of Manufacturers	5.3	7.4	9.5	4.3	4.2	4.5	5.3	6.6
Share of Manufactures in DC Exports								
All Exports	8.6	13.2	11.6	12.9	14.3	17.6	22.9	20.6
Non-fuel Exports	..	..	..	17.2	19.9	25.6	34.8	50.6

SOURCES: Yates 1959, op. cit., and UNCTAD Handbook, various issues.

Table 4(4): Imports from DCs as Percentage of Apparent Consumption in the EEC, UK, US and Japan by Commodity Groups: in 1973-74.

1	Agriculture	19.5
2	Fuels (crude)	50.7
3	Mining and Quarrying	24.7
4	Food, Beverage and Tobacco	2.4
5	Textiles	3.6
6	Clothing	6.0
7	Wood Products, Papers and Printing	0.9
8	Rubber	0.2
9	Chemicals	1.8
10	Petroleum and Coal Products	6.4
11	Non-metallic Mineral Products	2.6
12	Ferrous and Non-ferrous Metals	4.0
13	Transport Equipment	0.2
14	Machinery and Other Manufactures	1.0
	Primary Products	19.5
	Manufactures	2.0
	Grand Total	5.3

SOURCE: UNCTAD Handbook 1976, Table 7.1

There exists by now a large number of projections for the world economy and world trade. No attempt will be made to review these in the present context. However, a brief mention will be made of the so-called 'scenario X' of the UN study on the future of the world economy by W. Leontief.^{1/} In the 'scenario X' the developing countries' share of world manufacturing output is expected to rise to 18% by the year 2000. The corresponding trade shares for manufactured goods broken down into light industry and machinery and equipment is shown in Table 4 (5). It can be seen the share of the developing countries in world exports of machinery and equipment is expected to remain at a very low level.

Another projection made by the Secretariat of the OECD Interfutures project and taken as the basic scenario for that project shows the market shares of developing countries in manufacturing going up only slightly from 9% in 1975 to somewhat over 10% in the year 2000. The structure of the models used is quite different but the basic exogenous assumptions, notably about production development, are the same. It is, therefore, interesting to note that both models generate slower world trade growth in relation to world output growth than in recent history. Another common feature is that historical trends in trade patterns tend to repeat themselves in the future. This is not due to the structure of the models. Developing countries would remain deficit regions even when assumptions of increased import substitution, preferential tariff treatment and improved access to markets in industrialised countries have been introduced.

A Trade Projection for Industry 2000 - New Perspectives

A special projection of the export possibilities of developing countries has been made for Industry 2000 - New Perspectives by Professor H. F. Lydall.^{2/} The basic hypothesis behind the projection is that exports of manufactures promote the growth of manufacturing industry in the exporting country and thereby the general level of economic development, the availability of skills, the level of real wages and technical capacity in that country. Two different products are identified: (a) L goods which are labour-intensive and require a relatively simple technology; (b) C goods which are capital- and skill-intensive and using more advance technology.^{3/} The proportion of C goods in total manufacturing exports will increase as the per capital GDP level in the country rises. Actual values of this relation have been estimated by econometric methods. By making assumptions about the rate of growth of per capital GDPs and the rate of growth of total world trade in manufactured goods it is possible to make a projection of the future trade pattern. The assumptions made are shown in Table 4 (6). The resulting projection is presented in Table 4 (7).

1/ W. Leontief, et al The Future of the World Economy (UN Sales No. E.76.IIA.6)

2/ H.F. Lydall: "Prospects for Further Industrialisation of Developing Countries Through Exports of Manufactures" (in this volume).

3/ See Table 4 (6) for definitions.

Table 4(5): Shares of Regions in World Exports of Manufactured Goods

(Percentage in 1970 prices)

<u>Region</u>	<u>Year</u>	<u>Light Industry</u>	<u>Machinery and Equipment</u>
Developed market economies ^{1/}	1970	75.2	83.9
	2000	69.6	73.2
Centrally planned economies	1970	7.5	13.0
	2000	9.1	20.2
Developing market economies	1970	12.8	1.5
	2000	13.8	2.7
Latin America	1970	1.2	0.4
	2000	1.9	0.9
Asia and the Middle East	1970	9.9	1.0
	2000	11.2	1.7
Africa (non-oil)	1970	1.7	0.1
	2000	0.7	0.1

SOURCE: W. Leontief et al: "The future of the World Economy".^{1/} Non including medium-income regions

Table 4(6): Trade Projection for Developed Market Economies in Year 2000

	<u>1974</u> <u>data</u>	<u>Rate of growth</u> <u>1974-2000</u> <u>(per cent per</u> <u>annum)</u>	<u>2000</u> <u>projection</u> <u>in 1974</u> <u>prices</u>
GDP per capita (\$)	5,557	3.0*	11,984
Imports of M goods (\$ billion)	264	5.5*	1,060
Exports of M goods (\$ billion)	320	5.5*	1,286
Net export of M goods (\$ billion)	56	5.5	226
L/M import ratio (%)	38.4	-	48
L/M export ratio (%)	31.0	-	25
Imports of L goods (\$ billion)	101	6.4	509
Exports of L goods (\$ billion)	99	4.6	322
Net export of L goods (\$ billion)	-2	-	-187
Net export of C goods (\$ billion)	58	7.8	413

* Exogenous variables

SOURCE: Lydall: op. cit. Base data from UN Statistical Yearbook and UNCTAD Handbook of International Trade and Development Statistics, supplement 1977.

Note: M goods are total manufactured goods (SITC 5, 6, 7 and 8 except 67 and 68)
L goods are labour intensive goods (SITC 6 + 8 - (67 + 68))
C goods are capital and skill intensive goods (SITC 5 + 7).

Table 4(7): Trade Projection for Groups 1, 2, 3 and 4 in Year 2000 ^{1/}

<u>1974 data</u>	<u>Group 1</u>	<u>Group 2</u>	<u>Group 3</u>	<u>Group 4</u>
GDP per capita (\$)	187	867	2,047	5,557
Imports of M goods (\$ billion)	23.1	26.9	50.0	264
Imports of L goods (\$ billion)	5.5	6.2	15.3	101
L/M import ratio (%)	23.8	23.0	30.6	38.4
Exports of M goods (\$ billion)	8.3	5.4	41.9	320
Exports of L goods (\$ billion)	6.9	3.1	21.4	99
L/M export ratio (%)	83.1	57.4	51.1	31.0
<u>Projected rates of growth</u>				
<u>1974-2000 (per cent per annum)</u>				
GDP	7.0	6.0	5.0	3.75
GDP per capita	4.8	3.5	3.3	3.0
Imports of M goods	12.0	8.0	7.0	5.5
Exports of M goods	15.0	14.0	8.0	5.5
<u>L/M ratios in 2000 (%)</u>				
Import ratio	23	30	37	48
Export ratio	75	45	34	25
<u>Projection for year 2000 in</u>				
<u>1974 prices</u>				
GDP per capita (\$)	633	2,121	4,761	11,984
Imports of M goods (\$ billion)	440	199	290	1,060
Exports of M goods (\$ billion)	314	163	310	1,286
Net export of M goods (\$ billion)	-126	-36	20	226
Imports of L goods (\$ billion)	101	60	107	509
Exports of L goods (\$ billion)	236	73	105	322
Net export of L goods (\$ billion)	135	13	-2	-187
Net export of C goods (\$ billion)	-261	-49	22	413

SOURCES and Notes as for Table 4(6).

^{1/} The country grouping is the following:

	GDP/capita, 1974 (\$)
Group 1	< 500
Group 2	500-1200
Group 3	1200-3000
Group 4	> 3000

The following predominantly petroleum-exporting countries have been excluded: Bahrain, Brunei, Kuwait, Libya, Netherlands Antilles, Saudi Arabia and Trinidad and Tobago. For further details, see Lydall: op. cit.

The main results of Lydall's projections can be summarised as follows. The starting point is the GDP growth rates shown in Table 4 (7). It is then assumed that the imports and exports of total manufactured goods will grow at the same pace in the industrialised countries. In the developing countries exports of manufactured goods will grow faster than imports of manufactured goods, and the gap between the growth rates will be particularly great in the middle income countries. By the year 2000 the developing countries will have an export surplus of labour intensive goods of roughly 150 billion dollars over 1974. This will be more than counter-balanced by a net import of capital-intensive goods of roughly 290 billions of dollars. In 1974 the surplus of labour-intensive goods amounted to 5 billion dollars and the deficit on capital- and skill-intensive goods amounted to roughly 50 billion dollars. (All values at 1974 US \$)

The projection described above uses a somewhat different country grouping than the one normally used in UNIDO contexts. As is clear from Lydall's paper, there is some uncertainty concerning the growth rates in GDP and manufacturing which are implied in his trade projections. In a special report annexed to his main paper, Professor Lydall discusses this problem. After adequate adjustments it can be seen that the maximum manufacturing growth rates compatible with the trade projections would be the following for the period 1974-2000:

Developing Countries	8.5%
Developed Market Economies	4.0%
Centrally Planned Economies	5.5%

Under these assumptions the percentage share in the manufacturing output for developing countries in the year 2000 would be about 20%. The Lima target would thus not be achieved in this scenario.

Table 4 (8) gives the full results of the trade projections. It can be seen from the table that the total annual rate of growth of exports from developing countries could amount to 13% during 1974-2000. Such a rate of increase may seem feasible, given the fast growth in the historical period. However, it must be remembered that those past increases were achieved from a very small basis. A better understanding of the effort involved is to look at the development of the share of the GDP of developed market economies spent on imports of manufactured goods from the developing countries. This share amounted to 0.5% in 1974. The projections imply that it should rise to about 4% in the year 2000. It is quite clear that this would imply a major change in the structure of world trade.

General conclusions from trade projections. There is no need to repeat in the present context the well-known arguments about the uncertainty - and maybe futility - of economic and trade projections in general. The projection exercise is, nevertheless, useful since it forces economists and politicians to couch their various arguments in quantitative terms. On a very general level, certain relevant features seem to

Table 4(8): Projection of DC Trade in Manufactures in 2000 ^{1/}

(Values at 1974 prices and exchange rates: trade valued f.o.b.)

	<u>Trading Partners</u>				<u>TOTAL</u>
	<u>DMEC</u>	<u>DC</u>	<u>CPE</u>	<u>CPA</u>	
<u>1974 Data</u>					
DC Imports (\$ billion)	77.4	9.6	3.9	1.2	92.1
Percentage Shares	84.1	10.4	4.2	1.3	100.0
DC Exports (\$ billion)	18.5	9.6	0.9	0.1	29.2
Percentage Shares	63.7	33.1	2.9	0.3	100.0
<u>2000 Projection</u> ^{2/}					
DC Imports (\$ billion)	595	230	120	30	975
Percentage Shares	61.0	23.6	12.3	3.1	100.0
DC Exports (\$ billion)	380	230	60	30	700
Percentage Shares	54.3	32.9	8.6	4.3	100.0
DC Net Imports (\$ billion)	215	-	60	-	275
<u>Implicit Ratios</u> ^{3/}					
Annual Rate of Growth of DC Exports 1974-2000 (%)	12.3	13.0	17.5	24.5	13.0
EC Exports as Percent of DC Imports	63.9	100.0	50.0	100.0	71.8
Imports from DC (f.o.b.) as percent of area GDP in:					
1974	0.51	-	0.09	-	-
2000	4.05	-	1.91	-	-

^{1/} Manufacturers defined as SITC No. 5 + 6 + 7 + 8 - (67 + 68).^{2/} For assumptions underlying these projections see text.^{3/} The first two sets of ratios are derived from data given in the table. The GDP estimates used for the last two pairs of ratios are as follows (\$ billion) at 1974 prices):

	<u>DMEC</u>	<u>CPE</u>
1974	3,600	1,000
2000	9,375	3,141

The estimates for 2000 are based on the assumptions that over the period 1974-2000 GDP in the DMEC will grow at an average annual rate of 3.75 per cent, and GDP in the CPE will grow at an average annual rate of 4.5 per cent.

emerge from most of the projection exercises presently performed.^{1/}

1. Most projections assume a slowing down in output growth in industrialised countries, compared to the development in the 60s.
2. Most projections assume that the relationship between trade growth and output growth will fall over the long run.

The combined effects of 1. and 2. will, of course, lead to a strong deceleration in the development of world trade. It will also lead to:

3. Increased competition on the world markets for manufactures.

Persistent balance of payment problems will force certain developed industrialised countries to try to accelerate their exports. The same is true for the socialist countries. The development of China remains uncertain, but we cannot exclude the possibility that Chinese exports of manufactures will increase considerably.

4. The slowing down of world trade and increased competition may lead to protectionist tendencies and artificial trade barriers, particularly in the form of open or disguised support for domestic industries.

5. The Lima target is not reached in any of the more sophisticated projections.

6. Even if all projections include very high growth rates for exports of manufactures from developing countries there seems to be no fundamental or underlying change in the pattern of world trade. By and large the developing countries are expected to continue to supply world markets with low-priced labour-intensive consumer goods and to be recipients of exports of skill-intensive capital goods from the North.

The tendencies mentioned seem to make it essential that the Lima target should be supplemented by indications of the necessary quantitative evolution of exports of manufactures from the developing countries. It is, of course, not possible to define a 'trade target' in the same way as was done with the target for manufacturing output. The figures of Table 4 (8) above could, however, be used as indications in such a context. Particular reference is made to the share in the GDP of the industrialised countries that has to be spent on imports of manufactures from the developing countries. Another interesting figure is that for DC exports of manufactures as a percentage of imports. In Lydall's projections this share rises from approximately 24% in 1974 to 64% in the year 2000. Since the underlying development does not fully satisfy the Lima target it would, of course, in principle be possible to have somewhat greater ambitions.

^{1/} Apart from the projections mentioned in the text reference could be made to work within the ECE on an Overall Economic Perspective; Scenario work done by UNIDO for the industrial development survey, work with the LIDO model within UNIDO, and for Industry 2000 - New Perspectives, and special calculations. All this is long term projections. There is an abundance of medium term material available which also seems to confirm all the points made in the present context.

4.4 Market Access for Exports from Developing Countries.^{1/}

The developed countries impose a variety of barriers to market access for exports from developing countries. The present section contains a systematic assessment of trade barriers, past development and the present state of affairs, including an opinion on the likely outcome of ongoing negotiations. Each sub-section also outlines policy measures which could be taken in order to improve market access for exports from developing countries.

This section comprises two subsections. The first one treats conventional tariff barriers. Following World War II the major emphasis in lowering trade barriers was through reciprocal tariff reduction under the General Agreement on Tariffs and Trade (GATT). In the early 1930s the developing countries were granted especially favourable, though limited, market access through the General System of Preference (GSP) schemes. The second subsection deals with non-tariff barriers (NTBs), the importance of which has led to intensified multi-lateral efforts to liberalise them.

4.4.1 Tariffs

The guiding principle of the GATT is the administration of barriers to imports on a non-discriminatory, most favoured nation (MFN) basis. The tariff system may not, in principle, discriminate among countries of origin for the same product. Nonetheless, the product structure of MFN tariffs can be said to discriminate against exports from certain groups of countries.

The tariff structures of the developed countries are relatively biased in favour of the importation of raw materials (with certain exceptions) and against the importation of semi-finished and finished manufactured products, especially those that utilise relatively labour-intensive production techniques and thus are of export interest to the developing countries.

(i) Problems of tariff evaluation and incidents of tariffs on developing country exports

Any evaluation of the level or effects of tariffs encounters many conceptual and measurement problems. For instance, most tariff rates must be averaged using some kind of weight system which is bound to introduce a bias in one direction or the other. It is also extremely difficult to compute the effective rate of protection for domestic production as it depends not only on tariffs on the final product, but also on the inputs concerned.

^{1/} This section is based on the paper by Pugel and Walter (in this volume).

Both nominal and effective tariff rates in developed countries generally rise progressively with the stage of production (or 'degree of fabrication') of products, and tend to be directly related to the degree of labour-intensity - and especially unskilled-labour intensity - of production. The tariff structures of the developed countries therefore tend to offer the highest degree of import protection to those industries which produce goods of special export interest to the developing countries. It follows that the MFN tariff structures of the developed countries discriminate systematically against the developing countries as exporters. As an illustrative case, Table 4 (9) demonstrates for the United States this general tendency of tariff escalation and its persistence following the Kennedy Round of tariff reductions, which had been fully implemented by 1972. The nominal and effective tariff rates of other developed countries follow a similar pattern.

(ii) Tariff Preferences

It has already been stated that tariffs are generally levied on a "most favoured nation" (MFN) basis, institutionalised in the GATT, providing that the tariff rate applied on a particular product is the same for all countries supplying that product. This is the principle of "horizontal equity" (equal treatment of equals). In recent years, the developing countries have argued that they are not "equals" in this sense, and that they should be afforded "vertical equity" (unequal treatment of unequals) in the tariff structures of the developed countries. Their exports should be given more favourable tariff treatment than the exports of competing developed countries in the major industrial-country markets.

Table 4 (9): Nominal and Effective Rates of Protection in 1964 and 1972

<u>Product Group</u>	<u>Nominal Rates</u>		<u>Effective Rates</u>	
	<u>1964</u>	<u>1972</u>	<u>1964</u>	<u>1972</u>
Primary Products	.08	.07	.10	.09
Intermediate and Consumer Goods	.10	.07	.18	.11
Capital Goods	.11	.06	.16	.08
Average	.10	.06	.17	.10

Source: R.E. Baldwin, Montariff Distortions of International Trade, Brookings, p. 165.

Development of the GSP. The concept of preferences was first raised at the first session of the United Nations Conference on Trade and Development in 1964, and brought up again at the second UNCTAD in 1968.^{1/} After intensive negotiations GSP schemes were progressively implemented by the EEC (1971), Japan (1971), the Nordic countries (1972), the United States (1976), and other industrialised nations. The GSP was made possible

1/ For a discussion, see Review and Evaluation of the Generalized System of Preferences (UNCTAD document TD/232, January 1979).

by a waiver of the MFN principles contained in the GATT. There are now 16 different GSP schemes involving 19 developed market economy countries of Eastern Europe.

GSP beneficiaries include all developing country members of the Group of 77 and several others. Eligible products include all industrial goods with some exceptions, notably textiles, leather and petroleum products, and selected agricultural products. Product coverage has been increased since the beginning of the GSP under several of the schemes. Most schemes provide duty-free market access for eligible products, although in some cases reduced-rate tariffs are specified. The 'margin of preference' is the difference between the MFN rate and the GSP tariff rate.

Evolution of the GSP. Preference margins would be expected to increase imports from developing countries, partly in response to reduced selling prices in the preference-giving country, partly as a result of trade diversion from non-preference suppliers. If the beneficiary developing countries have limited supply capabilities, the preferences should at least raise the prices they receive for their exports. Thus, the GSP was expected to improve both the balance and the terms of trade of developing countries, as well as convey "dynamic" benefits associated with export-led growth and attraction of foreign investment.

Unfortunately, several aspects of the GSP have served to diminish significantly the benefits to developing countries. First, most preference donors have reserved the right to institute "escape-clause" actions. They maintain the right to withdraw, in whole or in part, preferential tariff treatment when the product in question is imported in such increased quantities that it causes or threatens to cause serious injury to import-competing suppliers. The EEC instituted a priori "triggers" for the temporary suspension of preferences when imports reach pre-determined levels in the form of tariff quotas (sensitive products), tariff ceilings (special semi-sensitive products), ceilings (semi-sensitive and non-sensitive products), as well as maximum country limits. Japan imposes ceilings on preferential imports for virtually all industrial products based on past-year imports, and imports from any one beneficiary may not exceed 50% of the total. The United States instituted "competitive need" criteria, which generally suspend preferences when GSP imports from any single beneficiary exceed \$ 25 million or 50% of the total preferential imports of any particular product. A similar but less rigid scheme exists in Australia. In addition, "rules of origin" strictly limit eligibility for preferences to goods that have been produced or are "substantially transformed" in the country of origin and are "directly consigned" from an exporter in that country to an importer in the preference-granting nation. The rules of origin are often defined in such a way that it is impossible for products to qualify for GSP treatment even if substantial value-added is involved. The developing countries have argued that they should be considered as a group for purposes of rules of origin.

A recent study by the UNCTAD Secretariat shows the extent to which imports from the developing countries have actually benefited from GSP treatment in the case of agricultural products and industrial products. Imports by the developed market-economy GSP donor countries from the beneficiaries in 1976 were \$ 134.4 billion, of which \$ 55.2 billion were dutiable and hence relevant from the standpoint of the GSP. Of these, only \$ 26.3 billion were actually covered by the various GSP schemes, and an estimated \$ 10.5 billion actually received GSP treatment, mostly in the industrial products categories. The UNCTAD Secretariat estimates are that this would have been 50% higher in the absence of a priori limitations and competitive need exclusions. However, growth in preferential imports is estimated to have exceeded the growth of non-GSP imports, and the GSP "utilisation rate" is thought to be rising - indicating greater efforts on the part of exporters to make use of the preferences.

Multilateral Trade Negotiations and the GSP. The recent multilateral trade negotiations represent a mixed blessing for the developing countries. On the one hand, they will erode the margins of preference attributable to the GSP by lowering MFN rates of duty on eligible products, thereby reducing some of the GSP-related benefits described above. On the other hand, the developing Countries benefit from MFN tariff reductions on all products which they export and which are not subject to GSP advantages because of product limitations or quantitative restrictions and exclusions under the various schemes. A recent study - which assumes that no developing country's exports benefit from GSP at the margin - concludes that developing country exports, excluding petroleum products and textiles, would have been \$ 1.8 billion greater in 1974 if MFN tariff reductions under the MTN had already been in force at that time.^{1/} Sixty per cent of this expansion would be in the manufactured goods sector.

In contrast, an UNCTAD study, which omits products benefiting from GSP, concludes that the expansion of exports from the developing countries due to MFN tariff reductions would have been less than \$ 1 billion based on 1976 trade flows and excluding textiles.^{2/} Whereas the former study may be biased towards overstatement of export expansions by ignoring GSP, the latter may be biased towards understatement of export expansion by overstating the importance of GSP at the margin. The UNCTAD study also concludes that developing country exports of GSP-covered products would have been reduced by at least \$ 2.1 billion in 1976 due to erosion of GSP preference margins. The UNCTAD conclusions are based on the view that developing countries exporting industrial products are likely to be adversely affected by the multilateral trade negotiations, i.e. because of a significant erosion of existing GSP margins. The developing countries will also stand to receive less-than-average or zero MFN cuts on products not covered by the GSP.

^{1/} W.R. Cline, et al., Trade Negotiations in the Tokyo Round (Washington, D.C.: Brookings Institution) 1978, chapter 7.

^{2/} United Nations Conference on Trade and Development, Manufactures and Semi-Manufactures, Review and Evaluation of the Generalised System of Preferences, Report by the UNCTAD Secretariat, to be presented at the Fifth session, Manila, 7 May 1979, Item 11 (c) of the provisional agenda.

It is clearly difficult to argue the merits of these opposing views, except to conclude that each effect will partially or wholly offset the other. In any case, the developing countries' export expansion attributable to the MTN is unlikely to exceed two or three percent of their total non-oil exports, a large proportion of which are raw materials imported duty-free and hence unaffected by the MTN.

(iii) Future Progress on Tariff Barriers to Market Access

In the light of the limited benefits the developing countries appear to have obtained both from the historical pattern of multilateral tariff liberalisation (frequently leaving tariff-escalation intact), the Generalised System of Preferences (with its serious limitations and exclusions), and the erosion of GSP margins of preference by the MTN, developing country spokesmen have proposed a number of further steps.

They have suggested that the principles of generalised, non-reciprocal and non-discriminatory system of preferences be reaffirmed, broadened, extended ten years beyond its scheduled expiration in 1981, and made more secure and stable. Furthermore, GSP product coverage should be extended ultimately to include all dutiable developing country industrial exports and substantial agricultural exports. Competitive need exclusions and a priori limitations should be abolished or limited only to the most "sensitive" products and using only liberal and generally non-binding ceilings. Rules of origin should be harmonised and liberalised, exports from the least developed among the developing countries should be accorded unlimited duty-free entry, and technical assistance should be provided for developing countries to help them take advantage of the GSP.

With respect to broader MFN tariff reductions, the developing countries proposed that no products of special export interest to them should be exceptions to formula tariff reductions in the MTN unless these products were already generally covered by the GSP. Indeed, they proposed that MFN reductions on non-GSP products of special export interest to developing countries be deeper than the formula cuts, and that implementation of such tariff reductions be accelerated. Such deeper-than-formula cuts would tend to reduce the detrimental effect on developing country exports of escalation in the tariff schedules of the developed countries on products for which GSP has not already offset tariff escalation. The developing countries also proposed gradual implementation of those MFN tariff reductions which erode GSP margins, in order to reduce the detrimental impact of such erosion, as well as some form of "compensation" for export reductions due to the erosion of GSP margins. During the course of the Multilateral Trade Negotiations, little progress was made either in GSP liberalisation or in improving the MTN outcome for developing countries. Hence there remains considerable scope for future initiative in the area of tariffs.

4.4.2 Non-Tariff Barriers to Trade

The recent trend towards a decrease in the importance of tariffs as trade-restrictive devices is likely to continue, and so the relative importance of non-tariff barriers to trade will increase. The often subtle effects of NTB's frequently fall disproportionately

on exports from the developing countries. This is because the product-groups that are considered "sensitive" and thus subject to NTB protection are also the ones of serious export interest to the developing countries.^{1/} Therefore, the multilateral agreements and codes of the recent MTN designed to reduce NTB's are of special importance to improving the access of the developing country exports to developed country markets.^{2/}

(i) Quantitative Import Restrictions

Quantitative trade controls represent an obvious alternative to tariffs as a trade restricting device. Unilaterally-imposed quotas are not permitted under the GATT, except for balance of payments purposes, in conjunction with domestic agricultural programmes, or to protect the national defense. The two most significant U.S. quotas, on oil and on sugar, have been eliminated within the last decade. At the same time political pressure has grown to impose additional quotas, but this pressure has so far been resisted in large measure. Quotas on various agricultural products exist in a number of developed countries, however.

The GATT has been rather successful in limiting the use of unilaterally-imposed quotas by the developed countries. In addition, the new framework negotiated as part of the MTN calls for GATT signatories to avoid trade measures, including quotas, in dealing with balance of payments problems.

In contrast to the limited use of unilaterally imposed quotas, the use of bilaterally and multilaterally negotiated quantitative restrictions on international trade has increased dramatically in recent years. These voluntary export restraints (VERs) and orderly marketing arrangements (OMAs) are often imposed to "safeguard" import-competing industries in the developed countries. Developing country exports of such manufactured goods as textiles, footwear, consumer electronics and steel are restricted. Individual developing countries, notably Taiwan, Brazil, Mexico, Hong Kong, and South Korea may be especially adversely affected in their drives to industrialise according to comparative advantage by producing for export. More generally, exports of manufactured goods from developing countries are increasingly likely to be subject to safeguard actions in the developed countries.

A "safeguards code" was negotiated under the MTN to re-establish GATT authority over safeguard actions in the developed countries. The code requires formal investigation which factually demonstrates actual or potential injury before a safeguard may be imposed. If feasible, the safeguard should be liberalised over its lifetime, to encourage economic adjustment by the affected industries. Overall the code makes major improvements in the

1/ See Ingo Walter, "Non-Tariff Barriers and the Export Performance of Developing Countries", American Economic Review, May 1971

2/ For a summary, see "International Trade Agreements", Federal Register, 8 January 1979, Part VIII.

international regulation of the use of safeguards, and should improve to some extent the export market access of developing countries. However, the code contains only a weak commitment by the developed countries to adjust out of industries in which comparative advantage is shifting to the developing countries.

(ii) Licensing

The role of import licensing in international trade is the enforcement of policies which themselves may or may not restrict the international flow of goods. Nonetheless, the administration of licensing may distort trade by raising costs or increasing uncertainty. Licensing may be especially restrictive of imports from less sophisticated developing country exporters because of the often detailed information requirements and administrative conditions imposed by the licensing arrangement.

A licensing code was negotiated under the MTN covering both automatic import licensing (often for statistical purposes) and licensing to administer quantitative import restrictions. Automatic licensing procedures must be published and must not restrict imports nor penalise minor documentation errors. Licensing to administer quantitative restrictions is bound by similar procedural rules, and should permit the addition of new suppliers into the restricted market. Developing countries are likely to benefit from the simplification and liberalisation of licensing procedures as the code is implemented in the developed countries.

(iii) Government Purchasing

Government purchasing is an area in which virtually all national and subnational governments discriminate in favour of domestic and against foreign suppliers. In the United States the discrimination is written into various "Buy American" legal provisions. In other developed countries the practice is pervasive if usually not explicitly written into law. The developing countries may be particularly affected adversely because of their own relatively lower levels of government procurement and hence limited bargaining power in gaining access to foreign government contracts.

A code on government procurement was negotiated as part of the MTN in order to eliminate administrative discrimination against or among foreign suppliers in public-sector purchasing. It provides for non-discrimination or "national treatment" in bidding, awards and disclosure, as well as substantial "transparency" in the procurement process. In addition, the developed countries agreed to attempt to facilitate developing country exports by improving information dissemination, continuing GSP provisions, and providing technical assistance, especially to the least developed of the developing countries. They can negotiate special time-limited derogations from the "national treatment" provisions, and thus can avoid adhering to non-discrimination when this threatens to interfere with the development process. Although the developing countries argued for but did not receive additional special and differential treatment in this area, the code should, when implemented, substantially liberalise government procurement practices to the long run benefit of exports from the developing countries.

(iv) Technical standards

The number of technical standards in existence has increased remarkably in recent years. Technical standards may be disproportionately burdensome for developing countries because of their limited information-gathering, technical, engineering, marketing and related supply capabilities.

A code on technical barriers to trade has been devised as part of MTN. The code requires signatory countries to avoid unnecessary standards and the unnecessary creation of trade barriers through technical standards. Advance publication of all technical standards is required. Certification methods should not discriminate against foreign goods, and testing and certification undertaken in the country of export should be accepted whenever possible. International standards should be adopted to the greatest possible extent. Technical assistance is to be provided to developing countries on request, in order to promote compliance of their exports with the technical standards of the importing country. The exports of developing countries should benefit from the liberalisation and non-discrimination embodied in the code, and especially from the technical assistance provisions.

(v) Subsidies

Both export subsidies and domestic production subsidies alter the pattern of international trade, the latter by tending to reduce imports or increase exports. In recent years the imposition of countervailing duties to combat or neutralise subsidised exports has increased in frequency, in part because the U.S. Trade Act of 1974 reduces the flexibility of the U.S. Treasury in imposing such duties. In fact, U.S. law has never been in conformity with the GATT, in that U.S. law does not require the demonstration of domestic injury prior to the imposition of countervailing duties. The developing countries have often been the targets of actual or threatened countervailing action because of their heavy use of export subsidies, in part to neutralise domestic distortions or overvalued exchange rates.

A code on subsidies and countervailing duties, negotiated under the MTN, reaffirms the right to use domestic subsidies, although their trade-distorting consequences must be considered. Export subsidies are banned except on agricultural products or if used by developing countries for specifically development purposes. The imposition of countervailing duties against subsidised exports requires a factual finding that the subsidy exists and that injury due to the subsidised imports exists or is likely to occur. Thus, the value of the right of developing countries to subsidise exports is reduced because no parallel special and differential treatment of developing country exports with respect to countervailing duties exists. Nonetheless, the code should benefit the developing countries, by at least requiring injury tests to be included in national countervailing duty laws. At the same time, developing countries should pursue alternatives to subsidise in expanding exports, such as the elimination of export-reducing domestic market distortions or the imposition of a compensatory devaluation.

Another problem not explicitly considered in the MTN is dumping - selling abroad below price in the domestic market. The MTN participants have agreed to revise the Anti-Dumping Code of the GATT to bring it into conformity with the subsidies code described above.

(vi) Customs Classification and Valuation Methods

Customs practices may act as important obstacles to trade. Most developing country complaints against customs valuation practices in the developed countries are directed towards the United States, Canada, and New Zealand, the three principal countries not using the so-called Brussels Definition of Value.

A code on customs valuation was developed during the MTN to provide an explicit, simple, and universal valuation system based on actual prices of internationally traded goods or, as a last resort, on a computed cost of production. The code achieves the developing countries' objective of banning valuation based on domestic prices, but unfortunately applies only to valuation for ad valorem tariff purposes. Therefore, other more complex or discriminatory valuation methods may continue to be used in other cases.

(vii) Variable Levies

By setting a minimum duty-inclusive import price, variable levies act much like quotas in eliminating the ability of imports to compete for an expanded share of the domestic market. The most notable use of variable levies is by the European Economic Community in implementing the Common Agricultural Policy. In accord with the GATT tradition of exempting the Common Agricultural Policy. In accord with the GATT tradition of exempting agricultural products from its provisions, little progress was made by the recent MTN toward altering the EEC variable levies. In addition, the U.S. trigger price mechanism on steel imports, although technically an anti-dumping provision, may eventually have effects similar to a variable levy. In contrast to a variable levy system, however, cost-efficient exporters are permitted to price below the trigger price if they can show that they are not dumping. A variable levy system was recently imposed on steel by the EEC.^{1/}

(viii) Summary Evaluation of Multilateral Agreements to Liberalise Non-Tariff Barriers

In total, the multilateral agreements of the recent MTN to liberalise NTBs would significantly improve the market access of developing country exports. The developing countries are nonetheless disappointed by the outcome because very few substantial areas

^{1/} See Ingo Walter, "Sectoral Protection and International Trade: The Case of Iron and Steel", The World Economy, April 1979.

of special and differential treatment are provided for within the agreements. In addition, the actual implementation of the arrangements is not assured. They must still be approved and enacted by individual developed country governments in the face of sometimes powerful domestic special interests. Once enacted, monitoring must assure compliance. The developing countries can assist the monitoring by participation - as individual countries or through international organisations - in the multilateral committees established as an integral part of each of the codes.

CHAPTER 5: BILATERAL TRADE AGREEMENTS ^{1/}5.1 Various Forms of Bilateral Trading Arrangements

There are a variety of bilateral trading arrangements between industrialised and developing countries, some of which may be highly supportive of export-driven industrial development, while others may seriously retard this goal. These include: (a) Historical trade ties and post-colonial supply relationships: (b) Rubrique trade facilitation agreements between pairs of industrialised and developing countries: (c) Bilateral-clearing trade agreements between developing countries and socialist countries of Eastern Europe: and (d) Bilateral trade agreements covering individual products under voluntary export restraints (VERs) or orderly marketing arrangements (OMAs).

5.1.1 Historical Bilateralism

Historically, the most important forms of bilateralism between industrialised and developing countries clearly involved trade relations under the Commonwealth Preference system and smaller but perhaps more intensive arrangements involving the Francophone countries. These often had an essentially multilateral political overlay, but for practical purposes functioned bilaterally with respect to international trade. The developing countries involved were given preferential access to the market of the industrialised country involved through tariff concessions and the relaxation of a variety of non-tariff barriers. The terms of such market-access was often quite liberal, although they generally also required "reverse preferences" - i.e., that the developing country involved grant preferential market access to the respective industrialised country over suppliers from industrial countries. This frequently meant preferential treatment in government procurement and for products subject to state trading.

The effects of such bilateralism on the developing countries involved were clearly mixed, combining rather clear export-volume and possibly export-price advantages with the necessity of substituting imports from high-cost suppliers for lower-cost imports under the reverse preferences. Some vestiges of post-colonial bilateralism remain in the French, British and Portuguese cases, specifically with respect to an over-representation of the metropolitan countries in the trade of their former colonies, (Section 3 above). One piece of evidence suggests, however, that there were overall net benefits associated at least with the Commonwealth Preference system. ^{2/} This form of bilateralism was, of course, substantially eroded by the Yaounde and Lomé agreements between the EEC and the Africanised Caribbean States in association with the EEC and the Generalised System of Preferences, both of which are discussed elsewhere in the Joint Study.

^{1/} This chapter is based on the papers by Pugel and Walter and Nayyar (in this volume).

^{2/} Cf. UNCTAD: Operation and Effects of the Generalised Preferences Granted by the United Kingdom (Geneva: UNCTAD document TD/B/C.5/7, 1973.)

5.1.2 Rubrique Bilateralism

Trade facilitation agreements between individual developing and industrialised countries (or the EEC as a whole) essentially serve as broad statements of intent. An agreement may be signed to double or triple bilateral trade between two countries over a given period of time, for example. In the manufacturers sector, such agreements clearly cannot abrogate MFN, GSP or other multilateral commitments of the countries involved, and preferential treatment on both sides must be confined to non-tariff barriers, such as government procurement. These give ample scope for preferential treatment, but will be narrowed with the implementations of codes of conduct agreed upon in the Tokyo Round. Scope for such preferences on both sides remains, of course, to the extent that the developing countries do not become signatories of codes on NTBs negotiated under auspices of the GATT, or receive special and differential treatment in the form of exclusions or derogations. The other important effect of bilateral trade facilitation agreements involves credits, often large-scale and on concessionary terms, by the industrialised country to finance the developing country's imports. Here again there is the danger of diverting trade to a high-cost supplier and hence deterioration in the terms of trade of the developing country involved, although this may be partly or wholly offset by concessionary financing terms.

5.1.3 Bilateral Trade Controls

Recent years have seen the development of bilateralism under so-called 'voluntary export restraints' (VERs) and 'orderly marketing arrangements' (OMAs). Normally OMAs and VERs are straight forward bilateral arrangements but occasionally they are sanctioned multilaterally, as in the Multifibre Arrangement (MFA) covering textiles under the auspices of the GATT. It is always incumbent upon the exporting country to police its own shipments. Indeed, under certain conditions bilateral OMAs or VERs may be more restrictive than nominally equivalent tariffs or quotes.^{1/}

Such trade distorting bilateralism is almost totally negative from the point of view of the developing country. Exports may have to be diverted to other markets at lower prices, damaging the terms of trade. If these diverted exports are in turn disruptive of third markets, they may lead to additional trade restrictions there as well. Even so, developing countries have become heavily involved with VERs and OMAs because they perceive them as the lesser of several evils. They also, of course, create costs of information and negotiation, and they imply risk and uncertainty that deters trade.

^{1/} See Tracy Murray, Wilson Schmidt and Ingo Walter, 'Alternative Forms of Protection Against Market Disruption', Kyklos, Fasc. IV, 1978.

5.1.4 Bilateral Agreements

Bilateralism and trade-clearing arrangements between centrally planned economies and developing countries are often the product of non-market determination of international trade manifested in strict exchange controls. Centrally-planned economies direct imports under state trading and the economies are generally characterised by recurrent foreign-exchange shortages. Many developing countries face much the same conditions, and so the stage is set for bilateral trade-clearing.

The principal features of such arrangements in the past (and to some extent even now) between the East and the South were as follows: (i) The agreements specified the objectives of economic co-operation for both partners and attempted to set out planned needs as accurately as possible. (ii) Trade balances outstanding at the end of each period were settled in exports and imports of mutually agreed products or in inconvertible currency. (iii) Aid as well as debt repayments were automatically converted into trade flows: credits extended to DCs, for instance, could be repaid in inconvertible domestic currency, traditional exports or the output of aid-financed projects. (iv) As far as possible, all transactions were carried out in terms of world prices, except that bilateral agreements sought to eliminate short-term fluctuations. This is a typical but by no means universal example. In a few cases, trade, along with other transactions was conducted in terms of hard convertible currencies. In that case, trade between the East and the South was no different from the usual international exchange of commodities between the North and the South. Special advantages, or disadvantages, arose only if the relationship had a bilateral character.

5.2 The Rationale for Bilateral Agreements

Little attention has been paid to bilateral agreements in the theory of international trade. Bilateralism is generally subsumed in the set of non-optimal trade policies that diverge from free trade. However, under certain conditions, even orthodox economic theory allows for bilateral trade arrangements. In such analysis, multi-lateral free trade is the optimum policy, but, if for some reason, the import restrictions cannot be dispensed with, bilateralism does provide a second-best solution. Situations where bilateral agreements could bring gains to DCs can also be projected.

First, bilateral trade on a selective basis with some countries might improve the terms of trade with the rest of the world. This would be the case when a developing country exports a primary commodity whose supply in competing countries is less than infinitely elastic and whose demand is price inelastic. Incidentally, these conditions are not uncommon in the world market for some commodities. Now, if partner countries buy a significant proportion of the DCs exportable output of the commodity, entry into the market might push up prices and thereby improve the terms of trade for the exporter, provided that these partner-country imports do not substitute for imports from some other country.

Second, bilateral trade might create greater export stability. Fluctuations in the level of prices and of demand are common features of the world commodity markets. Several developing countries still dependent on the export of one or a few commodities are therefore particularly vulnerable. The reliance on a small number of traditional metropolitan markets, dictated by historical factors, often compounds difficulties. In such cases, bilateral economic relations with other DCs, or the socialist bloc, may give rise to significant benefits because they offer the possibility of long-term contractual agreements.

Third, bilateral trade agreements might eliminate, or significantly reduce, the risk and uncertainty of convertible currency markets in the North. In fact, partner countries might provide alternative markets for manufactured exports from DCs without the uncertainty, the sales efforts and the advertising expenses which would be unavoidable in convertible currency markets. This potential benefit is particularly crucial in the case of non-traditional manufactured exports wherein product differentiation, brand names and selling costs are an all important part of any successful export effort.

5.3 The East/South Experience of Bilateral Trade

In recent years, economic relations between the European socialist countries and the developing world have become quite strong. A significant proportion of these ties have developed since the late 1950s, when several newly independent nations emerged from the colonial era in Asia and Africa. Available evidence suggests that the relationship between the two groups of countries strengthened considerably in subsequent years. There was, for instance, a phenomenal expansion in trade between the centrally planned economies of USSR and Eastern Europe on the one hand and the developing market economies on the other.^{1/} It is worth noting, however, that trade as well as other economic ties were directed towards a limited number of DCs. This is hardly surprising, because the remarkable growth in economic co-operation between the East and the South has taken place largely in a framework of bilateral agreements. Economic aid, development credits, technology transfer and trade are all incorporated into long-term agreements negotiated with individual governments. In fact, bilateralism is an integral part of the overall system of economic and political relations between communist countries and the less developed world.

Obviously, it is difficult to generalise about the experience of East/South trade. Existing research on the subject does, however, suggest that trade between the CMEA countries and DCs, carried out in a framework of bilateralism, led to mutual benefits

^{1/} From 1952 until 1976, the turnover of trade virtually doubled every four years: cf. UN Yearbook of International Trade Statistics, several issues.

for both sets of partners.^{1/} For the South, the socialist countries provided welcome new markets for a large number of traditional commodity exports which faced rather low income elasticities of demand in the metropolitan countries.. At the same time, an overwhelming proportion of DC imports from the socialist bloc were capital goods and intermediate products, which were essential to their industrialisation programmes and not low priority goods which they were forced to import. As far as the DCs were concerned, the terms of trade offered by the East were sometimes better and, at any rate, no worse than those offered by the rest of the world.^{2/}

For the East, trade with the South offered an opportunity to import goods which were either too expensive to produce at home or could not be produced at all. Under bilateral arrangements, such imports were financed through exports so that there was no need to part with scarce convertible currencies. Thus the socialist countries sold machinery and other manufactured goods in exchange for primary products and industrial raw material.^{3/} Of course, such traditional patterns of trade neither transformed the structure of production in the South, nor made for a new international division of labour. Admittedly, patterns of production and trade in the DCs which have evolved over a long period could not have been changed overnight. However, the diversification in the pattern of East/South trade, with the possible exceptions of India and Egypt, was not very significant. In the long run, such diversification is imperative for industrialisation in the Third World.

^{1/} For a detailed discussion of the issues, as also evidence from different countries, see D. Nayyar ed. Economic Relations Between Socialist Countries and the Third World, London, 1977.

^{2/} An examination of international trade statistics reveals that machinery and transport equipment account for nearly half the DC imports from the socialist world, while intermediate goods such as base metals, chemicals, fertilisers and petroleum products constitute a very large proportion of the remainder.

^{3/} Until as late as 1976, 78 per cent of East European and USSR exports to DCs were constituted by manufactured goods, whereas primary products and raw materials accounted for 88 per cent of Third World exports to the socialist bloc: calculated from the United Nations Monthly Bulletin of Statistics, June 1978, Table F.

CHAPTER 6: THE DEVELOPMENT OF SOUTH/SOUTH TRADE AS A VEHICLE FOR INDUSTRIALISATION.
PAST EXPERIENCE AND NEW POSSIBILITIES.^{1/}

In recent years economists and policy-makers have emphasised South/South trade, not only as a means of reshaping the division of labour among nations, but also as part of an industrialisation strategy. A priori, the case for an expansion of trade between countries in the developing world is attractive. The notion of collective self-reliance has an obvious political appeal insofar as it would reduce the age old dependence on rich countries, and improve the bargaining power of the South vis-à-vis the North. It is difficult to visualise any significant progress on "collective" self-reliance without a vigorous development of trade relations, which are usually a pre-condition for further economic integration. Economic co-operation between developing nations, particularly in the sphere of trade, should help these countries to realise economies of scale, overcome the limitations of domestic market size, exploit complementary resources through regional specialisation, reduce the exposure to risks or cyclical fluctuations, and, in the long run, foster indigenous technological development. It is probably that increased mutual trade will favourably influence the flow of capital technology and managerial skills whose supply is rapidly increasing in developing countries. Perhaps most important, however, the growing network of trade flows will foster an increased awareness of common problems and potentialities.

The future prospects of growth in volume and diversity of intratrade are considerably enhanced by the growing "complementarity" in economic structures among the developing countries. This latter phenomenon, in turn, is intimately related to long-run structural factors connected with the appearance of industry in hitherto primary-oriented economies, and offers an important opportunity to increase mutual trade both in manufactured products and in primary commodities.

A second favourable factor in fostering future intra-DC trade is the present trend towards abolishing trade barriers in DCs. These are at present, on the average, much higher than the ones in DMECs and, consequently, there is more to reduce and more trade to be created, not the least on a South/South basis.

The purpose of this chapter is to analyse some of these aspects of South/South trade with particular emphasis on trade in manufactures. It is broken down in four sub-sections. Sub-section 6.1 gives a statistical perspective of the development. Sub-section 6.2 analyses some of the major determinants behind South/South trade. In sub-section 6.3 the major obstacles for South/South trade are reviewed and sub-section 6.4 discusses how its evolution will be affected by specific policy initiatives.

^{1/} This chapter is based on the papers by Ahmed and Nayyar (in this volume).

6.1 Statistical Perspective

This section attempts to provide an overview of the changing pattern of developing countries' intra-trade by main regions and SITC groups during the 17-year period 1960-1976.^{1/} It reviews the relative size, growth rates, commodity composition, and the regional distribution of trade relations among developing countries. The data on which the analysis of this section is based is contained in the statistical appendix to this section.

6.1.1 Growth Rates and Shares

A comparison of annual average growth rates of individual trade flows between major groups of countries during 1960-1970 indicates that trade among developing countries showed the lowest rate of growth. However, a very significant change in intra-trade flows appears between 1970 and 1976 when the intra-trade share increased from 3.5% in 1970 to 5.9% in 1976. If oil is disregarded, however, the share rose more modestly.

The share of intra-trade in both total exports and imports of the developing countries decreased somewhat between 1960 and 1970, followed by an increase during 1970-1976. By 1976, close to 23% of exports of the developing countries went to other developing countries while 26.5% of their imports originated in the developing world.

It should be pointed out that the high annual growth rate of the period 1970-1976 also reflects the price changes, particularly the rapid increase in oil prices since 1973. However, the fact that intra-trade also recorded significant increases in 'real' terms is confirmed by an examination of the available quantum index. According to this index annual intra-trade between 1970 and 1976 grew at the rate of 9.2%, compared with 5.8% during 1960 - 1970. The growth rates for the period 1970-1976 are thus higher than those of trade flows among industrialised countries (5%), and higher than those of total exports of developing countries (5.8%). Moreover, the volume growth rates appear to be considerably higher if fuels are excluded from intra-trade. The share of fuels exports in intra-trade is approximately one-fourth of the total.

6.1.2 Commodity Composition

Developing countries' total exports of manufactures (SITC 5-8, less 68) amounted to \$ 30 billion in 1976. Of this two-thirds, i.e. \$20.5 billion were destined for developed market economy and socialist countries, while \$ 9.6 billion worth were sold to

^{1/} This section is based on data obtained from the UNCTAD Secretariat in Geneva. Particular reference is made to Review of Recent Trends and Developments in Trade in Manufactures and Semi-Manufactures: Report by the UNCTAD Secretariat, TD/B/C.2/190 21 March 1978, and Trade Among Developing Countries by Main SITC Groups and by Regions: Statistical Note by the UNCTAD Secretariat, TC/B/C.7/21, 20 September 1978.

other developing countries. This means that the intra-DC share is higher in manufactures than in total trade (cf. above). In fact, the share of manufactured products in intra-trade of the developing countries rose from 26.9% in 1970 to 46.3% in 1975.

The intra-trade in manufactures among the developing countries exhibits a wide diversity in product composition. In 1976, nearly half of this trade was in a wide variety of products under SITC 6 and 8, a third in machinery and equipment (SITC 7), while chemical products (SITC 5) accounted for one-sixth of the total. The increase in the share of manufactured products traded among developing partners has been particularly pronounced in chemicals, machinery and transport equipment and clothing. In 1976, markets of other developing countries accounted for the highest shares of developing countries' exports of passenger road vehicles (78%), machinery and transport (44%), chemicals (50%) and iron and steel (46%). The lowest shares were recorded in non-ferrous metals (18%), oilseeds (14%) and crude fertilizers and ores (8%).

The largest gains in shares in intra-trade in manufactures were registered in machinery and transport (from 3.6 to 14.6%), chemicals (from 2.7 to 7.4%) and iron and steel (from 0.9 to 2.8%). The lowest growth in shares is accounted for by minerals, ores, crude fertilizers, clothing and textile fibres. The small percentage of intra-trade in such products can be attributed to the similarity of factor endowments in specific raw materials among a large number of developing countries. On the other hand, the fact that the total demand of the developing countries for some of the above product groups increased faster than the growth of intra-trade reveals considerable potential for further intra-trade expansion.

6.1.3 Regional and Inter-Regional Composition

In 1976, exports to other developing countries accounted for the highest share in South and Southeast Asia (29%), followed by Latin America (22.9%), West Asia (21.8%), and Africa (10.9%). These shares seem to have been remarkably stable since 1960. Traditional trade links established in the past, the complexion of recent growth and the artificial barriers to trade are some of the factors which account for this diversity in shares. However, all regions shared in the increase in the weight of manufactured products in developing countries' intra-trade. The sharpest increase was recorded in Latin America (from 11.9% in 1960 to 38.5% in 1975), and the highest levels in South and Southeast Asia (from 33.3% to 51.3%).

The commodity composition of intra-trade between various developing regions also varied considerably. In 1975, exports from South and Southeast Asia to the developing countries represented over one-half of developing countries' non-fuels trade and over 60% of intra-trade in manufactured products. Unlike Latin America, which developed its manufacturing sector on the basis of regional demand, over one-third of exports of manufactures from South and Southeast Asia to other developing countries went outside the region, chiefly to West Asia and Africa. Exports from Latin America to other

regions are still heavily concentrated on food, destined mainly for West Asia and Africa. Manufactured products and industrial inputs, such as iron and steel, are traded mainly within the regions. Although exports of manufactures to other regions in 1975 accounted for only 15% of total exports to other regions, they rapidly expanded in value, from \$ 9 millions in 1960 to \$ 233 millions in 1975. Manufactured exports to developing countries outside the region are heavily concentrated in machinery and transport equipment.

Among all trade flows between developing countries in 1975 African exports to developing countries registered the highest share of food and agricultural raw materials, and the lowest of manufactured goods. Moreover, the unit value of agricultural raw materials and minerals exported to other regions is far higher than that of the same trade flows within Africa. This reflects the lack of industrial capacity for the processing of local materials. The main flow of goods from Africa to other developing regions consists of fuel to Latin America and food and crude materials to South and Southeast Asia. The bulk of manufactures imported from developing countries originates in South and Southeast Asia. Exports from West Asia to other developing regions consist almost exclusively of fuel oils and their derivatives.

The bulk of intra-trade among developing countries is still carried out on an intra-regional basis. However, between 1960 and 1976, the share of intra-regional trade in total intra-trade among developing countries declined from 73% to 50%. This change appears to have been mainly caused by the increasing value of petroleum trade among developing regions. Excluding petroleum, the share fell from 75% in 1970 to 68% in 1975. In any event, during 1970-1975, interregional trade among developing countries expanded faster than trade within the regions. The highest reliance on regional markets is observed in Latin America where in 1975 close to 76% of all exports to developing countries went to other countries of the region. The corresponding figures for West Asia is 70%, for South and Southeast Asia 65%, and for Africa 55%. The emerging relative importance of expansion in interregional trade can be observed in almost all major commodity groups. The most pronounced increases were recorded for crude fertilizers, minerals and ores (796%), chemical products (689%), and machinery and transport equipment (688%). These changes clearly highlight a trend toward broadening the geographical scope of intra-trade and reflect the increasing maturity of many developing countries as suppliers of manufactured products.

6.1.4 Preferential Trade

Intra-trade within regional groups benefiting from mutual tariff reductions in 1975 amounted to \$ 4 billion or roughly 18% of trade among developing countries. Between 1960 and 1976, the share of trade covered by preferential schemes within the total export flows of regional groupings increased as follows: for the Latin American Free Trade Association, from 7.7% to 12.1%; for the Central American Common Market, from 7.5% to 21.3%; for the Caribbean Economic Community, from 4.8% to 8.3%; for the West African Economic Community, from 2.5% to 9.4%; and for the Central African Customs and Economic Union, from 1.7% to 8.4%.

Since intra-regional trade in manufactured products among developing countries usually is subject to high tariff and non-tariff barriers, a substantial proportion of this trade is most likely the result of preferences. Thus, CACM which is the most advanced group in liberalising internal trade barriers, exports of such products as synthetic fibres, glassware, metal containers, plastics, chemicals and drugs, motor vehicles, and telecommunication apparatus, and others, are traded exclusively among partner countries of the group. Similarly, in the Andean Group, trade in machines and apparatus, electric equipment, man-made fibres and pharmaceuticals is confined to sub-regional exchanges among the bloc countries. In Africa, certain manufacturing industries developed solely thanks to the existence of regional preferences. Within the Central African Customs and Economic Union, clothing, glassware, wire products, pharmaceuticals, plastics, metal containers, and tools are traded almost exclusively among bloc-partners. Preferences granted within the West African Economic Community stimulated internal trade in plastics, rubber products, household appliances, and agricultural machinery.

That internal trade subject to trade preferences still represents only a modest share of the total demand of the individual regions for the products currently traded is a measure of the potential for future expansion of mutual trade. Similarly, it is observed that developing countries not part of the regional preference schemes import from industrial countries goods which in some instances could be supplied by industries within the preferential groups on competitive terms. CACM has hardly penetrated the market of other Latin American countries for manufactured products and industrial inputs, despite considerable imports of these products from the developed countries. The same lag in the pattern of market penetration can be observed in all regional groupings as far as trade in manufactures is concerned.

6.1.5 Concluding Observations

The statistical survey of this section permits some general conclusions, both for current levels and current trends. First, the share of developing countries' intra-trade in world trade as well as the share of intra-trade in total exports and imports of the developing countries has shown a secular rise since 1970. Second, intra-trade has undergone a radical shift in its structure toward a growing preponderance of manufactured products, the most pronounced increases being in products normally classified as heavy-industry goods. The long-term trend would appear nearly equally pronounced in constant prices. Third, although the bulk of intra-trade is still accounted for by trade within regions, there has been a steady shift away from intra-regional toward inter-regional trade. Fourth, the growth in preferential trade has been rather substantial and the share of preferential trade in total trade has been rising in all regional preferential groups. All long-term trends point to a vast potential for increasing mutual trade, both within and between the regions, particularly in manufactured products and industrial inputs. These trends could be significantly reinforced by specific policy initiatives to be proposed in this paper.

6.2 Long-Run Determinants of Intra-Trade

Neoclassical trade theory suggests that the dissimilarity of capital/labour ratios between individual developing countries should lead to considerable specialisation and exchange of goods among themselves. The Third World is composed of a large and heterogeneous set of countries with widely divergent endowments of resources so that their individual modes of specialisation are likely to complement and reinforce each other. In addition, a sizable proportion of international trade in differentiated manufactured products takes place between countries with broadly similar patterns of demand and per capita incomes. On both these counts, the developing countries offer promising opportunities for increasing the volume and diversity of their mutual trade through inter-industry as well as intra-industry specialisation.

In the short run, the developing countries' demand for imports from other developing countries will be governed by normal market signals such as relative prices, transport costs and trade barriers. In the long run, and considering the totality of all developing countries, supply influences stemming from the degree of industrialisation, the growth of production capacity in particular sectors, and the growth of real incomes are likely to be more powerful determinants of the growth of intra-trade. The positive impact of industrialisation on trade between developing countries can take four forms:

The first impact on trade is linked with the emergence of industrial capacity in an increasingly large number of developing countries, hand in hand with an outward re-orientation. This provides obvious preconditions for export of industrial goods, the most dynamic facet of world trade. This sequence of trade expansion among developing countries is likely to induce substantial intra-industry specialisation in the production of manufactured products.

The second is that industrialisation tends to increase the degree of complementarity among developing countries, as cross-country differences in the size and composition of industrial structures increase. This sort of complementarity, accentuated by differential response to domestic economic conditions, is to be expected in a group of countries as large and diverse as the developing countries. The growing complementarity in production structures among them is in marked contrast to an earlier period when they 'competed' with each other in exporting raw materials to the industrialised countries and obtained practically all their imports from the latter. The available evidence shows that a small number of developing countries with a higher ratio of manufacturing to total GDP export large volumes of manufactures to other developing countries and a wide range of products among each other. This pattern is in evidence both in inter-regional trade between developing countries and in trade between partners of the same regional grouping.

In the third place, a very large proportion of purchasing power in the world economy is still located in the industrialised nations. During the mid-1970s, the high income countries with 27.5% of the population earned as much as 80.7% of the world's income, whereas low-income countries with 57.7% of the population earned only 9.7%

of that income.^{1/} The recently acquired affluence of the OPEC nations, an increase in total and per capita incomes, in the wake of renewed outward-oriented industrialisation, will also be important factors in long-term intra-trade developments. Income elasticities of demand for manufactured products are generally high, and rising income will therefore generate a larger than proportionate increase in the demand for industrial goods. As the DCs move up the income ladder, the share of labour-intensive manufactures in their imports tends to increase significantly. This would tend to favour intra-trade among the Third World countries.

Fourth, the present skewed distribution of income in most DCs isolates the majority of people from the market for industrial products. As a result, there is also a bias toward demand for goods by high-income groups that are not currently traded among developing countries but are imported from outside the region. If acceptable means can be found to distribute future incomes more equitably, the resulting impact on intra-trade can be quite significant. The data on income distribution presented above, suggest that the re-orientation towards a more outward-looking industrialisation strategy now under way in many DCs will have a favourable effect also on income distribution which would affect demand patterns in a way to encourage intra-DC trade.

The economic factors which might constrain the growth in South/South trade are paradoxically the development needs of poor countries themselves. The emphasis varies but industrialisation is a major goal of development planning in most DCs. And, in the early stages, any strategy of industrialisation generates a demand for raw materials, intermediate inputs and capital goods. That most raw materials can be procured in the developing world, should be conducive to South/South trade, but the ability of the South to meet its own demand for intermediate and capital goods is rather limited. It is not as if production abilities or capacities are non-existent. Many developing countries manufacture intermediate or capital goods (a few, such as Brazil and India, even export them), but it is important to place the magnitudes in perspective.^{2/}

6.3 Institutional and Policy Limits and Obstacles to South/South Trade

In practice any plans to extend South/South trade would face a number of difficulties. In the preceding section the economic factors influencing and limiting South/South trade were discussed. In the following section, an analysis of other obstacles

^{1/} See World Bank Atlas, 1977; high-income countries are defined as those with a per capita income greater than \$ 2000 and low-income countries as those with a per capita income less than \$ 500. Middle income-countries, with a per capita income in the range of \$ 500 to \$1999, accounted for the rest of the world's population and income.

^{2/} In a global context, exportable surpluses of intermediate or capital goods in the South fall far short of the demand for such goods in the South. However, even the existing export capacities are often under-utilised because manufacturers from LDCs find it difficult to compete in the world market, with producers from the North, in terms of both price and quality.

to intra-trade is presented and a distinction is made between institutional and policy-induced obstacles, which interact and reinforce one another. While economic limits are in a sense fundamental, they do leave considerable room for manoeuvre. If the international co-ordination of policies reduces the impact of institutional obstacles and a commitment on the part of governments reduces the problems of implementation, South/South trade could be extended much beyond its present levels.

6.3.1 Institutional Obstacles

The existing pattern of trade in the world economy is very much the outcome of historical forces (cf. section 3.2.1 above). The international division of labour between metropolitan and peripheral countries took shape in the colonial era when trade and flag were inextricably linked. The direction of trade flows was determined by the straight-jacket of de jure or de facto colonial relationships. These historical factors have come to be embedded in the system of international trade and commerce and now constitute institutional obstacles to one expansion of trade between DCs. In the contemporary world, facilities for transport, shipping, insurance and banking as well as channels for communication and marketing remain oriented towards trade between the North and the South, and, of course, within the North. No comparable infra-structure exists for South/South trade. Moreover, the purchase of technology by DCs ties imports to the original source, and the terms of technology transfer from the North often restrict exports. Thus it is not surprising that there is hardly any international exchange of commodities between Latin America and Asia though there is a considerable potential. The limited South/South trade that does take place is mostly confined to regions and is not inter-continental.

6.3.2 Policy-Induced Obstacles

In the world of today, there are a number of policy-induced obstacles to South/South trade. First, the tying of aid forces developing countries to import from the industrialised world. Second, the import of manufactured goods depends on the availability of credit, and export credits are extended largely by the North.^{1/} Third, businessmen and vested interests in DCs might want to retain trade links with the North for a number of political or economic reasons: one such motive is to obtain convertible currencies abroad through under invoicing of imports. It is no doubt possible to think of other such obstacles but these are mostly dependent on conscious policy and, in principle, surmountable.

^{1/} Countries in the South find it difficult to match the volume or terms of export credit offered by their competitors from the North because, in effect, it implies an export of capital

6.3.3 The Case for Promotion of South/South Trade

It is not self-evident that governments would be willing to press for South/South trade considering the vested interests with strong political influence opposing the move. Most DCs have sought to industrialise behind protective trade barriers, and those at similar stages of development protect a similar range of industries, thereby choking potential trade flows. A growth in South/South trade would necessitate a reduction or removal of such restrictions. This implies not only a reallocation of resources and a restructuring of production, both of which impose significant economic and political adjustment costs, but also a loss of income and employment for certain groups in the country, who would naturally exert all possible influence on the government in the opposite direction. Such difficulties can be overcome only if there is a serious commitment and resolve on the part of the governments.

Fundamental problems would arise if there were a serious attempt to promote South/South trade in a cohesive and systematic manner. Such problems are likely to stem from two sets of factors: first, the conflict of national interests within the South, and second, the inability of governments in DCs to influence the direction of trade flows.

To seek an expansion in South/South trade may, in some instances, be an attractive course of action, but discussion on the subject often skirts the important question: Is there something to gain from the move towards collective self-reliance, who will gain, and how much? The developing world is not a united political or economic entity; it is, after all, made up of nations whose relations with one another are characterised as much by contradiction as by harmony. Even more important, perhaps, countries in the Third World are at markedly different stages of development, with the least developed at one end of the spectrum and the newly industrialised at the other end. In these conditions, attempts at organising co-operation on an international basis are likely to come up against serious conflicts of national interests. The pattern of specialisation, the structure of production, or the share of markets - within the South - are potential sources of such conflict. In sum, the distribution of gains from South/South trade might be just as unequal as that of the gains from North/South trade. Countries which lose, albeit in a relative sense, would not want to pursue the objective of South/South trade with the same vigour as those who stand to gain relatively more. There would also be a legitimate fear that, in the long run, the unequal distribution of gains might have cumulative consequences and widen the gap between the least developed and the more industrialised nations.

The other set of policy problems arises from the ability of governments to mould the direction of trade in accordance with their priorities. An overwhelming number of developing countries are market economies where decisions about consumption, investment, production and trade are made largely through the price mechanism. Governments here can,

of course, use taxes, tariffs, subsidies and laws and regulations to steer their economies in the direction they want, but poor administrative and executive bodies may to some extent render such policies rather inefficient in many DCs.

6.4 Review of Policy Instruments

6.4.1 Regional Integration

Since 1960 a number of regional groups of varying size, level of development and economic structure have entered into arrangements to liberalise trade among themselves and to further the integration of their economies. There are eight arrangements involving formal free trade areas or common market agreements in 1979.^{1/} Trade liberalisation arrangements among developing countries are not, of course, confined wholly to free trade areas and common markets. In December 1971 a group of sixteen developing countries signed a Protocol within GATT under which tariff preferences could be extended among members of the group.^{2/} In general, the tariff cuts under the Protocol range from 12 to 50% of MFN rates. A wide range of agricultural and processed goods are covered by concessions, but the lists vary from country to country. In addition, a looser form of preferential trade agreement between five members of the Association of South East Asian Nations (ASEAN), covering 71 primary and manufactured products went into effect on January 1, 1978.

The growth rates of intra-regional trade in various groups range from very high to moderate during the recent past. But it is noteworthy that in all cases, the growth rate of intra-regional trade is significantly higher than total trade for each region. In the case of LAFTA, this is so despite the fact that intra-trade was subject to new forms of protective restrictions in some years of the 1960s in order to permit weaker nations to consolidate their positions. However, the rapid pace at which trade has expanded in all groups since 1970 underlines the capacity of the developing countries to conduct mutually beneficial trade behind common protective barriers. Moreover, since the bulk of the increase in regional trade among major groups is concentrated in manufacturing

^{1/} These are: Latin American Free Trade Association (LAFTA) consisting of eleven Latin American countries; Central American Common Market (CACM) comprising five Central American nations; Caribbean Economic Community (CARICOM) consisting of thirteen Caribbean nations; East African Community (EAC) which consists of Tanzania, Uganda and Kenya; Economic Community of West African States (ECOWAS) consisting of sixteen countries; Union Douaniere et Economique de l'Afrique Centrale (UDEAC) comprising four central African countries; and Communauté Economique de l'Afrique de l'Ouest (CEAO) consisting of six countries. A sub-group of LAFTA is the Andean Bloc consisting of four countries.

^{2/} These are India, Brazil, Chile, Egypt, Greece, Israel, South Korea, Spain, Mexico, Pakistan, Peru, Philippines, Tunisia, Turkey, Uruguay, Yugoslavia.

sectors (e.g. in CACM and the Andean Bloc, over 75% of all intra-trade is in manufacturing categories), the scope for industrial growth can be greatly expanded by trade liberalisation. In general, integration arrangements have resulted in fuller utilisation of industrial capacity, and most partner countries have reaped net benefits in terms of industrial output and employment.

Even though in most groups a majority of partners seemed to have experienced an expansion of exports due to integration, the extreme diversity in rates of growth of exports and the resulting imbalances in their intra-zonal trade remain major stumbling blocks to further growth. If there are severe imbalances among member countries at the outset, the tendency for a widening income gap between rich and poor countries of the group as a result of liberalisation is likely to be reinforced. Consequently, there are misgivings among weaker countries in all groups that a uniform trade liberalisation policy will benefit the more developed members at the weaker's expense. Future progress in trade expansion clearly requires that gains from trade liberalisation be more equitably distributed.

Excessive reliance on economies of scale seems to have further complicated the problem, as countries that already have a viable industrial structure tend to be favoured in the competition for future growth of industrial capacity. Some progress in solving the problem within LAFTA has been made by means of 'industrial complementarity' schemes in the Montevideo Treaty, even though they have failed to get substantial new lines of production off the ground. The dissatisfaction of the relatively less developed countries in LAFTA, who find it difficult to build viable manufacturing sectors within the existing framework of the treaty has not vanished totally.

It appears, therefore, that a crucial concern of industrial policy in all regional trading groups must be with the allocation of industrial capacity according to criteria which go beyond freeing trade in general. This does not imply that freeing trade is not important; it simply calls attention to the wider consideration of equity and the need for correcting mechanisms. The frequently suggested method of lump-sum fiscal transfers, of the kind attempted in the East African Community, for redistributing the gains from trade liberalisation have not done much to solve the problem of structural imbalance. The most important, if not the only means, of eliminating the structural causes of mal-distribution of benefits of trade expansion may consist of increasing the rate of industrial development in weaker countries. Part of this task can be accomplished by a phased reduction of tariff barriers in relatively less developed member countries. They are, however, unlikely to guarantee a balanced distribution of industrial capacity in the region as a whole. What in some instances might be required is some sort of co-ordinated planning of industrial development within the region, supported by an active bargaining process to balance considerations of efficiency and equity.

A move to establish one industry to serve the total market in any given region may mitigate against a reciprocal development of industry throughout the region. When one large regional plant, even though technically more efficient, displaces a number of small, protected national producers, the resulting disruption in individual countries may be difficult to cope with, at least in the short run. But, more significantly, the desire to initiate some industrial activity is a powerful motivation in many countries, and if the argument of economies of scale is used in a way which effectively deprives them of the opportunity to share in the industrial development of the region, integration may simply confirm the dominant position of one or a few countries or firms.

In any event, the long-term solution calls for some concept of "balance" among different countries of a region in designing large industrial projects. Some industries in any given region may be tied to a particular location, either because of availability of raw materials, cheap sources of power, or the influence of transport costs. Others, in particular those requiring large inputs of labour, may be more flexible in their choice of location. For industries for which location is not critical, a good deal of weight should be given to considerations of regional balance. In many instances, this may not increase unit cost of production at all. A number of recent studies have confirmed that, economies of scale notwithstanding, several countries in every region would qualify as minimum cost locations for a large variety of industrial products. For other, second-best, locations, production costs are expected to be only slightly higher. The slight increase in costs of production can be counteracted by staggering the implementation of tariff cuts, as has been done in the Andean Bloc.

6.4.2 Prospects for Interregional Trade

Contemporary discussions of intra-trade have tended to concentrate on achievements and problems of regional trade, while prospects of interregional trade (i.e. trade among all developing countries) have received only modest attention. However, recent trends suggest that interregional trade is the more dynamic of the two types of flows and has expanded faster than trade between regional partners during 1970-1975. The possibilities of expanding interregional trade appear to be vast, given the larger matrix of countries, products, supply capabilities and demand patterns of developing countries at large.

It was suggested earlier that vigorous import substitution efforts behind national protective barriers have enabled a number of developing countries to acquire a wide spectrum of industrial capacity, which frequently suffers from lagging demand and, consequently, short production runs. This factor, which greatly enhances the potential for intra-trade, is paradoxically also a major obstacle to it. Maintenance of national protective regimes in developing countries means that potential exports of industrial products to each other also face formidable trade barriers. It is obvious, therefore, that an important precondition for enlarged trade among the developing countries is a change in the tariff and other commercial policies with respect to each other. This change should aim at a preferential treatment of traded products originating in developing countries.

Therefore, a future task of considerable significance is the setting up of a forum where the developing countries could undertake trade liberalisation among themselves, either through rounds of trade negotiations or in any other suitable way. Such an effort would initially require a large amount of preparatory work for identifying the trade flows most likely to benefit from trade liberalisation. UNCTAD estimates suggest that initially some 36 per cent or \$ 18 billion worth of developing countries' intra-trade could become subject to trade negotiations. Initially, limited and looser forms of trade liberalisation agreements involving a limited number of products may be preferable to more general techniques of trade liberalisation, such as across-the-board reductions common under the auspices of GATT, which are likely to trigger widespread fears about the survival of nascent domestic industries. It is too early to judge the recent treaties involving limited trade concessions among ASEAN countries, but it may serve as a useful example.

One may conceive of the entire set of developing countries as a vast preferential trading area for manufactured goods. A programme of expanding intra-trade which goes beyond regional exchanges will have to be fitted into a framework of existing or incipient integration schemes. Possibilities exist for the retention of existing free trade areas and other preferential schemes within the larger framework of preferential trading agreement extending to all developing countries. In free trade areas, for instance, where intra-union trade is wholly or substantially liberalised, the preferential tariffs extending to developing countries outside the given free trade area could be higher than the tariff applicable to partner countries, but lower than the MFN tariff applicable to non-developing countries. In common markets, where intra-community trade is wholly liberalised, the preferential tariff applicable to developing countries outside common market could be higher than zero but lower than the common external tariff.

The problem of non-tariff barriers is in general more intractable, but devices such as differential heights of QRs, selective safeguards, uniform customs valuation procedures are possible. These and other devices would ensure that general preferential arrangements extending to all developing countries on a non-discriminatory basis do not erode existing or incipient integration movements.

Initially, the major part of increases in intra-trade resulting from preferential arrangements would come from trade creation, i.e. through a switch in the source of supply from domestic producers to other developing countries, and would thus represent a net increase in world trade. Preferences should be designed so as to promote both inter-industry and intra-industry specialisation. The former should aim at curbing the tendency towards "proliferation" of an uneconomic range of manufacturing industries in individual developing countries, regardless of cost and efficiency considerations.

Intra-industry substitution, by contrast, should aim at diversifying the locus of production of the various stages of fabrication in a vertically integrated industry, e.g. steel, as well as of production processes in consumer goods industries, e.g. textiles which run through a whole chain of man-made fibres and fabrics to made-up garments. The natural advantage of the larger, industrialising developing countries may, for instance, lie in fibres or textiles which are relatively less labour-intensive, while other developing countries may specialise in apparel-making which is relatively more labour-intensive. Similarly, in the garment sector there are significant possibilities of specialisation in types and sizes of garments. The two types of substitution outlined above will have the effect of reducing the real cost of a given degree of industrialisation for each of the countries. They may also have the effect of increasing developing countries' capacity to export to developed market economy countries through the emergence of larger and more specialised firms.

6.4.3 Other Institutional Arrangements

It is clear that preferential tariffs alone would not be sufficient for increasing intra-trade unless accompanied by parallel development in transport, marketing networks and financial mechanisms.^{1/} In particular, the development of new monetary mechanisms to provide credit facilities for intra-trade are crucial. They could take the form of new commercial banking links, payments unions, clearing houses and accounting units for trade between developing countries. One of the inhibiting factors for intra-trade is the developing countries' preference for "hard-currency" exports due to the non-convertibility of their currencies. The lack of convertibility of currencies can be remedied by a payments union, which also extends credit to member countries for trading among themselves without use of scarce convertible currencies. A common unit of account based either on SDR (such as the one proposed for the Asian Clearing Union) or on a "basket" of major developing country currencies may further strengthen the financial arrangements. Similarly, development of shipping, port facilities, and joint chartering of large vessels may also remove bottlenecks towards greater trade linkages.

6.4.4 Impact of Intra-Trade on Traditional Trade Flows

Despite impressive recent growth of intra-trade, traditional trade flows established during the colonial period continue to dominate developing countries' pattern of trade. Aggregate data suggests that developing countries continue to increase the rate of growth of their exports both to the rest of the world and to other developing countries, while absorbing increasingly larger quantities of imports from all sources.

^{1/} This subject is treated extensively in Volume 1 of the Collected Background Papers to Industry 2000 - New Perspectives, International Financial Flows.

The available data, therefore, show little evidence as yet that the growth of intra-trade is in the process of supplanting the developing countries' trade with their traditional partners,^{1/} although their share of DC intra-trade grew somewhat between 1970 and 1976. This could be due to a number of reasons. First, the major proportion of increase in intra-trade in manufactures seems to have been due to "trade creation", i.e. a switch in the source of supply from domestic producers in other developing countries. Second, it is plausible that an increase in export capability due to increased intra-trade has favourably influenced the export growth in general, including exports to the industrialised countries. Third, various preferential schemes under the GSP extended by the developed market economy countries may have been instrumental in maintaining exports to the industrialised countries. Fourth, the unusually rapid growth in demand in developing countries for capital equipment and various industrial goods in recent years has necessitated imports from all sources.

However, some analyses of trade creation and trade diversion effects under various preferential trading schemes among the developing countries have found evidence of both trade-creation and trade-diversion. Within CACM, for example, common market arrangements have promoted industrial specialisation by type of product, which suggests that the emergence of new trade, rather than displacement of linkages with outside, dominates the intra-trade pattern. In other cases, particularly in the Andean Group, there is some evidence of a slight diversion of trade from the developed market economy countries towards their own partner countries. But even in these cases, there is no clear presumption that the common external tariff has caused production and consumption of one or more member countries to shift from lower-cost sources of imports in the developed countries to higher-cost producers in member countries.

It is, of course, inconceivable that a prolonged rapid expansion of intra-trade could occur without some trade diversion. Trade diversion resulting from intra-trade among developing countries, however, should be considered in its long-run, dynamic context. Firstly, if in the absence of integration, each member country were to protect its national import-competing industry against all lower-cost foreign producers, a common external tariff of member countries may not cause more trade diversion than would have happened anyway. Second, because of potential economies of scale and the growth of income within the integrated region, what appears to be trade diversion in the short run may turn into trade creation in the long run.

^{1/} A cross section, multiple regression equation, fitted by Jaleel Ahmed, in order to test the sensitivity of developing countries' intra-trade to their trade with the developed market economy countries, found no evidence of "trade diversion". In other words, mutual exports are not at the expense of developing countries' traditional exports to industrial countries, while mutual imports from each other do not substitute for imports from the industrial countries. This regression was based on the 1976 data on SITC 5-8 flows. If other flows were to be included, the results would be reinforced.

STATISTICAL ABSTRACT
to Section 6.1

This statistical abstract has been prepared from data contained in UNCTAD reports, Review of Recent Trends and Developments in Trade in Manufactures and Semi-Manufactures, Report by the UNCTAD Secretariat, TD/B/C.2/190 dated March 21, 1978 and Trade Among Developing Countries by Main SITC Groups and by Regions, Statistical Note by the UNCTAD Secretariat, TD/B/C.7/21, dated September 20, 1978.

This appendix provides only part of the data on which the analysis of the paper is based. Detailed data is available in the above reports.

Table 6 (1): Annual average growth rates of world exports by regions

From	To	World	Developed Market Economy Countries	Developing Countries	Socialist Countries
<u>World</u>					
1960/61 - 1965/66		8.3	9.3	5.7	7.6
1965/66 - 1970/71		11.1	11.8	9.3	8.9
1970/71 - 1975/76		29.1	21.6	28.1	22.7
<u>Developed Market Economy Countries</u>					
1960/61 - 1965/66		8.9	10.1	5.0	10.5
1965/66 - 1970/71		12.0	12.6	9.5	10.8
1970/71 - 1975/76		21.2	18.7	26.4	27.2
<u>Developing Countries</u>					
1960/61 - 1965/66		6.1	6.5	5.0	11.4
1965/66 - 1970/71		9.0	9.3	8.3	7.3
1970/71 - 1975/76		32.3	31.4	35.9	27.2
<u>Socialist Countries</u>					
1960/61 - 1965/66		8.4	11.6	13.9	8.0
1965/66 - 1970/71		9.4	10.4	10.4	8.9
1970/71 - 1975/76		20.9	25.1	21.3	20.0

Table 6 (2): Relative importance of exports to developing countries in total exports of individual regions, 1960 - 1975^{a/}
(percentages)

Region	Year			
	1960	1965	1970	1975
Latin America	9.1	12.9	14.8	21.4
South and South-East Asia	32.8	30.8	28.4	31.7
West Asia	32.2	29.1	31.3	46.9
Africa	13.1	13.4	11.3	14.1

^{a/} Total exports exclude mineral fuels

Table 6 (3): Trade matrix of intra-developing country flows by regions
(million \$)

From	To	Developing America	South and South East Asia	West Asia	Africa	Total
<u>Developing America</u>						
1960		1,680	46	29	105	1,859
1965		2,150	86	55	130	2,421
1970		3,120	160	37	125	3,442
1975		9,580	350	840	1,260	12,030
<u>South and South-East Asia</u>						
1960		165	2,100	165	195	2,625
1965		180	2,280	230	310	3,000
1970		175	3,180	365	485	4,205
1975		1,080	9,160	2,360	1,380	13,980
<u>West Asia</u>						
1960		61	285	355	230	931
1965		165	400	550	235	1,350
1970		200	640	770	350	1,960
1975		4,360	8,130	3,820	1,710	18,020
<u>Africa</u>						
1960		44	190	100	350	684
1965		41	160	120	600	921
1970		235	240	115	650	1,240
1975		1,590	410	390	1,500	3,890
<u>Total</u>						
1960		1,950	2,621	648	880	6,099
1965		2,536	2,926	955	1,275	7,692
1970		3,730	4,220	1,287	1,610	10,847
1975		16,610	18,050	7,410	5,850	47,920

Table 1 (4): Trade in manufactures among developing countries (SITC 5-8 less 68), 1970-1975
(percentages)

From	Exports to	Latin America	South and South-East Asia	West Asia	Africa	Total
Latin America	1970	25.4	0.7	-	0.9	27.0
	1975	22.0	0.6	0.4	1.3	24.3
South and South-East Asia	1970	3.3	38.2	6.2	10.1	57.8
	1975	2.9	36.3	11.1	8.1	58.4
Western Asia	1970	-	0.4	5.2	1.3	6.9
	1975	0.5	1.4	9.2	2.0	13.1
Africa	1970	0.2	0.6	0.9	6.6	8.3
	1975	0.2	0.5	0.7	2.8	4.2
Total	1970	28.9	39.9	12.3	18.9	100.0
	1975	25.6	38.8	21.4	14.2	100.0

Table 6 (5). Relative importance of exports and imports from and to developing countries in countries (% share)

<u>SITC</u>	<u>Product</u>	<u>% of</u>	<u>1960</u>	<u>1965</u>	<u>1970</u>	<u>1976</u>
5	Chemicals	Exports	35.0	48.0	52.3	50.2
		Imports	4.8	7.6	8.8	11.3
67	Iron and Steel	Exports	40.9	61.0	46.5	46.0
		Imports	2.4	7.4	8.3	7.7
7	Machinery and Transport Equipment	Exports	71.0	69.6	45.1	44.4
		Imports	1.7	2.4	3.3	5.2
6 + 8	Other manufactured goods	Exports	40.5	33.5	28.6	25.6
		Imports	12.9	14.9	28.6	20.1
5 - 8	All manufactures	Exports	42.7	38.6	32.9	32.3
		Imports	6.4	7.4	8.3	9.7
0 - 9	TOTAL	Exports	22.3	21.0	19.8	22.9
		Imports	20.8	20.2	18.9	26.5

Table 6 (6): Shares of intra-regional exports in total exports to all developing countries, 1960-1976^{a/} (percentages)

<u>Region</u>	<u>Year</u>				
	<u>1960</u>	<u>1965</u>	<u>1970</u>	<u>1975</u>	<u>1976</u>
Latin America	84	86	86	76	-
South and South-East Asia	27	74	72	65	-
West Asia	62	72	75	70	-
Africa	51	63	59	55	-
All developing regions	73	75	74	68	62

a/ Exports exclude mineral fuels.

CHAPTER 7: SUMMARY, CONCLUSIONS AND SUGGESTIONS FOR ACTION7.1 Summary

The expansion of DC trade is a vital part of spreading the benefits of industrialisation among these countries. It enables DCs with small markets to improve their resource allocation and become more productive. It also earns them foreign exchange with which to buy goods needed for industrialisation. The share of manufactures in total world trade (excluding mineral fuels) has increased from roughly 60 per cent in 1960 to about 75 per cent in 1976. The shift to manufactures has been particularly marked in DC trade. This has included a rapid increase in exports. For projections of DC trade growth between 1974 and 2000, see table 4 (5).

Despite the apparently impressive performance major problems remain. First, the intercountry distribution of manufacturing exports shows a marked degree of concentration. Within the DC group, Mexico, South Korea, Brazil and India dominate the export trade in manufactures both in terms of absolute numbers, and in terms of the share of manufactures in total exports. Second, even taking the aggregate data, one finds that the share of DCs in total world manufactured exports remains quite low (see table 7 (1) below). Third, a substantial part of the expansion of the volume of trade consists of non-market transactions insofar as it takes place within TNCs. Fully a third of world trade is now intra-firm trade.

Table 7 (1): Shares of world exports of manufactured goods - 1960, 1970 and 1976
(per cent)^{a/}

	<u>1960</u>	<u>1970</u>	<u>1976</u>
Developed market economies	84	85	84
Centrally planned economies (Europe)	11	9	8
Developing countries	4	5	8
Others	1	1	1

a/ If mineral fuels are also included in total world trade, the share of manufactured goods increased from about 55 per cent in 1960 to about 60 per cent in 1976.

Note: Manufactured goods comprises SITC 5 to 8 except 67 and 68 (i.e. iron and steel and non-ferrous metals are not included).

Source: UNCTAD, Handbook of International Trade and Development Statistics, 1979, Annex A.

Increasing trade among developing countries is most important. The growth of South/South trade between 1970 and 1976 amounted to 9 per cent annually compared to 5.8 per cent between 1960 and 1970. The growth rates for 1970 to 1976 are also higher than those of ICs for the same period. The fastest growth has been registered for machinery, transport equipment, chemicals, iron and steel. Although the bulk of the intra-DC trade is still regional, there has been a steady growth of inter-regional trade.

Prospects for the development of intra-DC trade are encouraging because DCs have widely divergent resources, which give them many opportunities for complementary trade. DCs also have a uniform and overlapping pattern of demand for manufactured products which offers numerous possibilities for new markets.

Over-specialisation should be avoided. If a country is too dependent on only one or two products, sharp international fluctuations in price or demand can seriously damage its economy, as can unexpected policy changes in other countries, due to the absence of established codes of behaviour for international trade relations.

7.2 Issues and Problems

If the Lima target for a higher DC percentage in the production of world manufactures is to be achieved, there must be special initiatives in the trade field to encourage this. Both better market access to the North and greatly increased South/South trade must be achieved. The following specific problems are areas where international co-operation might help improve the situation.

(i) Macro-economic policies both between North and South and within the South should be co-ordinated to compensate for adverse trends being transmitted through trade links.

(ii) Existing tariff structures are biased in favour of imports of raw materials and against processed products made in DCs from these materials. Even the GSP has been damaged through the extensive use of escape clauses.

(iii) Non-tariff barriers also fall disproportionately on DC exports because many of these products are considered "sensitive". The increase in the use of VERs and OMAs which restrict DC exports, has increased significantly in recent years. Complicated licensing requirements, government purchasing policies and the enforcement of sophisticated technical standards further circumscribe export opportunities for DC products.

(iv) Today there is a bias in the North in favour of having recourse to protection instead of restructuring policies for ailing industries. The heaviest cost of such adjustments falls on the workers in declining industries. They may be jobless for prolonged periods, have to learn new skills, and have to move to new locations. All this means the use of adjustment policies and what form they take can easily become very political issues. No government wants to lose its mandate simply to benefit DC exporters.

(v) Although South/South trade has expanded rapidly, it is still only a small percentage of what it could be. The expansion of intra-South markets is essential for rapid industrialisation regardless of how much market access is gained in the North. South/South trade should enable DCs to realise economies of scale, exploit the complementarity between their economies, reduce exposure to risks and cyclical fluctuation and foster indigenous technological development. The increase in intra-trade in manufactures has been largely

due to "trade creation" and has not diverted trade from traditional markets. The unusually rapid growth of DC demand for capital goods and other industrial goods has enabled them to absorb imports from all sources. An increase in South/South trade could also help DCs by having a beneficial effect on trade as a whole.

While the gains from increased intra-DC trade are clear, there are both economic and institutional obstacles to such an increase. Economic limits connected with unequal distribution of wealth within, as well as between, DCs are one form of obstacle. Institutional factors mostly inherited from the past and connected with trade and communication links, such as shipping, are both barriers to increased South/South trade. In addition, internal conflicts within the South and the inability of some governments to influence the direction of trade also hinder intra-DC trade.

In spite of the general gains for South/South trade from regional integration and trade liberalisation the benefits have not been uniformly distributed among participating countries. Future progress requires that gains from integration be more equitably distributed. Regional industrial development plans should give special consideration to the less developed members of the group.

7.3 Conclusions

Given the problems noted above certain guiding principles for the development of concrete policy proposals can be derived. They are summarised below.

- (i) The need for a direct link between DC exports and imports of manufactured goods.

To secure a fair share of world trade in manufactures for DCs, there must be a direct link between the percentage of world trade held by DCs and the amount of capital goods imported by the South from ICs.

- (ii) The role of trade in relation to the chosen industrialisation strategy.

If a country chooses an export promotion strategy, new mechanisms should aim primarily at facilitating market access and liberalising international movements of goods and services. Methods must be found to reduce the vulnerability of these countries to global economic disturbances and recessionary impulses from abroad. The role of TNCs is particularly great in countries where export promotion is the basic strategy. Principles aimed at changing the balance of bargaining power between TNCs and national governments should apply fully in this case.

If a country chooses an import substitution strategy, the emphasis should be laid on a steady movement from production of relatively simple import substitution goods to more sophisticated equipment which eventually can be exported. In the beginning of this process, action will be directed chiefly, towards increasing market access and securing non-reciprocal treatment in a North/South context. The elimination of the particular bias in tariff structures against the exports of DCs should be pursued along with parallel

action against the non-tariff barriers. However, the development of a more sophisticated range of exports and the concomitant industrial structure will necessitate larger markets and specialisation. Hence the South/South relationship will become focal, particularly in later stages of the development process. Principles of non-reciprocal treatment of developing countries, of exploiting the complementarity between these countries, and of generally giving preferences to intra-regional trade should be emphasised. What was said about the bargaining positions between TNCs and national governments is perhaps even more important for countries following this strategy because, in some cases, they will be less attractive for foreign investors than countries following a more free-market oriented strategy.

A self-reliant strategy is not to be equated with a closed door policy or autarky. The exchange of goods and services between countries is assumed to constitute an important element of self-reliant industrialisation. Trade will, however, be highly selective. Inherent in the concept is preference for trade with other developing countries. Surveillance and control of trade will be necessary to ensure maximum gain for the country and also to distribute these gains within the country.

(iii) Vigorous development of South/South trade

A leading principle when designing new mechanisms for developing trade is that South/South trade must come in the forefront.^{1/} An intensification of trade between the developing countries will be a necessary and crucial step towards increasing other economic links between them and thus reducing their dependence on the North. Increased mutual trade will lead to increased flows of capital, technology and skills. It will also foster increased awareness of common problems and potentialities.

(iv) Work on regional integration and the creation of free-trade areas must continue.

Previous experience from regional integration and group trading schemes in developing countries is not entirely encouraging. This is to a large extent due to special factors and problems associated with developing countries that make the principle of economic integration followed in the North more difficult to apply in the South. The classical methods of expanding markets and harmonising policies through economic integration may by no means be abolished. They may come to play a greater role than before as the level of development increases. However, they must be adapted to the particular problems of the DCs involved, and include a conscientious attempt to achieve a reasonable balance in the industrial structure.

^{1/} This and other elements of economic co-operation between developing countries are treated in UNCTAD resolution 127 (V).

- (v) New trade links should be systematically investigated.

Only a fraction of possible avenues for trade in manufactured goods has been utilised so far. A systematic search for new trade possibilities should be undertaken. Initiatives and introductory activities for stimulating Third World markets could be undertaken by international organisations, governmental enterprises or Third World transnationals. It is important particularly for capital goods or more capital-intensive goods that developing countries should be given more information about the products design and manufacturing techniques appropriate for exports and for selling in different markets. Exhibitions of products that have sold well could be organised. Participation in international fairs and exhibitions, skillfully trained sales personnel, invitations and study tours in the developing countries by Western buyers could be elements in a marketing effort. For consumer goods, similar methods should be applied. Here, there are also opportunities for direct contacts with the consuming public. Contacts could be sought with progressive circles, consumer movements, women's movements, etc. which may be interested in promoting Third World consumer goods.

In the field of South/South trade the importance of improving measures and statistics, as well as close observation and review of development is obvious. Here also a systematic scanning of possible new links in the network of trade should be undertaken. Since developing countries are likely to evolve a high degree of complementarity, the scope for intra-trade becomes enormous. It cannot, however, be utilised without an efficient dissemination of information about products, quality and other requirements.

New bilateral agreements could provide new trade opportunities for the developing countries, without disturbing or diverting attention from already established trade relationships. In bilateral negotiations, however, developing countries may be at a disadvantage in relation to their potential partners in the North. Methods must be found to increase the benefits of such arrangements for the developing country without the partner from the developed country losing interest in the deal. Involvements by IC governments and by international organisations may be useful in this context, even if governments and enterprises in some countries resent such interference.

- (vi) Marketing problems must receive more attention

Marketing problems and their resolution including elimination of non-tariff barriers to trade, as discussed in chapter 4 of this paper, should receive much greater emphasis in the international community than they have in the past. For example, exporters of capital equipment, or their governments must assume some share of the responsibility for seeing that the resulting output can be sold on world markets under favourable conditions.

In addition, information about product design and manufacturing techniques appropriate to different markets and products should be assembled and widely disseminated. Reference libraries, or other information centres, should be established in developing countries where trade and technical journals from all parts of the world could be freely consulted by

potential exporters. Another possible way of spreading the relevant information would be through the publication of a quarterly bulletin for widespread dissemination to governments and interested firms in both developing and developed countries.

(vii) Stabilisation of export earnings and co-ordination of policies must continue

The risks of sharp and random fluctuations in production levels or export earnings must be reduced. Previous efforts in this field should be renewed, in spite of the political difficulties which have emerged from time to time. It is realistic to assume that it will take some time before more large-scale schemes will be effective. In the meantime, looser and simpler forms of co-operation and co-ordination of policies might not only pave the way to the larger ones; but also be beneficial in themselves. Even an increased and more efficient dissemination of information on plans and policies would be useful.

7.4 Suggestion for Action

7.4.1 Need for Greater Availability of Marketing Information and Techniques

(i) The first prerequisite for the success of a programme for expanding DC manufacturing exports is the acquisition of the fullest possible information about market possibilities. Hence, new trade possibilities for manufactured goods should be investigated through a systematic scanning of the potential network. Complete matrices could be constructed for the selection of items on the lowest possible level of the SITC. Demand and supply conditions for each column and row could be reviewed. Potential products for new trade could thus be identified. This work should be done on different levels. The first step might be to construct the matrices, and to undertake a superficial scanning in order to identify theoretical possibilities. Then commodity exports should be consulted. As a last step, country experts should be brought together in the cases where the possibilities to establish new links seem most promising.

(ii) There is also a scope for greater and more systematic dissemination of information concerning different countries' projections, plans and policies for trade and manufacturing development. Models for such information-spreading exist with the EEC, the UN Regional Economic Commissions and the OECD. The problem to be overcome would be that of making the system fast and flexible in spite of the many countries involved. Information collection and systematisation on a regional basis would be essential. Through an intra-regional computerised network certain flexibility problems could be resolved.

(iii) Technical standards, quality requirements and consumer protection measures in the North may operate as barriers for exports of DC manufactured goods. Although codes of conduct in this area have been set up through recent multinational trade negotiations, it remains to be seen how efficient these codes will be and how frequently breaks and exceptions will appear. The field of technical standards as artificial barriers is of special interest; here, not only is the code of conduct important, but trade obstacles often arise from mere lack of knowledge of existing technical standards, which, once

known, could be easily overcome by producers. The systematic collection and dissemination of information could achieve great results without any overwhelming costs. One element would be to screen international standardisation activities, and to determine how the result of such work is and could be applied and distributed to the developing countries.

(iv) Efforts to increase information flows can be complemented by special efforts to develop marketing opportunities in the North for Southern products. One of the reasons why such a large part of the exports of developing countries is in the hands of TNCs (it has been estimated to amount to 40-50 per cent) is that the TNCs have the control over efficient distribution and marketing channels. This TNC control is likely to continue. Therefore, additional initiatives and promotional activities for stimulating Third World marketing should be undertaken. Control and operation should in the long run stay with regional organisations, governmental enterprises or Third World multinationals.

7.4.2 Technical Assistance in Bilateral Trade Negotiations

Bilateral trade arrangements can give benefits to DCs additional to those derived from participation in the global exchange of goods without detracting from the latter.^{1/} Such arrangements have been discussed or touched upon in the context of intergovernmental framework agreements. DCs should be assisted in finding bilateral trade opportunities and given technical assistance in constructing and negotiating such arrangements concerning manufactured goods.

International efforts to obtain a reduction in tariff and non-tariff barriers and measures to stabilise prices should be vigorously pursued. It is by now a common opinion that non-tariff barriers are more important than the remaining tariff barriers, and that important progress is being made in the NTB field under the present multilateral negotiating structures. But the classical obstacles to trade still impede exports from the DCs. Built-in biases in tariff structures and most-favoured nation clauses still operate against the exports from developing countries, while gradual erosion of the benefits from North/South preference schemes continue to be caused by the general lowering of duties. Proposed remedies include the enlargement of the GSP scheme and its liberation from various ceilings and exceptions; deeper-than-formula cuts for products of special interest for developing countries; and gradual implementation of and compensation for tariff cuts which erode the preference benefits. Since very little progress, if any, has been made in recent negotiations obviously there remains a great scope for further initiatives in this field.

In the field of export earnings stabilisation plans, existing schemes could be improved and expanded in ways which would benefit DC exports of manufactured goods. To stabilise export earnings, mechanisms could take the form, first and foremost, of buffer stocks and funds modelled on the fund for commodities. An agreement in principle was

^{1/} See report for this study by Nayyar, D., Limits and Obstacles to South/South Trade.

reached on a Commodity Fund in March 1979.^{1/} The proposed fund, however, remains limited in scope and can only be put into effect at earliest by 1980-1981. The capital base of the proposed fund will initially be \$ 750 million. The prime responsibility for attempting price stability will rest with individual commodity associations. Such associations must have sufficient financial resources and their own buffer stocks, in order to hold prices to a long-term trend. Through a deposit system within the Fund the participating commodity associations will be able to borrow money from the Fund. The size and success of the Fund will depend on how many commodity associations are formed and which decide to join the fund system. Two schemes with similar purposes are already in force, namely the IMF Compensatory Financing Facility and the so-called STABEX system under the Lomé Convention. Both these systems have proved viable, although limited in scope and magnitude.

7.4.3 A Target for Trade in Manufactured Goods

The principle of having a direct link between imports by developing countries of manufactured goods and the exports from these countries of such goods was established earlier in this paper. The projections indicate that the import flow will be covered by the export flow to 65 per cent by the year 2000, but also that the underlying growth rate of such trade will not be adequate to assure that the Lima target is achieved.

Accordingly, it is necessary to increase the degree to which DC imports of manufactured goods are covered by their exports of such goods. This must be done by increasing the propensity to buy manufactured goods from DCs, at all income levels. Some of the instruments which can be used to achieve this are described below. As a starting point, it is proposed to set a target for the trade in manufactured goods between developing and industrialised countries, which is compatible with the Lima target. The target should be expressed in terms of the coverage ratio of DC exports of manufactures to DC imports of manufactures. The target figure noted above which always must be somewhat aspirational, should be put at at least 50 per cent by the end of the 1980s and at 100 per cent by the year 2000. Such figures would be consistent also with earlier formulations of trade targets, e.g. at UNCTAD V in Manila and the preceding Arusha Conference.

The overall progress made in achieving a trade target in manufactured goods should be measured and reported with widespread publicity. The reporting should be done on an individual country basis, so that for each industrialised country a profile of its exports and imports of manufactures can be presented. The data are available from UN statistics and no extra reporting would be necessary. The only extra effort required would lie in the dissemination and publishing activities mentioned in 7.4.3.

^{1/} Cf. also UNCTAD resolution 124 (V).

7.4.4 Third World Collective Self-Reliance

It is necessary to continue to give high priority to the pursuit of regional economic integration schemes at various levels. In 1979, eight arrangements for regional free trade areas or common market arrangements were in force. Without doubt, these have stimulated intra-regional trade, which has grown faster than exports to other areas. However, diversity between countries, imbalances in trade, and the inability to establish criteria for the distribution of the benefits are major stumbling blocks for further regional integration. Trade liberalisation alone is not enough to ensure a reciprocal development of industry within regions. Methods for co-ordinated planning of industrial structures will have to be devised. Liberalisation of trade, however, remains an important prerequisite for the achievement of a diversified industrial structure.

It is obvious that a basic precondition for enlarged South/South trade is a change in tariff and non-tariff policies among developing countries. They should aim at preferential treatment of products from the other developing countries, preferably without asking for full reciprocity from the LDCs.^{1/} An international forum for trade negotiations between the developing countries would appear to be useful. The creation of a vast preferential area with existing schemes as subsets is one possibility that should be explored. It is obvious that any such schemes would have to be supplemented with adequate financial and payments arrangements, perhaps with a full-fledged common payments system.

The systematic search for new trade possibilities and the attempts to match suppliers and purchasers should be particularly emphasised in the South/South context. Information on South/South trade opportunities is very scanty, and hence a major effort to develop information banks should be high on the agenda of policy makers. This was recognised also in UNCTAD resolution 127 (V) concerning economic co-operation between developing countries.

7.4.5 Third World Multinational Corporations

Third World Multinational Corporations could emerge as a major vehicle for promoting exports of manufactures from developing countries on a world-wide basis, but particularly for breaking into the markets of the North. Third World Multinational Corporations would in principle have a much wider scope than marketing and would, for instance, engage in both research and production. Nevertheless, trade would be a primary field of activity for such entities.^{2/} Marketing and distribution of DC exports is now often in the hands of the importers in other countries, among which TNCs have a particularly dominant position. Common

^{1/} During discussions at UNCTAD V in Manila, in May 1979, India offered to join in a 50 per cent tariff reduction on selected products of interest to developing countries.

^{2/} This subject has been studied by UNCTAD over the past few years. See Annex II of TD/24, Economic Co-operation Among Developing Countries: Priority Areas for Action - Issues and Approaches, Manila, 1979. UNCTAD resolution 127 (V) on economic co-operation between developing countries requests UNCTAD to prepare the work on the establishment of multinational marketing enterprises among developing countries.

marketing efforts could give developing countries enough strength to provide alternative outlets for their products. Producers associations and state trading enterprises or organisations could form the nuclei around which multinational marketing corporations could be built. Wide scope for co-operation between state trading organisations appears to exist in trade intelligence, training, joint procurement from ICs in homogeneous goods, joint market research and joint distribution outlets for the export of differentiated non-traditional manufactures. Joint export promotion measures such as the sharing of trade fair and exhibition costs, and the building of joint warehousing facilities among neighbouring countries, are all potentially valuable avenues for co-operation between state trading organisations or MNCs. Harmonisation of administrative procedures and joint facilitation centres in particular markets, leading to the establishment of joint trading offices and finally of multinational marketing enterprises could be attempted. Obstacles to setting up such enterprises stem from the competition among DCs for breaking into new markets. A phased, unambitious process starting with information exchange, joint market research and joint distribution outlets could be fruitful, using existing producers' associations such as regional and sub-regional chambers of commerce and industry to initiate such co-operation.

In order to become effective, it will in many cases be necessary for the multinational corporation to become directly involved in production, stocking, transport and related financial and other services. There is a considerable amount of experience in the creation and operation of Third World multinational production enterprises, particularly in East Asia.^{1/} Such enterprises could achieve substantial economies of scale, utilise the complementarity between DC economies and become strong enough to offer alternatives to Northern-based TNCs, for operations both in the Third World itself and in the industrialised countries.

One of the obstacles to the establishing and operating of Third World MNCs is the heterogeneous corporate legal environment between countries concerned.^{2/} It is important, therefore, that the work on legal harmonisation should proceed. The variety of the requirements of corporate law (e.g. concerning incorporation, registration, disclosure of information, organisation and minority protection) is a serious obstacle to international co-operation between developing countries. The ASEAN and the Andean Pact countries have already taken steps towards harmonising their corporate statutes and their experience should be studied with great interest.

Attempts should be made also to elaborate an international statute for regional industrial joint ventures. Such a statute should permit, between countries recognising the statute, universal recognition and special privileges regarding tax treatment, investment incentives, tariff conditions and foreign exchange terms for corporations set up under the statute. Experience of such work is available from the EEC, the CMEA and the Andean Pact.

^{1/} Cf special report prepared for Industry 2000 - New Perspectives - O'Brien, Hasnain, Lechuga, Direct Foreign Investment and Technology Exports Between Developing Countries, Volume 3 of the Collected Background Papers.

^{2/} See Volume 2 of the Collected Background Papers on International Industrial Enterprise Co-operation.

It is suggested that the development of Third World multinational corporations should be actively promoted and that certain pilot activities should be started as soon as possible. Co-operation in the marketing field would be a suitable starting point. Full account should be taken of the regional experience of such attempts to date, e.g. within CMEA, EEC, Latin America and South-East Asia.

Such Third World MNCs should also be seen in combination with regional mineral processing and marketing schemes, as well as with recent proposals for common trademarks between developing countries.

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THE ROLE OF TRADE UNDER ALTERNATIVE INDUSTRIALISATION STRATEGIES

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TABLE OF CONTENTS

	<u>Page</u>
<u>CHAPTER 1: INTRODUCTION</u>	93
<u>CHAPTER 2: STRATEGIES</u>	94
2.1 Classification of Strategies	94
2.2 Export-oriented Strategies	96
2.3 Import-Substitution Strategies	99
2.4 Self-reliant Strategies	103
2.5 Concluding Observations	107

CHAPTER 1: INTRODUCTION

This study is concerned with the role of international trade under alternative strategies of industrialisation that are representative of the range of possible situations in the developing countries. It studies the basic aims and processes of each of the strategies with a view to:

- a) delineate the proper role of trade and the implied trade policy;
- b) describe the effects of the implied trade policies on the goals of industrialisation;
- c) discuss how the different strategies and the trade policies associated with them effect the pattern of industrialisation and its structural features.

In particular, the study explores whether the countries following any particular strategy and the implied trade policy will acquire an industrial structure that would significantly differ from the one that countries following alternative strategies may develop. The overall emphasis is on spelling out the ability of each of the strategies to deal with specific rigidities, lags and other characteristics encountered in the process of industrial development. The consequences for the capital goods sectors in each case will be elucidated whenever appropriate.

CHAPTER 2: STRATEGIES

2.1 Classification of Strategies

Two broad analytical approaches to the complex issue of trade policies for development have evolved over the years. They may be termed as "outward-looking" or "inward-looking", depending primarily on the degree of trade orientation of the economy and its alignment with the international economic system. This dichotomy has perhaps been overdrawn in that it ignores the fact that continuous differentiation of strategies is possible and that elements of both may co-exist in a given country's overall development initiatives. It also hides the fact that "inward-looking" orientation may have more than one interpretation, each with quite different practical consequences for the country's alignment with the world economy. An "inward-looking" approach based on altering the existing parameters of a country's foreign trade sector may in fact imply a greater interaction with the international trading system, while other variants based on "delinking" may result in a lesser degree of participation. Stating the alternatives in terms of trade orientation also obscures the fact that, despite crucial importance of trade, internal development issues relating to the quantity and quality of domestic resources are likely to dominate the development picture in the newly industrialising countries.

Nevertheless, these approaches do identify a country's primary orientation with respect to the sources of markets, capital and technology for its industrialisation process. The "outward-looking" approach, in general, has overtones of free trade in goods and factors of production, while "inward-looking" approaches have come to be identified with protection behind national borders and, more recently, with a certain degree of disengagement from the dominant world economic system.

Bearing in mind the complexities of any typology, the broad strategies of industrialisation relevant to the developing countries may conveniently be divided into the following three types:

1. those oriented toward export markets and acceptance of international division of labour as determined by the operation of world markets, either "free" or influenced by oligopolistic policies abroad;
2. those featuring a planned attempt, through national import substitution policies and with varying emphasis on the production of consumer and capital goods, to alter the structure of production in favour of manufacturing sectors;

3. those that are basically internal, aimed at satisfying primarily the domestic markets for industrial goods of mass consumption - goods that directly satisfy the "basic needs" of the majority of people, and utilise locally available resources and technological capabilities. They may be termed as "self-reliant" strategies.

The choice of this typology is based primarily on a country's participation in the international economy, with a somewhat lesser emphasis on factors related to the level of internal development. Under each strategy, the nature of resources, the inflow of capital and the size of the market affect the sectoral allocation of labour and capital primarily through the impact of the trade pattern, although there are indirect effects on the choice of technology, relative prices and demand patterns. At the same time, the trade pattern has both a static and dynamic effect on all aspects of industrial development. In a static sense, trade pattern influences the choice of sectors, levels of output, and the efficiency with which factors of production are utilised. In a dynamic sense, the ability to sustain a given structure of production is profoundly influenced by the prevailing trade pattern. Thus, trade patterns and patterns of domestic industrial production interact with each other in a complex manner.

Although it is evident that these strategies are not mutually exclusive, they nevertheless indicate the major industrialisation thrust of a country at any given time, or a hint of its priorities. Most countries in their industrial plans exhibit some mixture of these strategies, or reflect a process of transition from primary emphasis on one to the other. This phenomenon underscores that the appropriate strategy for a country may differ according to its stage of development. Further differentiations in the choice of strategies may arise due to the size of the country. Large countries, even those with low initial per capita incomes, tend to have a greater degree of freedom in the choice of strategy, due to the existence of potentially large domestic markets and a broad range of resources. Smaller countries, by implication, are severely constrained in the choice of their strategy at least initially, until per capita incomes have risen to a sufficiently high level. Moreover, the nature of external relations, including trade in goods and technology, may be different in different industrial sectors, each with a more pronounced impact on some sectors than on others. A country may designate certain sectors or subsectors to be oriented toward export promotion or toward collaboration with foreign enterprises in seeking capital and technology. Other sectors may be oriented toward domestic markets or other social and strategic objectives, and hence may be kept relatively independent of foreign influences.

An analysis of alternative industrialisation strategies must also take account of another crucial dimension. The present heterogeneity of the developing countries is obvious when one considers the various countries with regard to their size, their resource endowment, their levels of per capita incomes and their stages of development. It is in the relative importance of manufacturing sectors that one finds the widest variations among developing nations. This diversity is a function of both a large variance in their

initial conditions and in the industrial strategies subsequently followed. Some of the countries have already developed a varied and sophisticated industrial structure, while others earn a major part of their foreign exchange through the export of manufactured products. Still others rely almost exclusively on primary production and have only rudimentary industrial sectors. Further, the heterogeneity and the number of dimensions which differentiate them in terms of their prospects for industrial growth are likely to increase in the future, as cross-country differences are magnified due to differences in their policies. It is, therefore, useful to bear in mind the implications of heterogeneity in the elaboration of broad strategies for industrialisation. More significantly, the range of choices must be kept flexible to allow for various forms of evolution which cannot be accurately predicted at any point of time

The following sections discuss the three alternative strategies with regard to the major characteristics set forth in the preceding sections.

2.2 Export-oriented Strategies

Export-oriented strategies are nothing new to the developing countries. The promotion of exports has long been considered a major ingredient in their economic development. The chief characteristic of the export-oriented strategy is a reliance on relatively freer trade as the mainspring of domestic industrial activity. The choice of sectors and industries where development may concentrate is largely dictated by the prevailing international division of labour. The behavior of exports, chiefly to the industrialised countries, provides the dynamic element in the growth of domestic industrialisation. The expansion of exports contributes to industrial growth directly by raising the share of industry in the GDP and indirectly by providing foreign exchange for import needs of further industrialisation. Concentration on export markets fosters specialisation through reduced product variety.

Outward-orientation in this context must be understood in a much broader perspective than simply the export of goods. Such policies encourage not only the free flow of goods and services, but also free movement of capital, transfer of production techniques, consumption patterns, institutional arrangements, and a generally enhanced role of foreign enterprises. A characteristic of virtually all countries that have followed this strategy has been an abnormally high inflow of external capital. In early stages, the inflow is largely public capital, but once growth is established the private component increases. Familiarity with foreign markets as well as active collaboration with foreign enterprises provides incentives for technological change and improvements in productivity. The transfer of technologies from abroad is generally more pervasive, particularly if the transfer is effected through wholly-owned subsidiaries of foreign enterprises.

Since resource allocation under this strategy is influenced primarily by price mechanism, the implied trade policy is one of relative absence of tariffs and other impediments to trade. Even if tariffs on imports are maintained, they may take the form of a uniform

ad valorem rate, in order that all industries receive equal tariff protection. The trade policies are generally accompanied by maintenance of a correct rate of exchange, given domestic inflation and changes in foreign prices, so as to ensure balance-of-payments equilibrium. The role of government policy is generally limited to provision of infrastructure and, frequently, special treatment of export sectors in the form of production or export subsidies. The profitability of exports may further be improved by a host of government measures, such as tax rebates, export credits, and credit guarantees on export sales as well as for purchase of inputs used in the manufacture of exports. In general, major entrepreneurial decisions affecting the process of industrial development are by and large decentralised.

Access to markets of industrialised nations can provide an important stimulus for the greater utilisation of idle human and capital resources. The strategy, under ideal conditions, offers great flexibility in increasing employment in relation to output and capacity. There occurs a rapid development of those types of industry in which relatively small scale of production is efficient. To the extent that the average size of establishment is relatively smaller, a larger aggregate volume of industrialisation may result through dispersion. Firms in export-oriented countries also participate in international division of the production process by manufacturing parts, components and accessories for assembly abroad. Countries following this strategy are usually able to attract from the industrialised countries footloose industries through the incentive of low wages, tax concessions and export platforms. Examples of such industries are clothing, electronic components, business machines and automobile accessories.

Primary emphasis on production for exports, rather than for domestic markets, is likely to play a crucial role in countries that have small domestic markets and a limited range of resources. But the impact of associated economic, technological and institutional factors on the character of industrial development can either be benign or malevolent. Much will depend on the flexibility and the "openness" of the international system as well as on the internal mechanisms of the country and its developmental priorities. It is quite clear, however, that the degree and the characteristics of industrialisation under this strategy depend to a great extent on external factors over which the individual countries have little or no control. To the extent that such a strategy relies on known markets outside its borders and utilises its relatively cheaper factor, it focuses attention on the value of flexibility in adapting resource allocation to changing circumstances. However, dependence on external markets also implies a greater vulnerability to global economic disturbances and a greater proclivity to recessionary impacts from abroad.

Since markets in industrialised countries are often unstable due to periodic fluctuations in economic activity, this strategy carries with it a certain risk with respect both to levels of export demand and prices. Moreover, it ignores the difficulty and the cost of shifting resources to meet changing international market conditions. An indiscriminate outward-looking strategy can be as disruptive of the development process as the

self-centred inward-looking strategies. In extreme circumstances, it may greatly limit a developing nation's ability to decide the most desirable development pattern for itself.

Even though the strategy promises a rapid growth of employment and incomes in industrial sectors, it may unduly bias the structure of production towards goods demanded abroad rather than at home. By not according priority to the production of domestic goods, the strategy may also reinforce the dualistic and inequalitarian character of domestic economic growth. Countries where a large proportion of export earnings accrue to foreigners are particularly prone to possibilities of domestic impoverishment in the face of rising industrial production. Similarly, the concentration on a few specific products for exports can be a highly successful strategy for initial industrialisation, but is generally unsuited to the development of capital goods and other heavy industry sectors. Moreover, the exceptional level of the inflow of external resources in almost all countries that have successfully followed this strategy casts some doubt on the value of this experience for other countries.

A chief value of this strategy is the exceptional role of transnational corporations as vehicles for the transfer of capital, technology and managerial know-how. However, a heavy reliance on foreign enterprises for basic development purposes may have a number of deleterious effects on industrial development. The continued presence of multinationals may discourage the necessary investment in deepening the industrial capacity and for developing inter-sectoral linkages with the rest of the economy. Production may become vulnerable to the increasing cost of imported inputs largely used by multinational firms. Excessive export promotion supported by multinational enterprises with many privileges, concessions and incentives may result in negative value-added in exporting industries - a phenomenon familiar in import-substituting industries. These circumstances may eventually result in a worsening of terms of trade against heavy export-oriented countries. The export orientation of multinational firms may mean that in order to remain competitive the comparative advantage of low wages will have to be maintained, which is inconsistent with the reduction of inequalities. In countries highly integrated with the world economy, therefore, wage increases may be difficult to obtain, as it would clearly be advantageous to keep profits high.

One variant of the export-oriented strategy, where multinational enterprises play a leading role, is the processing of agricultural or mineral raw materials which are largely exported. The major question is whether these countries will be in a position to use this externally-induced process of industrialisation to reorient future industrial development toward international priorities and an eventual expansion of the domestic markets. It is generally difficult for the foreign-operated mining and other processing industries to develop sufficient linkages with the rest of domestic economy, and hence "enclave" sectors become quite common.

Therefore, one major weakness of this variant of industrialisation is that decisions concerning the choice of sectors, volume of output, and the level of earnings tend to be externally determined. The recent export-oriented experience in a number of countries, outside of a few well-known exceptions, has not been able to ensure the basis for a self-sustained industrialisation process. Multinational corporations often pursue a long-term price and production strategy which is inconsistent with diversification and industrialisation on a wider front. Such decisions are often beyond the control of political power in many developing countries. In principle, it is possible to enter into contractual arrangements with respect to transfer of ownership, technology and training of nationals, but few countries are in a position to extract such favourable terms.

The structure of industrial production resulting from the export-oriented strategy is likely to be characterised by a preponderance of industries producing final goods, including assembly operations. The transition to capital and intermediate goods industries is not only likely to be opposed by foreign enterprises, but also hampered by the peculiarities of the industrial structure. Such a structure, while offering possibilities of horizontal expansion of similar and related industries, is likely to mitigate against a vertical expansion. In particular, it would be extremely difficult for countries following this strategy to extend the industrialisation process "backward" by manufacturing the industrial inputs and capital goods required for domestic industries. It is quite possible, therefore, that in countries that initially start with export orientation, the response to constraints arising from their industrial structure may well result in a move toward import substitution.

It is interesting to speculate on the limits of absorption by the markets of the industrialised countries if a significant number of developing countries, including many of the larger ones, were to expand industrial production substantially for exports. While an individual developing country does have some freedom in increasing its exports through unilateral pricing and promotion policies, such an increase is likely to be at the expense of other developing countries. If they all attempt to simultaneously increase their exports to the industrial countries, the total effort is bound to be frustrated. A major problem at present seems to be the inability of the developed industrial countries to effect certain structural adjustments in their own economies in order to accommodate increased exports from the developing countries. Despite rather uncertain international outlook, however, the peculiar circumstances of some countries point to the inevitability of export orientation for their industrial development.

2.3 Import-Substitution Strategies

This alternative for industrial development involves a pronounced orientation toward the domestic market by producing goods that were normally imported from abroad. Such strategies are frequently undertaken with the ostensible aim of dealing with foreign exchange gaps arising from stagnant or slowly-rising export earnings. It is evident, however, that import-substitution strategies have far wider aims than merely a saving of

foreign exchange. They are motivated in significant parts by a planned alternation of the structure of domestic production and trade, and purport to reduce dependence on foreign sources of supply and demand. What lies at the heart of import-substitution strategy is not an ephemeral short-run structural disequilibrium that has hampered the growth of industry in the past. These strategies, however, tend to be ambivalent in their involvement with the international trading system; while they profess to be motivated by a search for independence, the process typically results in increasing the degree of dependence on the international economy.

The main thrust of the strategy is to direct investment in a planned manner into import-replacing domestic manufacturing sectors, as well as in supporting infrastructure. The expectation is that the accumulation of capital, skills and technology initially concentrated in import-substitution sectors, will gradually spill over into other sectors, particularly those producing industrial inputs and capital goods. Domestic policies with regard to allocation of resources are supplemented by trade policy regimes consisting of a mix of tariffs, quotas, exchange controls, over-valued exchange rates and a host of other administrative procedures designed to enhance the profitability of domestic production of manufactures. The mix of policy instruments and the intensity of their protective effect has in the past varied from country to country.

Available experience with import-substitution policies shows a wide range of variations of nominal and effective protection among countries. In most cases, tariffs on final products are higher than those on intermediate and capital goods, resulting in a substantial divergence between protection for final goods and for intermediate goods industries. The tariff structure is also characterised by a wide dispersion within the manufacturing sector, evidently designed to provide encouragement to certain subsectors more than to others. In general, tariffs, quotas and exchange rates are cascaded in a manner which discourages imports of consumer goods and favours those of intermediate and capital goods. Protection of manufacturing sectors is frequently combined with export subsidies to neutralise the resulting bias of import-substitution strategies against exports. The high tariff and non-tariff barriers are often accompanied by relatively capital-intensive production and large-scale importation of foreign technology, either embodied in imports of capital goods or directly through use of patents and licensing. The role of multinational corporations is, as a rule, substantially lesser than under export-oriented strategies, although there are important exceptions.

The evolution of industrial structures resulting from import-substitution strategies may now be summarised. The peculiar structure of tariffs results in limiting import substitution initially to production of consumer goods. The initial scope of industrialisation based on import-substitution is also constrained by limitations arising from existing resources and technology. In a dynamic sequence, however, production of consumer goods requires intermediate goods, such as steel, and capital goods, such as machine tools, thereby raising the profitability of their domestic production and prompting further import substitution. This is the essential process by which import substitution extends into ancillary sectors through inter-industry repercussions.

However, most countries are likely to encounter serious difficulties in their transition from consumer-goods phase to a predominantly capital-and intermediate-goods phase. These difficulties arise because as import substitution moves into the latter phase, there is a rise in the capital-intensity of the production processes which also raises the requirements for imports. The process is further weakened by the small size of the domestic market which tends to grow only slowly. In addition, the structure of tariffs itself inhibits the development of intermediate-and capital-goods sectors. The failure to extend the process into capital-and intermediate-goods sectors perpetuates the dependence of the economy on rising volumes of imports. As long as the import-substitution process remains confined to final-goods sectors, the availability of essential materials and replacements becomes essential to the smooth functioning of the economy. Any impairment in the capacity to import, therefore, leads to underemployment and underutilisation of capacity.

It is indeed misleading to characterise import-substitution policies as "inward-looking" when in fact such policies have increased the degree of dependence on the international economy through rising volumes of imports and, consequently, the need to export. The nature of dependence, of course, changes, giving rise to new links with the industrialised countries. These links, in addition to trade in goods and services, take such forms as industrial licensing, foreign subsidiaries, joint enterprises, public and private foreign financing, the use of foreign technology and personnel. One extreme type of dependence, also encountered in primarily export-oriented strategies, is the establishment of finishing-touch type of processing or assembly operations, using imported inputs.

The difficulties of extending the process of import substitution into industrial inputs sectors can, however, be corrected by a change in the tariff structures and other supporting measures. Depreciation of the "real" rate of exchange may also serve the purpose. In several important cases, initial import substitution in final goods sectors has prompted further import substitution in sectors producing intermediate and capital goods, and has thus fostered industrialisation on a broad front. The process of permeation is not always automatic, and requires planned efforts to forge links with other sectors through strengthening the inter-industry relations and by making appropriate investments. There seems little doubt, therefore, that the gradual extension of the process to intermediate-and capital-goods sectors, though difficult, remains feasible.

Import-substitution regimes undoubtedly lend an initial bias against exports, since their primary reference point happens to be the domestic market. However, a number of developing countries have been able to progress from an initial strategy of import substitution to the promotion of manufactured exports after they had developed a sufficiently viable industrial base to do so. A country cannot export manufactures without first building the capacity to produce them, but it cannot build capacity without import-substitution. The ratio of imports to domestic production in many developing countries is so high that any attempt to create domestic capacity is bound to take the form of import substitution. This implies a dynamic sequence from primary specialisation, to import substitution, to exports of manufactures. This sequence underlines the generally complex nature of relationship between import substitution and export growth in newly

industrialising countries. Recent empirical evidence shows that the growth of exports of manufactures is positively correlated with the growth of import-substitution, albeit with a lag of sufficiently long duration. In other words, sectors that have experienced a high growth of import-substitution in a previous period are also the ones that have a relatively high rate of export growth. In this supply-oriented view of the matter, therefore, import-substitution and export expansion, far from being antagonistic as frequently assumed, are compatible and symbiotic.

The rationale of import-substitution is to manoeuvre a change in the structure of domestic production toward a greater diversity and expanded linkages with other sectors. As countries achieve a more diversified production structure and reduce their concentration on a few exports, the nature of external policies change, since constraints that had previously limited growth are no longer operative. Participation in international trade takes place in a radically altered domestic environment, as the composition of imports and exports undergoes a change. An assessment of recent experience of countries that have undergone this transition shows that earlier conclusions as to the real cost of import-substitution have to be re-examined in the light of their subsequent ability to develop exports of manufactures. This discussion also suggests that the dichotomy between inward- and outward-orientation has perhaps been overdrawn, and that these policies can be more usefully viewed as sequential elements of a strategy for industrial development.

The more "closed", less specialised trade pattern under import-substitution strategies is likely to have its counterpart in a more balanced and less variable structure of domestic production. Under certain conditions, import-substitution strategies may lead to "over-crowding" in particular industries through the establishment of firms to share in profits resulting from import quotas. The major characteristic of this strategy, in contrast to the export-oriented strategy, is that it permits a transformation of the domestic structure at an earlier point on the development path. The major differences in structure are concentrated in sectors such as basic metals, paper, chemicals, rubber products, and machinery, where economies of scale are important. The range of final goods industries is also larger than under the export-oriented strategies. More significantly, the structure resulting from the two strategies does not differ markedly at low levels of per capita incomes and they also appear to converge at the highest income levels. In between, however, several aspects of transformation of the industrial structure are accelerated under the import-substitution strategy.

It seems apparent that both import-substitution and export-oriented market strategies tend to aggravate income inequalities, though one may do so a little less than the other. The reason is that they both are urban-based and oriented toward consumers with effective purchasing power. In fact, one major constraint to the continued viability of industrialisation based on import-substitution arises from the limitation in the growth of internal demand which can be traced to an increasingly unequal distribution of fruits of development. The growth of demand for mass consumer goods may also be impeded by the tendency

for the worsening of terms of trade against the agricultural and rural sectors. Unequal distribution of incomes in certain cases seems to have been contributed by the use of foreign technology with a labour-displacing effect and hence a slower growth of employment.

In countries where structural changes from concentration in primary sectors to a strong development of industrial sectors have become firmly rooted, there is very little choice with respect to the overall strategy. For such countries, the important choices consist in deciding whether to continue production for wealthier sections of the society or to reorient production toward mass consumer markets while at the same time redistributing increments of growth to those that are presently outside of this process. In this connexion, the relationship between large-scale, urban-based, and small-scale, rural-based industrialisation seems to be crucial. The former is not inconsistent with the parallel and vigorous development of the latter. The development of village-based processing and other secondary activities using local materials and labour can be complementary to industrialisation at the national level.

The mutual development of these two types of activities requires a more decentralised pattern, depending on the flexibility of the production processes and other locational factors. This does not mean an abandonment of current industrial activities, but rather shifting some of the future industrial expansion at the margin to rural areas where they could be developed in conjunction with the agricultural sectors. It must be underlined, however, that such a decentralisation does impose a cost in the sense of postponing a rapid growth in the modern sector. If these are the only costs, it would appear that they are worth paying for the sake of a more egalitarian development strategy. It is also clear that the social costs of failing to undertake decentralisation in drawing the largest number of people in the development process are often much higher.

2.4 Self-reliant Strategies

The realisation that recent growth in developing countries has not been accompanied by a reduction of poverty and inequalities in income distribution has led to a number of proposals that attempt to deal directly with this problem. These proposals are based on the premise that the separation between optimum growth and distribution should be replaced with the notion of a development strategy that has built-in distributic.al implications. These approaches advocate "self-reliant" industrialisation based on production for satisfying the needs of the majority of the people through utilisation of locally-available resources and indigenous technology. They project only a minimum of linkages with developed, industrial countries.

A number of different, yet interrelated, strands appear to run through these approaches. Firstly, the notion of self-reliance appears to have a close interrelation with the strategy for provision of "basic needs", which implies superseding market mechanisms and acting directly on production, incomes and consumption. Secondly, the building of industrial structures that are progressively less dependent on industrial countries for

their inputs, markets and technology seems to be the main criterion for orienting future industrial development under a self-reliant strategy. Thirdly, realising that self-reliance in isolation may be an impossible goal, one variant of the strategy visualises "collective" self-reliance in the context of increased trade and other economic co-operation among developing countries.

These strategies have not yet progressed beyond a set of rather intuitive hypotheses and their practical content is far from clear at present. There is a serious lack of analysis of the possible components of this alternative, particularly with regard to the practical possibilities of being self-reliant, and the nature of international trade relationships that would be compatible with such a strategy. Moreover, the concept of self-reliance remains too vague to permit an identification of priority areas where it is desirable to reduce dependence. Presumably, the dimensions of self-reliance encompass not only the industrial sector but also all other sectors such as agriculture and minerals, nature of technology, system of education, consumption patterns and life styles. As such, they are concerned possibly with very long-run evolutions.

They are, however, unable to describe the process of transition from the present to desired future situations. In principle, it should be possible to stimulate and elaborate several possible industrialisation paths with different time horizons and to evaluate their individual consequences for the degree of dependence of the country. Different weights could be assigned to different objectives, depending on their relative priority in the development process. This mapping of choices could then yield a possible solution through a process of successive approximations, depending on the degree of freedom from dependence that is desired. Such an exercise will perhaps be done in the future. In the absence of clear notions about the process, it is difficult to draw any clear conclusions with respect to either the role of trade or the implied trade policy compatible with such a strategy.

The "basic needs" approach appears to give a renewed recognition to a reality which has been a major concern in all developing countries for a long time. It correctly draws attention to the desirability of disseminating social benefits of industrialisation to the largest possible majority. Yet, this approach also lacks a consistent perspective which would link specific policies around a small number of clearly-defined basic objectives. One difficulty is that desirable changes in industrial policy cannot be determined without explicitly defining the basic needs and their desirable levels for various groups of population. It is clear that in the absence of price signals no list of needs can either be complete or universally acceptable. Nevertheless, the point of view inherent in the strategy may progressively lead to a change in industrial priorities toward production of goods and generation of incomes to relieve poverty, rather than wait for aggregate growth to "trickle down". Instead of being conditioned by consumption patterns of a rich minority (or of consumers in industrialised countries), future industrial growth might concentrate on expanding production of goods demanded by the majority of people.

In low-income countries, consumer demand for basic industrial products, such as processed foods, clothing, shelter and a few other product groups, is essentially a function of income and not of relative prices. In such countries, the basic needs strategy would tend to allocate investments, regardless of market-oriented criteria, to sectors producing basic goods and expand output in relation to the pattern of demand. The rate of expansion will, therefore, be determined by the income elasticity of demand for mass-consumption products. It must be noted, however, that a shift in the production of basic goods alone is not sufficient. An improved distribution of income would be necessary to enlarge the domestic market.

The range of material inputs necessary at lower levels of income is relatively labour-intensive and relatively free of imported inputs. Production of the required output of food, clothing and housing will, therefore, open up rapid employment opportunities. Meeting local demand from local production would also mean a greater degree of popular participation in the development process. This strategy may turn out to be valuable for countries which suffer from limited price elasticity of demand for highly concentrated exports, since if their development emphasis was trade-oriented a slower growth of industrial production would result.

It is obvious that self-reliant strategies imply minimum linkages with the developed countries, but they should not be considered necessarily autarkic. They do, however, propose varying degrees of "delinking" and disengagement from trade and other economic interaction with the industrialised countries. At the same time, these approaches propose the strengthening of trade and other links among the developing countries. The question of trade relations among developing countries is being examined elsewhere in the Joint Study. It must be underlined, however, that the dominant hypothesis is that increased trade among developing countries, in order to be mutually complementary and beneficial to them, has to be additional to other trade, particularly with the industrialised countries. If new trade among developing countries simply supplants their existing trade with the industrialised countries, the resulting effects on import capacity and productivities may be highly disruptive of future industrial development.

It is difficult to draw clear implications for trade policy from strategies that have not yet been fully elaborated. These approaches do not provide an empirical basis for assessing comparative advantage over time and in relation to changing availability of resources. It is difficult to relate global orientation of these strategies with specific policies for particular sectors in regard to composition and direction of foreign trade. It is evident, however, that delinking will have to be accompanied by increased restrictions on trade with the industrialised countries. The same purpose may be achieved by a massive devaluation of developing countries' currencies against the currencies of major industrialised countries. Similarly, widespread official impediments will have to be placed on transfers of capital and technology which is deemed "unsuited" to domestic conditions. At the same time, policy instruments will have to be found to increase existing trade relations and devise new linkages with the developing countries. The process may result in a preferential trade area with or without a common external tariff against the developed countries.

Essentially, these approaches focus attention on development strategies which aim both to raise physical output and generate incomes amongst those that are poor. As such, they imply increasing productive employment in the traditional and rural sectors of the economy where most of the poor are to be found. The industrial structure that is likely to emerge under these strategies will be substantially different than the one resulting from import-substitution or export-oriented strategies. The resulting structure will be less varied and highly specialised in the production of final goods. While there would still be some production of intermediate and capital goods of factory-based production, it is difficult to visualise any large-scale development of such sectors.

The self-reliant strategy projects a world in which developing countries would do most of their trade with each other. This indeed would be a radical departure in many countries where growth prospects depend on exports directed for the most part toward industrialised countries or where industrialisation depends on inputs (equipment, technology and financial capital) that comes almost totally from the industrial countries. It is plausible that countries with a more varied structure of production will continue to look to industrial countries as close trading partners. One may, therefore, arrive at the paradoxical conclusion that relatively more self-reliant strategies may be possible only in very small, poor and isolated countries, since the more varied resource endowments of larger countries may favour a greater integration with world markets. It may also have an appeal to countries that have not yet embarked on industrialisation and have, therefore, not opted for any particular strategy. It is unlikely, however, that any country will pursue the self-reliant path exclusively. The most likely outcome seems to be the combination of some self-reliant features with other strategies.

While these strategies correctly emphasised the importance of meeting basic needs and of mobilising domestic resources to the fullest extent, they have misleadingly argued for their substitution in place of other industrialisation strategies. It would be more fruitful to attempt to remove those undesirable features of industrial strategies that either perpetuate or generate inequalities, instead of discarding them in favour of equally-biased and over-simplified formulations. There is a fair degree of unanimity that the reduction of dependence and self-reliance are desirable objectives within certain limits. However, there is no clarity with respect to the means for attaining them. A number of developing countries evidently wish to avoid extreme dependence on outside sources through a balanced industrial development of their own. Moreover, it is not clear whether the self-reliant strategy is the only way to progress toward satisfaction of basic needs.

The issues of poverty, deprivation and unemployment are important, and not just in the developing countries. And certainly large-scale redistribution of increments to growth must be an urgent concern everywhere. But if most of the resources of capital and technology are located in the industrialised nations, it is self-defeating to say that developing countries should become self-reliant. It is evident that no nation or group of nations in recent history has been or could hope to be self-reliant or dependent

only on its own resources, without incurring heavy costs. Each country opting for the self-reliant industrial pattern will have to elaborate its own priorities and decisions. A blanket advocacy of self-reliance carries with it the danger of isolating the majority of people in the world from developments in world industry and technology.

2.5 Concluding Observations

An analysis of trade and industrialisation in developing countries must adequately take account of the following additional factors:

a) The industrial sector in developing countries as a group has grown impressively over the past twenty-five years. This progress is also marked by significant changes in industrial composition toward a marked diversity. A particularly noteworthy feature of this diversity is the growth and viability of capital-goods sector, manufacturing products of increasing complexity and sophistication. Moreover, aggregative growth indices of the kind normally used in measuring industrial growth fail to capture the full range of qualitative changes that have taken place in the industrial sector. They do not, for instance, reflect the improvements that have taken place in the training of labour force and in the supply of managerial skills which play a crucial role in the development of modern industry. Nor do they depict the great expansion in the capacity to acquire and adapt technology that is vital to the expansion of the industrial sector.

These and related factors have perceptibly changed the industrial environment in a large number of developing countries, even though these factors are difficult to quantify. These changes are cumulative and, by and large, irreversible in their effect, not only on the economies of the countries concerned but on the world economy as a whole. Alternative strategies of industrialisation must, therefore, be evaluated in the light of these experiences which have significantly altered the prospects of future growth.

b) The supposed neutrality of economic growth to distributive questions has all too often obscured the nature of real issues facing the developing countries. Future initiatives must be informed by the judgement that industrialisation encompasses broader questions relating to unemployment, inequality and poverty. It must be underlined, however, that available data so far fail to identify a clear evidence of a trade-off between industrial growth, however defined, and income distribution. In view of the extremely low levels of industrialisation in most countries, the rate or the nature of industrialisation process has very little to do with the poverty problem. It is apparent that it is not the inward-or outward-looking stance that will determine developing countries' ability to deal effectively with poverty problems. Despite successive changes in industrial strategies, problems of poverty and maldistribution of income remain intractable. The solution to poverty problems will depend mainly on internal political factors, while trade and external policies at best play a marginal role.

The simplistic debate as to which set of industrial policies contribute more to inequality fail to address the fundamental question as to the causes of poverty, which reside in the nature of political and social structure. A truly constructive approach must pay attention to the characteristics of the social structure where exploitative relations are fairly generalised at all income levels in rural and urban areas, as well as under alternative industrial strategies. No general strategy which is supposed to generate industrial development with the desired redistribution can come to grips with these problems.

c) It is important to underline the predominance of internal factors when assessing the role of trade policies. This conclusion does not apply with equal force to large and small countries, but merely underlines the fact that an authentic development process requires an orientation toward internal priorities, and cannot be orchestrated by purely external inducements. It would be misleading to make the degree of openness and integration into world markets the central criterion of industrial prospects. The rigidities that accompany the process of industrial development require an external policy which is closely linked to domestic factors. Such a blending is possible under the various alternative strategies that have been discussed in this paper.

d) Despite the overwhelming role of internal problems, however, the complex consequences of a growing world interdependence must be borne in mind. Industrial development in newly emerging countries should be viewed in both a domestic and global context, taking into account the increasing interdependence of the world economy in such areas as natural resources, capital and technology. The growing networks of trade and financial transfers in their long-run evolution seem to project a world in which interdependence will have a far-reaching impact on domestic issues of all countries. By the same token, it is necessary to drop the fallacy of universal harmony of economic interests so that areas of parallel interest and negotiable compromises can be identified.

TRADE AMONG DEVELOPING COUNTRIES AS A VEHICLE FOR INDUSTRIALISATION:
PAST EXPERIENCE AND NEW POSSIBILITIES

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TABLE OF CONTENTS

	<u>Page</u>
<u>CHAPTER 1: INTRODUCTION</u>	113
<u>CHAPTER 2: STATISTICAL PERSPECTIVE</u>	114
2.1 Growth Rates and Shares	114
2.2 Commodity Composition	115
2.3 Regional and Interregional Composition	116
2.4 Preferential Trade	117
2.5 Interregional Trade Balance	118
2.6 Concluding Observations	119
<u>CHAPTER 3: LONG-RUN DETERMINANTS OF INTRA-TRADE</u>	120
<u>CHAPTER 4: IMPACT OF INTRA-TRADE ON TRADITIONAL TRADE FLOWS</u>	123
<u>CHAPTER 5: REVIEW OF POLICY INSTRUMENTS</u>	125
5.1 Regional Integration	125
5.2 Prospects for Interregional Trade	128
5.3 Other Institutional Arrangements	130

LIST OF TABLES

	<u>Page</u>
Table 1: Annual Average Growth Rates of World Exports by Regions	132
Table 2: Relative Importance of Exports to Developing Countries in Total Exports of Individual Regions, 1960-1975	132
Table 3: Trade Matrix of Intra-Developing Country Flows by Regions	133
Table 4: Trade in Manufactures among Developing Countries (SITC 5-8 less 68), 1970-1975	134
Table 5: Relative Importance of Exports and Imports from and to Developing Countries in Countries	134
Table 6: Shares of Intra-Regional Exports in Total Exports to All Developing Countries, 1960-1976	135

CHAPTER 1: INTRODUCTION

The purpose of this paper is to analyse some pertinent aspects of intra-trade among developing countries, with particular emphasis on trade in manufactures. It attempts to provide a statistical perspective on the growth and composition of such trade in the recent past, investigates its major determinants in relation to industrialisation with a view to infer how this process will evolve in future, and more significantly, how its evolution will be affected by specific policy initiatives.

The significance of the level and growth of trade among developing countries has been enhanced by a number of factors. First, the Lima Declaration for a target increase in developing countries' share in world production of manufactures from the present 8 per cent to 25 per cent by the year 2000 is predicated on a significant increase in intra-trade. Second, future prospects of growth in volume and diversity of intra-trade are considerably enhanced by the growing "complementarity" in economic structures between the developing countries. This latter phenomenon, in turn, is intimately related to long-run structural factors connected with the appearance of industry in hitherto primary-oriented economies, and offers an important opportunity to increase mutual trade both in manufactured products and in primary commodities. Third, increased mutual trade appears to be the first essential step towards greater economic interaction among the developing countries. It is difficult to visualise any significant progress on "collective" self-reliance without a vigorous development of trade relations, which are usually a precondition for further economic integration. Increased mutual trade will likely favourably influence the flow of capital, technology and managerial skills whose stock in developing countries is rapidly increasing. But, perhaps most important of all, the growing network of trade flows will foster an increased awareness of common problems and potentialities.

CHAPTER 2: STATISTICAL PERSPECTIVE

This section attempts to provide an overview of the changing pattern of developing countries' intra-trade by main regions and SITC groups during the 15-year period 1960-1976.^{1/} It reviews the relative size, growth rates, commodity composition, and the regional distribution of trade relations among developing countries. The data on which the analysis of this section is based is contained in the statistical appendix to this paper.

2.1 Growth Rates and Shares

A comparison of annual average growth rates of individual trade flows between major groups of countries during 1960-1970 indicates that trade among developing countries recorded the lowest rate of growth. Thus, developing countries' intra-trade grew at the rate of 5 per cent per year from 1960 to 1965 and at 8.3 per cent from 1965 to 1970 - figures well below growth rates of trade flows between and within other major groups of countries. During the same period, the share of trade among developing countries in the world trade recorded a decline from 4.8 to 3.5 per cent. However, a very significant change in intra-trade flows appears between 1970 and 1976 when this trade recorded a high growth rate of 36 per cent per year, with a record increase of 107 per cent between 1973 and 1974. Consequently, the share of developing countries' intra-trade in world trade increased gradually from 3.5 per cent in 1970 to 5.9 per cent in 1976.

The share of intra-trade in both total exports and imports of the developing countries remained stable around 20 per cent during 1960-1976. However, periodic fluctuations around this level reflect some clear and important trends. From 1960 to 1970 the share of intra-trade in total exports and imports of developing countries witnessed a gradual decrease from 22.3 per cent for exports and 20.8 per cent for imports to 19.6 per cent and 18.9 per cent respectively. Since 1970, however, the trend has moved upwards and by 1976 close to 23 per cent of exports of the developing countries were destined to other developing countries, while 26.5 per cent of their imports originated in the developing world.

It should be pointed out that the high annual growth rates for the period 1970-1976 reflect also the price changes, particularly the rapid increase in oil prices since 1973. However, the fact that intra-trade also recorded significant increases in "real" terms is confirmed by an examination of the available quantum index. According to the quantum index, intra-trade between 1970 and 1976 grew at the rate of 9.2 per cent annually, as compared to 5.8 per cent during 1960-1970. These growth rates for the period 1970-1976 are higher than those recorded by trade flows among industrialised countries (6 per cent) and higher than total exports of developing countries (5.8 per cent). Moreover, the growth rates appear to be considerably higher if fuels are excluded from intra-trade. The share of fuels exports in intra-trade amounts to approximately one-fourth of the total.

^{1/} This section is based on data obtained from the UNCTAD Secretariat in Geneva. Particular reference is made to Review of Recent Trends and Developments in Trade in Manufactures and Semi-Manufactures: Report by the UNCTAD Secretariat, TD/B/C.2/190, 21 March 1978, and Trade Among Developing Countries by Main SITC Groups and by Regions: Statistical Note by the UNCTAD Secretariat, TD/B/C.7/21, 20 September, 1978.

2.2 Commodity Composition

The quantum index for manufactured products for the period 1970-1976 also reveals that this product group is the most dynamic component of developing countries' intra-trade, since it is the most rapidly increasing flow not only within the developing countries but also among the developing and the industrialised world. Developing countries' total exports of manufactures (SITC 5-8, less (8)) amounted to \$ 30 billion in 1976. Of this, fully two-thirds, i.e. \$ 20.5 billion were destined for the developed market economy and the socialist countries, while only \$ 9.6 billion worth were sold to other developing countries. Nevertheless, developing countries' exports of manufactures to each other doubled in value between 1972 and 1976. For a number of developing countries, particularly those that are members of regional groupings, such as the Latin American Free Trade Association (LAFTA) and the Central American Common Market (CACM), the major markets for their exports of manufactures are in other developing countries. But even countries, such as Hong Kong, South Korea and Singapore, which are major exporters of manufactured products to the developed market economy countries, sell a sizable proportion of their total exports of industrial goods to developing countries. The pronounced difference between the shares of intra-trade in total exports and imports in manufactured products reveals a vast market in developing countries for all varieties of manufactured products of which only a small proportion is currently supplied by imports from other developing countries.

It is thus evident that intra-trade of the developing countries has not only been increasing in volume but has also witnessed significant changes in its structure. These changes in the commodity composition reflect to a great extent parallel changes which took place in the composition of total exports of developing countries. One common feature in the evolution of the structure of these two aggregates during 1960-1976 is a pronounced decrease in the share of food and agricultural raw materials and rapid increase in that of manufactured products. The share of intra-trade in total imports of food declined from 33 per cent to 31.8 between 1960 and 1976 and of agricultural raw materials from 54.7 to 43.2 per cent, while that of manufactured products increased from 7.5 to 9.7 per cent.

The intra-trade in manufactures among the developing countries also exhibits a wide diversity in its product composition. Nearly half of this trade in 1976 was in a wide variety of products under SITC 6 and 8, a third in machinery and equipment (SITC 7), while chemical products (SITC 5) accounted for one-sixth of the total. The increase in share of manufactured products traded among developing partners has been particularly pronounced in chemicals, machinery and transport equipment and clothing. In 1976, markets of the developing countries accounted for the highest shares of developing countries' exports of passenger road vehicles (78 per cent), machinery and transport (44 per cent), chemicals (50 per cent) and iron and steel (46 per cent). The lowest shares can be observed for non-ferrous metals (18 per cent), oilseeds (14 per cent) and crude fertilisers and ores (8 per cent).

The share of manufactured products in intra-trade of the developing countries rose from 26.9 per cent in 1970 to 46.3 per cent in 1975. The largest gains were registered for machinery and transport (from 3.7 to 14.6 per cent), chemicals (from 2.7 to 7.4 per cent) and iron and steel (from 0.9 to 2.8 per cent). The lowest growth in shares is accounted for by minerals and ores and crude fertilisers, as well as clothing and textile fibers. The small percentage of intra-trade in such products can be attributed to the similarity of factor endowments in specific raw materials among a large number of developing countries. On the other hand, that the total demand of the developing countries for some of the above product groups increased faster than the growth of intra-trade reveals considerable potential for further intra-trade expansion.

2.3 Regional and Interregional Composition

In 1976, exports to other developing countries accounted for the highest share in South and Southeast Asia (29 per cent), followed by Latin America (22.9 per cent), West Asia (21.8 per cent) and Africa (10.9 per cent). These shares seem to have been remarkably stable since 1960. The reasons for the pronounced variations in the respective shares of individual regions are numerous and complex. In general, the traditional trade links established in the past, the complexion of recent economic growth and the artificial barriers to trade are some of the factors that account for this diversity. However, all the regions shared in the increase in the weight of manufactured products in developing countries' intra-trade. The sharpest increase was recorded in Latin America (from 11.9 per cent in 1960 to 38.5 in 1975), while the highest was in South and Southeast Asia (from 33.3 per cent to 51.3 per cent).

The commodity composition of intra-trade between various developing regions also varied considerably. In 1975, exports from South and Southeast Asia to the developing countries represented over one-half of developing countries' non-fuels trade and over 60 per cent of intra-trade in manufactured products. Unlike Latin America, which developed its manufacturing sector on the basis of regional demand, over one-third of exports of manufactures from South and Southeast Asia to other developing countries went outside the region, chiefly to West Asia and Africa. Exports from Latin America to other regions are still heavily concentrated on food, destined mainly for West Asia and Africa. Manufactured products and industrial inputs, such as iron and steel, are traded mainly within the region. Although exports of manufactures to other regions accounted in 1975 for only 15 per cent of total exports to other regions, they have rapidly expanded from a value of \$ 9 million in 1960 to \$ 233 million in 1975. Manufactured exports to developing countries outside the region are heavily concentrated in machinery and transport equipment.

African exports to developing countries contained in 1975 the highest share among developing regions of food items and agricultural raw materials, and the lowest share of manufactured goods. Moreover, the value of agricultural raw materials and minerals

exported to other regions is far higher than the value of these goods traded within Africa. This reflects the lack of industrial capacity in transforming local industrial inputs. The main flow of goods from Africa to other developing regions consists of fuel to Latin America and food and crude materials to South and Southeast Asia. The bulk of manufactures imported from developing countries originate in South and Southeast Asia. Exports from West Asia to other developing regions consist almost exclusively of fuel oils and their derivatives.

The bulk of intra-trade among developing countries is still carried out on an intra-regional basis. The highest reliance on regional markets is observed in Latin America where in 1975 close to 76 per cent of all exports to developing countries went to partner countries of the region. The corresponding figure for West Asia is 70 per cent, for South and Southeast Asia 65 per cent, and for Africa 55 per cent. However, between 1960 and 1976, the share of intraregional trade in total intra-trade among developing countries declined from 73 per cent to 50 per cent. This change appears to have been caused mainly by the increasing value of petroleum trade among developing regions. Excluding petroleum, this share fell from 75 per cent in 1970 to 68 per cent in 1975. In any event, during the period 1970-75, interregional trade among developing countries expanded faster than trade between regional partners. The emerging relative importance of expansion in interregional trade can be observed in almost all major commodity groups. The most pronounced increases were recorded for crude fertilisers, minerals and ores (796 per cent), chemical products (689 per cent) and machinery and transport equipment (688 per cent). These changes clearly highlight a trend towards broadening the geographical scope of intra-trade and reflects the increasing maturity of many developing countries as suppliers of manufactured products.

2.4 Preferential Trade

Since a considerable part of intra-trade among developing countries is carried out on a preferential basis, some further trends can be noticed by analysing these particular flows. Intra-trade within regional groups that extend mutual tariff reductions amounted in 1975 to \$ 4.1 billion or roughly 18 per cent of trade among developing countries. It must be noted, however, that the share of intra-trade that can be ascribed to preferences is likely to be much lower as not all intraregional trade flows are covered by preferences. Nevertheless, the period 1960-1976 has witnessed a pronounced trade expansion within all regional groups that have implemented mutual tariff reductions. Between 1960 and 1976, the share of trade within the preferential schemes in total exports of regional groupings increased as follows: for LAFTA, from 7.7 per cent to 12.1 per cent; for CACM, from 7.5 per cent to 21.3 per cent; for the Caribbean Economic Community (CARICOM), from 4.8 per cent to 8.3 per cent; for the West African Economic Community, from 2.5 per cent to 9.4 per cent; and for Central African Customs and Economic Union, from 1.7 per cent to 8.4 per cent.

One notable feature of preferential trade among developing countries is the fact that intraregional trade in manufactured products, usually subject to high tariff and non-tariff barriers, developed only as a result of preferences. Thus, CACM which is the most advanced group in liberalising internal trade barriers, exports of such products as synthetic fibers, glassware, metal containers, plastics, chemicals and drugs, motor vehicles, and telecommunication apparatus, among others, are traded exclusively among partner countries of the group. Similarly, in the Andean Group, machines and apparatus, electric equipment, man-made fibers and pharmaceuticals are confined to subregional exchange among the bloc countries. In Africa, certain manufacturing industries developed solely due to the existence of regional preferences. Within the Central African Customs and Economic Union, clothing, glassware, wire products, pharmaceuticals, plastics, metal containers, and tools are traded almost exclusively among partners of the Community extending preferences to each other. Preferences granted within the West African Economic Community stimulated internal trade in plastics, rubber products, household appliances, and agricultural machinery.

The potential for future expansion of mutual trade is indicated by the fact that internal trade subject to trade preferences still represents only a modest share of the total demand of the individual regions for the products currently traded. In the same vein, it is observed that developing countries that are not part of the regional preference schemes import from industrial countries goods which could be supplied by industries within preferential groups. Thus, CACM has hardly penetrated the market of other Latin American countries for manufactured products and industrial inputs, despite considerable imports of these products from the developed countries. The same pattern of insufficiency of market penetration can be observed in all regional groupings as far as trade in manufactures is concerned.

2.5 Interregional Trade Balance

Data assembled by UNCTAD also permits an assessment of interregional trade balances on account of trade among developing countries. Developing countries' interregional trade traditionally resulted in a trade deficit of all regions vis-à-vis West Asia. All other regions are traditional net exporters of non-fuel commodities to West Asia, but even a considerable increase in such trade during 1970 and 1975 could not cover their combined deficit with West Asia, which had increased to over \$ 10 billion in 1975. South and Southeast Asia has a traditional surplus vis-à-vis all other regions in non-fuel trade, which in 1975 amounted to \$ 3 billion. The surplus is generated largely through exports of manufactured products to Africa and West Asia. Latin America, owing to the pronounced increase in food exports to West Asia and Africa during 1960-1970, turned its traditional deficit in non-fuel interregional trade to a small surplus in 1975 amounting to \$ 895 million. Africa's imports of food from Latin America and of manufactured products from South and Southeast Asia resulted in a deficit which in 1975 amounted to over \$ 1.5 billion. Its surplus with West Asia, to the tune of \$ 71 million, was not sufficient to offset the overall deficit in its interregional trade.

2.6 Concluding Observations

The statistical profile contained in this section permits some general conclusions, with respect to current magnitudes as well as to their trends. The share of developing countries' intra-trade in world trade as well as the share of intra-trade in total exports and imports of the developing countries has been on an increasing trend since 1970. Moreover, intra-trade has undergone a radical shift in its structure towards a growing preponderance of manufactured products, the most pronounced increases being in products normally classified as heavy industry. The long-term trend of changes in the share and structure of intra-trade cannot be attributed to price changes alone, since the quantum indices also show an upward trend. Accordingly, the long-term trends would appear to be more pronounced in constant prices.

Although the bulk of intra-trade is accounted for by trade within regions, there has been a steady shift away from intraregional and towards interregional trade. The pattern of trade now seems to favour trade between regions which is growing faster than trade between regional partners, particularly in manufactured products. These dramatic changes have broadened the horizontal scope of trade networks and call for bold policy initiatives for future expansion. The growth in preferential trade has been less modest, even though the share of preferential trade in total trade has been rising in all regional preferential groups. The most note-worthy feature of preferential trade is the fact that almost the entire growth of regional trade in manufactured products can be attributed to the fact of preferences. All long-term trends point to a vast potential in increasing mutual trade, both within and between the regions, particularly in manufactured products and industrial inputs. These trends are likely to be significantly reinforced by specific policy initiatives to be proposed in this paper.

CHAPTER 3: LONG-RUN DETERMINANTS OF INTRA-TRADE

Mutual gains in static and dynamic efficiency result when countries with disparate endowment of resources and with divergent patterns of demand trade with each other. The neoclassical theory of trade suggests that the dissimilarity of capital/labour ratios between individual developing countries should lead to considerable specialisation and exchange of goods among themselves. The Group of 77 comprises of a large heterogeneous collection of countries with widely divergent endowment of resources to an extent that their individual modes of specialisation are likely to complement and mutually reinforce each other. In addition, a sizable proportion of international trade in manufactured products takes place between countries with broadly similar patterns of demand and per capita incomes. Developing countries frequently have a uniform and overlapping pattern of demand for manufactured products which affords considerable opportunities for supplying each others demand. On both these counts, the developing countries offer promising opportunities for increasing the volume and diversity of their mutual trade through inter-industry as well as intra-industry specialisation.

In the short run, the developing countries' demand for imports from other developing countries will be governed by such customary factors as relative prices, real incomes, transport costs and trade barriers. However, from a long-run standpoint and considering the totality of all developing countries, supply influences stemming from the degree of industrialisation and the growth of production capacity in particular sectors, in conjunction with the growth of real incomes, seem to provide a fruitful source of explanation for the growth of intra-trade.

The relationship between industrialisation and trade is inherently circular, full of feedbacks and interdependence. While industrialisation enhances trade by broadening the range of specialisation, trade in turn favourably influences the prospects and diversity of industrial production through dynamic effects arising from economies of scale and stimulus to investment, technology and productivity. The role of industrialisation in fostering mutual trade among the developing countries can be visualised in two different ways. Firstly, the process of industrialisation is expected to increase the degree of complementarity among the developing countries, as cross-country differences in the size and composition of industrial structures are heightened by uneven and differentiated progress. This sort of complementarity, accentuated by differential response to domestic economic conditions, is to be expected in a group of countries as large and heterogeneous as the Group of 77. This growing complementarity in production structures among the developing countries is in marked contrast to an earlier period when they "competed" with each other in exporting raw materials to the industrialised countries and obtained practically all their imports from the latter.

This uneven development of industrial capacity in the developing world implies that there is considerable potential for intensive trade between the rapidly industrialising developing countries with a diversified structure and those that have a slower rate or a narrower range of industrial production. The available evidence shows that a small number

of developing countries with a higher ratio of manufacturing total GDP export large volumes of manufactures to other developing countries and between them they export a wide range of products. This pattern is in evidence both in interregional trade between developing countries, as well as in trade between partners of a regional grouping. These results lend considerable support to the hypothesis that the economies of the developing countries as a group are characterised by complementarity more often than by competitiveness. One might infer, therefore, that developing countries will experience an increase in their mutual trade as long as industrialisation of their domestic economies follows a characteristically complementary pattern.

Secondly, the emergence of industrial capacity in a large number of developing countries, chiefly in response to domestic pressures for structural changes, provides an obvious precondition for export of industrial goods. This goes beyond saying that the developing countries cannot export manufactured products unless they produce them. The point concerns the dynamic sequence in which trade expansion reflects the distinct stages of development policy, where import substitution at the national level is followed by import substitution at the regional level through liberalisation of trade among partner countries. The industrial capacity created through national import substitution is utilised in expanding trade among partner countries. This dynamic sequence of trade expansion among developing countries is likely to induce intra-industry specialisation in the production of manufactured products. Accordingly, it is unlikely that country A will produce shoes but no textiles, while country B produces textiles but no shoes. Rather, each of the countries is likely to specialise in a certain type of product or products within each of the two industries. Such a qualitative specialisation in broadly similar but "differentiated" products is likely to lead to intensive trade among countries with similar structures of income and demand.

In the reality of non-homogeneous products, a very large part of trade among countries takes place in highly differentiated tariff-line items. The early efforts at industrialisation in developing countries were characterised by a parallel development of broadly similar range of industries behind protective barriers. This inauspicious circumstance for the growth of trade among themselves is now being gradually corrected as industrial structures in many developing countries are beginning to acquire greater diversity in product composition. In fact, there is considerable evidence of intra-industry specialisation in the Central American Common Market which has led to the emergence of larger and more specialised firms in every industry which has enhanced their ability to export not only to partner countries but also to extra-union countries as well.

In a world as large as the one comprising the developing countries where supplies of productive factors, their productivities and techniques of production differ significantly, there are bound to be tendencies in individual countries' production to concentrate on certain manufactured products and not on others. A developing country will tend to concentrate on a relatively narrow range of manufacturing activities in its trading sectors whose factor requirements closely resemble the factor endowments domestically available. By implication, it will import those products whose factor requirements, if

they were to be produced domestically, would significantly diverge from its factor supplies. All this suggests that there are strong reasons to expect that the heterogeneous collection of developing countries will gradually acquire among themselves a wide spectrum of manufacturing activities. Since industrial firms will now be more specialised than under national import substitution policies, they would be better able to export to each other. Needless to say, the actual trade pattern may be blunted by the influence of transport costs, non-tariff trade policies and the actual or the perceived need for national self-sufficiency, and thus narrow the range of mutual trading. One may conclude, therefore, that the increasing degree of industrialisation in developing countries, through its impact on complementarity, will have a favourable effect on mutual trade.

An increase in the growth rates of total and per capita incomes is also likely to be an important factor in long-term outlook for trade expansion. Available evidence suggests that the expansion of intra-trade is positively correlated with the growth of real per capita income in developing countries. This is due to the fact that income elasticities of demand for imports of manufactured products from all sources generally tend to be high. That rising personal incomes generate a larger than proportionate increase in the demand for industrial goods is well-known. However, the uneven distribution of income in many developing countries would seem to mitigate against a fuller development of intra-trade. The highly skewed distribution of income in these countries isolates the majority of people from the market for industrial products. As a result, higher growth of incomes tends to be biased towards goods that are not currently traded among developing countries and are imported from outside the region. If acceptable means can be found to distribute future incomes more equitably, the resulting impact on intra-trade can be quite significant. A redistribution of future incomes will influence primarily the demand for goods at relatively lower levels of income which can be produced within the group of developing countries.

The foregoing section attempted to provide some plausible indication of the underlying structural factors that are likely to affect the growth and composition of intra-trade among developing countries. These factors should not be interpreted as "causes" of intra-trade; they are merely in the nature of possible factors where one should look for long-run indicators. The attention to long-run structural factors does not imply that short-run determinants of imports, such as relative prices, are insignificant. Nevertheless, they call attention to the need for appropriate trade and tariff policies for developing the full potential of mutual trade within the developing countries.

CHAPTER 4: IMPACT OF INTRA-TRADE ON TRADITIONAL TRADE FLOWS

Despite impressive growth of intra-trade recently, traditional trade flows established during the colonial period continue to dominate developing countries' pattern of trade. In 1976, 77 per cent of total exports of the developing countries were destined for the developed market-economy and the socialist countries, while 74 per cent of their imports came from the latter. Similarly, the growth rate of developing countries' exports to the developed market-economy countries was higher than the growth rate of exports to other developing countries for every year during the decade 1960-1970. It is only since 1972 that the growth rate of exports of developing countries has been slightly biased in favour of exports to other developing countries. An examination of the quantum indices (1970 = 100) for the SITC 0-9 reveals that the quantum index of developing countries' exports to other developing countries (169) in 1976 was higher than that of exports to the developed market-economy countries (132), with a noticeable upward trend since 1973. However, the quantum index of imports into the developing countries from both the developed market-economy and other developing countries moved remarkably close together. A detailed analysis of the aggregate data also suggests that developing countries continue to increase the rate of growth of their exports both to the rest of the world as well as to other developing countries, while they have been absorbing increasingly larger quantities of imports from all sources.

The available data, therefore, shows as yet no evidence that the growth of intra-trade is at the expense of developing countries' trade with their traditional partners.^{1/} This could be due to a number of reasons. First, the major proportion of increase in intra-trade in manufactures seems to have been due to "trade creation", i.e. a switch in the source of supply from domestic producers to producers in other developing countries. Second, it is plausible that an increase in export capability due to increased intra-trade has favourably influenced the export growth in general, including exports to the industrialised countries. Moreover, various preferential schemes under the Generalised System of Preferences (GSP) extended by the developed market-economy countries may have been instrumental in sustaining exports to the industrialised countries. Third, the unusually rapid growth in demand in developing countries for capital equipment and assorted industrial goods during recent years has been able to absorb imports from all sources.

^{1/} A cross section, multiple regression equation, fitted by the author, in order to test the sensitivity of developing countries' intra-trade to their trade with the developed market-economy countries, found no evidence of "trade diversion". In other words, mutual exports are not at the expense of developing countries' traditional exports to industrial countries, while mutual imports from each other do not substitute for imports from the industrial countries. This regression was based on the 1976 data on SITC 5-8 flows. If other flows were to be included, the results would be reinforced.

However, some analyses of trade creation and trade diversion effects under various preferential trading schemes among the developing countries have found evidence of both. Within CACM, for example, common market arrangements have promoted industrial specialisation by type of product, which suggests that the emergence of new trade, rather than displacement of linkages with outside, dominates the intra-trade pattern. In other cases, particularly in the Andean Group, there is some evidence of a slight diversion of their trade with the developed market-economy countries towards the partner countries. But even in these cases, there is no clear presumption that the common external tariff has caused production and consumption of one or more member countries to shift from lower-cost sources of imports in the developed countries to higher-cost producers in member countries.

It is, however, inconceivable that a prolonged expansion of intra-trade could occur without some trade diversion. But trade diversion resulting from intra-trade among developing countries should be looked at in its long-run, dynamic context. First, if in the absence of integration, each member country were to protect its national import-competing industry against all lower-cost foreign producers, the common external tariff of member countries would cause no more trade diversion than would have happened anyway. Second, because of potential economies of scale and the growth of income within the integrated region, what appears as trade diversion in the short-run may turn out to be trade creation in the long-run.

CHAPTER 5: REVIEW OF POLICY INSTRUMENTS

5.1 Regional Integration

Since 1960, a number of regional groups of varying size, level of development and economic structure have entered into arrangements to liberalise trade among themselves, and to further integrate their economies. There were eight such arrangements, involving formal free trade areas or common market agreements, in existence in 1979.^{1/} Trade liberalisation arrangements among developing countries are, of course, not confined wholly to free trade areas and common markets. A group of sixteen developing countries signed in December 1971 a Protocol within General Agreement on Tariffs and Trade (GATT) under which tariff preferences could be extended among members of the group.^{2/} In general, the depth of tariff cut under the Protocol ranges from 12 to 50 per cent of Most Favoured Nation (MFN) rates. A wide range of agricultural and processed goods is covered by concessions, but the lists vary from country to country. In addition, a looser form of preferential trade agreement between five members of the Association of Southeast Asian Nations (ASEAN), covering 71 primary and manufactured products went into effect on January 1, 1978.

A full-fledged analysis of contemporary integration experiences among developing countries cannot be undertaken here. This section attempts to provide an overview of the progress in trade expansion, its future prospects and some of its major problems. The various economic groups vary enormously in their composition, size, stage of development and the degree of commitment to economic integration. But they all subscribe to the common aim of trade expansion through increasing the market size, developing national or regional specialisations, strengthening the industrial sector, and co-ordinating efforts in international forums.

The growth rates of intraregional trade in various groups range from very high to moderate during the recent past. But it is noteworthy that in all cases, the growth rate of intraregional trade is significantly higher than total trade for each region. This is despite the fact that intra-trade in LAFTA was subject to new forms of protective restrictions in some years of the 1960s in order to permit weaker nations to consolidate their position. However, the rapid pace at which trade has started to expand in all

^{1/} These are: Latin American Free Trade Association (LAFTA) consisting of eleven Latin American countries; Central American Common Market (CACM) comprising five Central American nations; Caribbean Economic Community (CARICOM) consisting of thirteen Caribbean nations; East African Community (EAC) which consists of Tanzania, Uganda and Kenya; Economic Community of West African States (ECOWAS) consisting of sixteen countries; Union Douanière et Economique de l'Afrique Centrale (UDEAC) comprising four central African countries; and Communauté Economique de l'Afrique de l'Ouest (CEAO) consisting of six countries. A sub-group of LAFTA is the Andean Bloc consisting of four countries.

^{2/} These are India, Brazil, Chile, Egypt, Greece, Israel, South Korea, Spain, Mexico, Pakistan, Peru, Philippines, Tunisia, Turkey, Uruguay, Yugoslavia.

groups since 1970 testifies to the capacity of the developing countries to conduct mutually beneficial trade within common protective barriers. Moreover, since the bulk of increase in regional trade among major groups is concentrated in manufacturing sectors (e.g. in CACM and the Andean Bloc, over 75 per cent of all intra-trade is in manufacturing categories), the scope for industrial growth can be greatly strengthened by trade liberalisation. In general, integration arrangements have brought a fuller utilisation of industrial capacity, and most partner countries have received net benefits in terms of industrial output and employment.

Even though in most groups, a majority of partners seemed to have experienced an expansion of exports due to integration, the extreme diversity in rates of growth of exports and the resulting imbalances in their intra-zonal trade remain major stumbling blocks to further growth. The benefits of trade liberalisation among countries with different levels of development, are not likely to be uniformly distributed especially when there is one or few dominant countries in the group. If there are severe imbalances among member countries at the outset, the tendency for a widening income gap between rich and poor countries of the group as a result of liberalisation is likely to be reinforced. Consequently, there is an apprehension among weaker countries in all groups that a uniform trade liberalisation policy will benefit the more developed members at their expense. Future progress in trade expansion clearly requires that gains from trade liberalisation are more equitably distributed.

Present imbalances in structure among member countries has meant that trade liberalisation alone will not guarantee a reciprocal development of industry, which will have to be achieved by more direct and explicit means of distribution of future industrial capacity in given regions. Excessive reliance on economies of scale seems to have further complicated the problem, since countries that already have a viable industrial structure will tend to be favoured in future growth of industrial capacity. In fact, the problem of an equitable distribution of potential industrial capacity is one of the most critical issues facing LAFTA. Some progress in this direction has been made by means of "industrial complementarity" schemes in the Montevideo Treaty, even though they have failed to initiate substantial new areas of production. On the other hand, complementarity provisions may themselves have contributed to the dissatisfaction of relatively less developed countries in LAFTA, which find it difficult to build viable manufacturing sectors within the existing framework of the treaty.

It appears, therefore, that a crucial concern of industrial policy in all regional trading groups must be with the allocation of industrial capacity according to criteria that go beyond the mechanism of freer trade. This does not imply that freeing trade is unnecessary; it simply calls attention to wider considerations of equity and the need for correcting mechanisms. The frequently suggested method of lump sum fiscal transfers, of the kind attempted in the East African Community, for redistributing the gains from trade liberalisation will do little to solve the problem of structural imbalance. The most important, if not the only means, of eliminating the structural causes of maldistribution of benefits of trade expansion may consist of increasing the rate of industrial

development in weaker countries. Part of this task can be accomplished by phased reduction of tariff barriers in relatively less developed member countries. They are, however, unlikely to result in a balanced distribution of industrial capacity from the standpoint of the region as a whole. What is ultimately required is a co-ordinated planning of industrial development in the multinational region with an active bargaining process to balance considerations of efficiency and equity. As a minimum, it requires that a certain weight be given to the needs of the larger region in planning national industrial development.

One of the important deterrents to further progress on trade expansion seems to be ironically the economies of scale argument itself. The prospect of access to a regional market has in fact been a powerful stimulant to investment in many industries where small local markets would not have justified the endeavour. But the extent and the importance of economies of scale vary greatly from industry to industry. In industries such as steel, artificial fertilisers and chemicals - all heavily capital-intensive operations requiring a large initial investment and longer production runs - there are considerable economies in large scale production. But for many other industries - e.g. textiles and a whole range of consumer goods - the absolute scale of operation may not be very important in influencing the unit cost of production.

As a result, a move to establish one industry to serve the total market in any given region may mitigate against a reciprocal development of industry throughout the region. When one large regional plant, even though technically more efficient, displaces a number of small, protected national producers, the resulting disruption in individual countries may be difficult to cope with at least in the short run. But, more significantly, the desire to initiate some industrial activity is a powerful motivation in many countries, and if the argument of economies of scale is used in a way which effectively deprives them of the opportunity to share in industrial development of the region, then integration may simply confirm the dominant position of one or few countries or firms.

The long-term solution calls for some concept of "balance" among different countries of a region in designing large industrial projects. Some industries in any given region may be tied to a particular location, either because of availability of raw materials, cheap sources of power, or the influence of transport costs. Others, in particular those requiring large inputs of labour, may be more flexible in their choice of location. For industries for which location is not critical, a good deal of weight should be given to considerations of regional balance. In many instances, this may not increase unit cost of production at all. A number of recent studies have confirmed that, economies of scale notwithstanding, a large number of countries in every region would qualify as minimum cost locations for a large variety of industrial products. For other second best locations, production costs are expected to be only slightly higher. The slight increase in costs of production can be counteracted by staggering the implementation of tariff cuts, as has been done in the Andean Bloc.

The range of locational choices can be broadened further by increasing the number of industrial projects in the region. If only one or two big industries are planned for a region, there may be little locational choice, or that the larger countries may be able to attract a higher volume of industrial capacity. If a regional plan, on the other hand, contains a large number of projects, particularly of the footloose type, it is much easier to allocate industrial activity among the participating countries of the region. The experience of ASEAN suggests that the region has experienced a rapid development of those types of industry in which relatively small scale of production is efficient.

5.2 Prospects for Interregional Trade

Contemporary discussions of intra-trade have tended to concentrate on achievements and problems of regional trade, while prospects of interregional trade (i.e. trade among all developing countries) have received only modest attention. However, recent trends suggest that interregional trade is the more dynamic of the two types of flows and expanded faster than trade between regional partners during 1970-1975. Moreover, the most pronounced increases have occurred in products of heavy industry. It would, therefore, appear desirable that future thrusts of trade expansion policies should be directed towards this very promising flow.

The possibilities of expanding interregional trade appear to be vast, given the larger matrix of countries, products, supply capabilities and demand patterns of developing countries at large. It was suggested earlier that vigorous import substitution efforts behind national protective barriers have enabled a number of developing countries to acquire a wide spectrum of industrial capacity, which frequently suffers from lagging demand and, consequently, shorter production runs. This factor, which greatly enhances the potential for intra-trade, is paradoxically also a major obstacle to it. Maintenance of national protective regimes in developing countries means that potential exports of industrial products to each other also face formidable trade barriers. It is obvious, therefore, that an important precondition for enlarged trade among the developing countries is a change in their tariff and non-tariff policies with respect to each other. This change should aim at a preferential treatment of traded products originating in developing countries. In order to increase the range of products that could be traded, it is also necessary that trade preferences should be non-discriminatory between all developing countries. However, it would be desirable, at least in the short run, that full reciprocity is not demanded from countries at lower levels of development.

Therefore, a future task of considerable significance is the initiation of a forum where the developing countries could undertake trade liberalisation among themselves, either through rounds of trade negotiations or any other suitable modality. Such an effort would initially require a large amount of preparatory work for identifying the trade flows most likely to benefit from trade liberalisation. UNCTAD estimates suggest that initially some 36 per cent or \$ 18 billion worth of developing countries' intra-trade could become subject to trade negotiations. Initially, limited and looser forms

of trade liberalisation agreement involving a limited number of products may be preferable to more general techniques of trade liberalisation, such as across-the-board reductions common under the auspices of GATT. Such large scale methods may not be suitable for initial liberalisation efforts, since they are likely to trigger widespread fears about the survival of nascent domestic industries. The recent treaties involving limited trade concessions among ASEAN countries may serve as a useful example. It is too early to judge the trade impact of this agreement, but it is clear that such agreements are easier to devise and implement than across-the-board tariff cutting, and may form the genesis of increasing preferential trade among all developing countries.

One may conceive of the entire set of developing countries as a vast preferential trading area for manufactured goods. This larger set would undoubtedly contain smaller subsets in the form of existing free trade areas and common markets, such as the LAFTA and the CACM. A programme of expanding intra-trade which goes beyond regional exchanges will have to be dovetailed into a framework of existing or incipient integration schemes. Practical possibilities exist for retention of existing free trade areas and other preferential schemes within the larger framework of preferential trading agreements extending to all developing countries. In free trade areas, for instance, where intra-union trade is wholly or substantially liberalised, the preferential tariffs extending to developing countries outside of the given free trade area could be higher than the tariff applicable to non-developing countries. In common markets, where intra-union trade is wholly liberalised, the preferential tariff applicable to developing countries outside of the common market could be higher than zero but lower than the height of the common external tariff.

The problem of non-tariff barriers is in general more intractable, but devices such as differential heights of QRs, selective safeguards, uniform customs valuation procedures are possible. These and other such devices would ensure that general preferential arrangements extending to all developing countries on a non-discriminatory basis do not erode existing or incipient integration movement.

Initially, the major portion of increase in intra-trade resulting from preferential arrangements would come from trade creation, i.e. through a switch in the source of supply from domestic producers to other developing countries, and would thus represent a net increase in world trade. Preferences should be designed in a way that they promote both inter-industry and intra-industry specialisation. The former should at curbing the tendency towards "proliferation" of an uneconomic range of manufacturing industries in individual developing countries, regardless of cost and efficiency consideration. Intra-industry substitution by contrast should aim at diversifying the locus of production of the various stages of fabrication in a vertically integrated industry, e.g. steel as well as of production processes in consumer-goods industries, e.g. textiles which run through a whole chain of man-made fibers and fabrics to ready-to-wear garments. The natural advantage of the larger, industrialising developing countries may, for instance, lie in fibers or textiles which are relatively less labour-intensive, while other

developing countries may specialise in apparel-making which is relatively more labour-intensive. Similarly, in the garment sector there are significant possibilities of specialisation in types and sizes of garments. The two types of substitution outlined above will have the effect of reducing the real cost of a given degree of industrialisation for each of the countries. They may also have the effect of increasing developing countries' capacity to export to developed market-economy countries through the emergence of larger and more specialised firms.

There is, of course, the possibility that an expansion of the preferential market for developing countries may induce a diversion of their current exports to the industrialised countries to other developing countries. While increasing the volume of intra-trade, this diversion does not represent a net increase in world trade. However, if imports from each other simply displace their imports from the industrialised countries, this diversion must result in a net increase in developing countries' production of manufactures. This trade diversion, if it occurs, will clearly reduce the developing countries' capacity to import from industrialised countries, and could thus adversely affect the process of capital formation and acquisition of technology. In a dynamic, long-run context, however, preferential arrangements among the developing countries may generate a higher tempo of industrial activity in developing countries resulting in enlarged trade flows with the rest of the world.

F.3 Other Institutional Arrangements

It is clear that preferential tariffs alone would not be sufficient for increasing intra-trade unless accompanied by parallel developments in transport, marketing networks and financial mechanisms. In particular, the development of new monetary mechanisms to provide credit facilities for intra-trade are crucial. They could take the form of new commercial banking links, payments unions, clearing houses and accounting units for trade between developing countries. One of the inhibiting factors for intra-trade is the developing countries' preference for "hard-currency" exports due to the non-convertibility of their currencies. The lack of convertibility of currencies can be remedied by a payments union, which also extends credit to member countries for trading among themselves without use of scarce convertible currencies. A common unit of account based either on SDR (such as the one proposed for the Asian Clearing Union) or on a "basket" of major developing country currencies may further strengthen the financial arrangements. Similarly, development of shipping, port facilities, and joint chartering of large vessels may also remove bottlenecks towards greater trade linkages.

STATISTICAL APPENDIX

This statistical appendix has been prepared from data contained in UNCTAD reports, Review of Recent Trends and Developments in Trade in Manufactures and Semi-Manufactures, Report by the UNCTAD Secretariat, TD/B/C.2/190 dated March 21, 1978, and Trade Among Developing Countries by Main SITC Groups and by Regions, Statistical Note by the UNCTAD Secretariat, TD/B/C.7/21, dated September 20, 1978.

This appendix provides only part of the data on which the analysis of the paper is based. Detailed data is available in the above reports.

Table 1: Annual Average Growth Rates of World Exports by Regions
(percentages)

TO \ FROM	World	Developed Market-Economy Countries	Developing Countries	Socialist Countries
<u>World</u>				
1960/61-1965/66	8.3	9.3	5.7	7.6
1965/66-1970/71	11.1	11.8	9.3	8.9
1970/71-1975/76	29.1	21.6	28.1	22.7
<u>Developed Market-Economy Countries</u>				
1960/61-1965/66	8.9	10.1	5.0	10.5
1965/66-1970/71	12.0	12.6	9.5	10.8
1970/71-1975/76	21.2	18.7	26.4	27.2
<u>Developing Countries</u>				
1960/61-1965/66	6.1	6.5	5.0	11.4
1965/66-1970/71	9.0	9.3	8.3	7.3
1970/71-1975/76	32.3	31.4	35.9	27.2
<u>Socialist Countries</u>				
1960/61-1965/66	8.4	11.6	13.9	8.0
1965/66-1970/71	9.4	10.4	10.4	8.9
1970/71-1975/76	20.9	25.1	21.3	20.0

Table 2: Relative Importance of Exports to Developing Countries in Total Exports of Individual Regions, 1960-1975^{a/}
(percentages)

<u>REGION</u>	<u>YEAR</u>			
	<u>1960</u>	<u>1965</u>	<u>1970</u>	<u>1975</u>
Latin America	9.1	12.9	14.8	21.4
South and South-East Asia	32.8	30.8	28.4	31.7
West Asia	32.2	29.1	31.3	46.9
Africa	13.1	13.4	11.3	14.1

a/ Total exports exclude mineral fuels.

Table 3: Trade Matrix of Intra-Developing Country Flows by Regions
(Million \$)

TO \ FROM	Developing America	South and South-east Asia	West Asia	Africa	Total
Developing America					
1960	1,680	46	29	105	1,859
1965	2,150	86	55	130	2,421
1970	3,120	160	37	125	3,442
1975	9,580	350	840	1,260	12,030
South and South-East Asia					
1960	165	2,100	165	195	2,625
1965	180	2,280	230	310	3,000
1970	175	3,180	365	485	4,205
1975	1,080	9,160	2,360	1,380	13,980
West Asia					
1960	61	285	355	230	931
1965	165	400	550	235	1,350
1970	200	640	770	350	1,960
1975	4,360	8,130	3,820	1,710	18,020
Africa					
1960	44	190	100	350	684
1965	41	160	120	600	921
1970	235	240	115	650	1,240
1975	1,590	410	390	1,500	3,890
Total					
1960	1,950	2,621	648	880	6,099
1965	2,536	2,926	955	1,275	7,692
1970	3,730	4,220	1,287	1,610	10,847
1975	16,610	18,050	7,410	5,850	47,920

Table 4: Trade in Manufactures among Developing Countries (SITC 5-8 less 68), 1970-1975
(percentages)

FROM \ EXPORTS TO		Latin America	South and South-East Asia	West Asia	Africa	Total
<u>Latin America</u>	1970	25.4	0.7	-	0.9	27.0
	1975	22.0	0.6	0.4	1.3	24.3
South and South-East Asia	1970	3.3	38.2	6.2	10.1	57.8
	1975	2.9	36.3	11.1	8.1	58.4
Western Asia	1970	-	0.4	5.2	1.3	6.9
	1975	0.5	1.4	9.2	2.0	13.1
Africa	1970	0.2	0.6	0.9	6.6	8.3
	1975	0.2	0.5	0.7	2.8	4.2
Total	1970	28.9	39.9	12.3	18.9	100.0
	1975	25.6	38.8	21.4	14.2	100.0

Table 5: Relative Importance of Exports and Imports from and to Developing Countries in Countries (% Share)

SITC	PRODUCT	% OF	1960	1965	1970	1976
5	Chemicals	Exp.	35.0	48.0	52.3	50.2
		Imp.	4.8	7.6	8.8	11.3
67	Iron and Steel	Exp.	40.9	61.0	46.5	46.0
		Imp.	2.4	7.4	8.3	7.7
7	Machinery and Transport Equipment	Exp.	71.0	69.6	45.1	44.4
		Imp.	1.7	2.4	3.3	5.2
6+8	Other Manufactured Goods	Exp.	40.5	33.5	28.6	25.6
		Imp.	12.9	14.9	28.6	20.1
5-8	All Manufactures	Exp.	42.7	38.6	32.9	32.3
		Imp.	6.4	7.4	8.3	9.7
0-9	TOTAL	Exp.	22.3	21.0	19.8	22.9
		Imp.	20.8	20.2	18.9	26.5

Table 6: Shares of Intra-Regional Exports in Total Exports to All
Developing Countries, 1960-1976^{a/}
(percentages)

<u>REGION</u>	<u>YEAR</u>				
	1960	1965	1970	1975	1976
Latin America	84	86	86	76	-
South and South-East Asia	77	74	72	65	-
West Asia	62	72	.5	70	-
Africa	51	63	59	55	-
All Developing Regions	73	75	74	68	62

^{a/} Exports exclude mineral fuels.

09632

CO-ORDINATION OF ECONOMIC POLICIES AND THE NORTH-SOUTH TRADE

by

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In the integrated world economy, national policies concerning trade, foreign investment and balance of payments also tend to influence economic conditions in other countries, particularly through trade flows. The need for co-ordination of economic policies among developed countries is generally accepted, even though experience has shown that such a co-ordination is rather difficult to accomplish.

The need for economic co-operation has become apparent in the course of the last six years or so. No single country in the Western Hemisphere is big enough to pull the remaining countries out of the present economic slump. This has become an accepted fact and, as a result of it, the so-called Locomotive Approach has been developed. Backed by a number of governments (particularly the Carter administration, and some international organizations, particularly the Organization for Economic Co-operation and Development (OECD), the approach calls for a co-ordinated programme of stimulative aggregate policies.

No country in the world has today currency strong enough to stabilize international monetary system through unilateral actions. No country can at present pursue its economic policies without paying close attention to developments in the foreign exchange markets. The reform of the world monetary system, though as yet far from being complete, is clearly headed in the direction of co-ordination and supervision of national economic policies. Perhaps the best example of this trend is the idea of exchange-rate surveillance put forth by the International Monetary Fund. The Second Amendment of the IMF's Articles of Agreement explicitly recognize the need for a co-ordination of exchange rate policies, and calls for firm surveillance of exchange rate developments.

No individual country is in a position to stabilize international commodity markets. It is now widely recognized that it will take a joint action of producing and consuming countries to - if not eliminate completely - reduce fluctuations of prices of raw materials and agricultural products.

The energy problem and the control of environment are other examples of global problems which call for global solutions, if they are to be solved. One can go on and on, giving more examples showing that the world has become more interdependent. This growing interdependence should constitute the very foundation of international co-operation. Unfortunately this proposition, though generally accepted by all members of the international community, is often overlooked in practice. Countries have demonstrated time and again determination to cope with their problems on unilateral basis rather than through co-operation. This is particularly evident in the area of international trade where political pressures for quick and short-lived solutions are particularly strong. Countries often opt out of the system, taking unilateral actions which contradict the idea of free trade and economic co-operation. In the face of the world economic crises, it is only expected that these two opposing tendencies will take place.

Although the need for co-operation between developed countries has been generally accepted, contradicted though it may be by the actual behaviour of individual countries, relatively little has been said and done in this area in the context of North-South relations. The oil crises of 1973, recent fluctuations in commodity markets and the emergence of a number of developing countries as efficient producers of industrial goods, serve as a reminder that the world economic system does not consist of only industrialized countries.

The main goals for co-ordination of macro-economic policies between developed and industrialized countries could be described as follows:

1. Acceleration of real growth and expansion of trade
2. Reduction of negative effects of risk and uncertainty on economic relations
3. Alleviating adjustment problems resulting from structural changes in the world economy.
4. Establishing balance of payments equilibrium and stability in the foreign exchange markets.

Each of these goals will be discussed in turn. Benefits and costs of alternative policy options will be assessed. The question of the appropriate institutional framework for co-ordination of North-South economic policies will be taken up as well.

Growth and trade expansion

For a long time it has been generally observed that real growth and expansion of exports of developing countries were a function of the level of economic activities in industrialized countries. Growth in the North would usually result in an increased demand for imports, particularly imports of raw materials. Developing countries stood by ready to satisfy the additional demand coming from industrialized countries, and this would in turn stimulate their own economies through multiplier effects and new investment.

Growth and trade expansion in the South depended on economic growth taking place in the North. The corollary of this theory was that a slow-down of the pace of economic activities in the industrialized countries would lead to a reduction of imports from developing countries. The consequences of this for growth of real income in the South were equally obvious. In fact, negative income and trade effects in developing countries were expected to be a magnification of the effects observed in industrialized countries, for the former were used as marginal suppliers with the priority given to domestic producers.

It should be clearly understood that if growth of developed countries contributes to growth of developing countries, then an important element of co-ordination of economic policies should be stimulation of economic activities in the North. At this point, it is pertinent to look at the record of recent years to assess the nature of economic inter-dependence between the North and the South.

Table 1. Changes in GDP, growth rates of exports, and price indexes for exports of developing countries.

Year	Growth Rates of Real Gross Domestic Product		Growth Rates of Exports of Developing Countries	Price Indexes for Exports of Developing Countries (1970 = 100)	
	Industrialized countries	Developing countries		Oil Exporters	Other LDC's
1968	5.6	6.1	9.4	96	91
1969	4.9	6.9	12.0	96	96
1970	2.7	6.3	11.3	100	100
1971	3.8	5.0	9.6	125	97
1972	5.7	5.7	15.7	135	102
1973	6.0	7.4	48.1	187	139
1974	-0.1	7.2	100.7	584	191
1975	-1.0	3.2	-4.5	624	185
1976	5.2	5.8	18.9	663	197

Sources: Handbook of International Trade and Development, United Nations Conference on Trade and Development, United Nations, New York, 1972, 1976, 1977; International Monetary Fund, International Financial Statistics, May 1977.

One of the striking features of the above table is exceptionally good economic performance of developing countries during the whole decade, as measured by the rate of growth of real GDP. The South has consistently outperformed the North. The oil crisis of 1973 had relatively smaller impact on developing countries than on economies of industrialized countries, the former also recovered from the disturbance quicker than the latter. Developing countries, as a group, have not registered negative rates of growth during the whole period 1968-1976, and their lowest rate of growth (3.2% in 1975) was about equal to the average rate of growth achieved by industrialized countries in the last decade. It is thus tempting to conclude that growth in the South can take place even though the North experiences economic stagnation or even serious crisis. Individual studies for countries like Brazil, South Korea, Colombia and others provide a strong support to this thesis.

Export performance of developing countries is shown in column 3 of Table 1. Unfortunately, the rates of growth measure changes in nominal magnitudes. In order to shed some light on the behaviour of real changes, price indexes for exports of oil-producing countries and other developing countries (DCs) were added. It is quite clear that price movements account for substantial part of changes in export revenue of developing countries. The period following the 1973 crisis was particularly difficult for non-oil exporters. Drastic reduction in the real rate of growth of income and balance of payments disequilibrium in developed countries drastically restricted export opportunities of non-oil producing DCs. One would tend to conclude that economic recovery in developed countries would lead to an improvement in export performance of developing countries.

The questions to be asked at this stage are the following: 1) what is the nature of the slow growth of industrialized countries, 2) to what extent expansionary fiscal and monetary policies could accelerate economic expansion 3) what is the scope for co-ordination of economic policies between different groups of countries? The first of these questions raises the issue whether the present slow-down in the North is temporary or permanent. The problem can be put in a different way: are present economic difficulties of industrialized countries caused by insufficient demand or are they due to structural factors? In the first case, expansionary fiscal and monetary policies would be called for if more growth were desired; in the second case, the answer would be in restructuring of national economics and the removal of structural bottlenecks.

The existing evidence suggests a rapid deterioration of inflation-unemployment trade-offs in most of the OECD countries. The Phillips curve has become more vertical suggesting that the cost of reducing unemployment has increased. There are cases, not at all rare, where growing inflation rates have been accompanied by increasing unemployment. Individual countries find it increasingly more difficult to inflate their way out of the present economic slump. The unusually high unemployment rates have been persisting for unusually long periods of time. Difficulties of most of the OECD countries seem to be of structural nature rather than related to insufficient demand.

Specific studies have singled out the following structural factors as being of major importance in their negative impact on the natural rate of unemployment. First, unemployment compensation schemes adopted in most industrialized countries have changed income-leisure trade-offs for members of the labour force. In addition, these benefits have induced new entries into the labour market. Also, in as much as employers share in the financing of the unemployment benefits, the cost of hiring labour has increased. Second, the minimum wage legislation has had similar impact on the natural unemployment rate, with unemployment effects being imposed mainly on youth and unskilled workers. Third, unionization of the labour force and job security provisions have contributed to the reluctance of producers to expand employment in the face of growing demand. This process has also resulted in attempts to switch to more capital-intensive production techniques.

Distortions in commodity markets constitute another important structural change in industrialized countries. Those distortions sometimes take a form of monopolistic practices which result in the reduction of production and increase in prices. There is very little doubt that the degree of free competition in the OECD countries has been substantially reduced in the last decade. Governments of those countries often play an active role in limiting competition. This is particularly visible with regard to foreign competition. The latest example of d'Avignon plan clearly indicates co-operation between governments and the European Economic Community (EEC) steel industry. To be sure, most of the measures which restrict free competition in the goods markets are taken in the name of saving jobs. Their real effect is just the opposite; there is an increase in the cost of production, disappearance of incentives to improve technology, reduction in investment and so on. The net effect in the long-run must be an increase in the natural rate of unemployment.

The reasoning presented above suggests that demand-management policies alone have only a limited role to play in the recovery of the world economy. This conclusion was clearly expressed by the Council of the Organization for Economic Co-operation in June 1970:

"...there is a clear need to step up economic growth in the OECD area as a whole above the rate experienced over the last 18 months or so as to reduce unemployment. While expansionary demand management policies have a role to play, this cannot be achieved simply by injections of additional purchasing power. The difficulties now facing the world economy are inseparable and cannot be looked at in isolation: growth, jobs, price stability, energy, adjustment to structural change, are only individual facets of the overall predicament facing member countries today. What is needed now, and over the medium term, is a combination of policies to ensure adequate domestic demand and to create the right environment for sustainable growth, which requires less inflation, the maintenance of an open market-oriented economic system, and a recovery in productive investment and profits".

Although fiscal and monetary policies may not be as potent as they once were thought, there is still a great need for co-ordination of these policies on the international level. The basic reason for this is that a lack of the co-ordination may result in conflicting national policies which will, in turn, lead to tensions in commodity and foreign exchange markets. Co-operation in the area of aggregate demand policies should lead to the elimination or at least a reduction of the inflationary bias in the world economy. This does not mean that all countries should expand their aggregate demand at the same rate. There are certainly countries where the productive capacity has not been fully utilized and where sectoral bottlenecks have not yet been reached. In those cases, there is room or even need for more aggressive monetary and fiscal policies.

If, under present circumstances, the comparative advantage of demand-management policies lies in their effects on the world inflation what should be the scope and the form of the co-operation. The starting point must be a selection of the highest acceptable rate of inflation in the world economy. This is already a difficult task to accomplish for political tolerance of inflation varies across countries. The conflict has been already revealed between, on the one hand, Germany, Japan and Switzerland and, on the other hand, the United States. If this conflict is not resolved, an aggressive demand-management policy on the part of the Carter administration will lead to rekindling of inflation, worsening the balance of payments position of the United States, and fluctuations in exchange rates. The effects will not be restricted to industrialized countries, they will also spill over into the developing countries.

If the target rate of inflation for the world economy can be agreed on, the next stage of co-operation involves adopting national monetary and fiscal policies consistent with the target. In practical terms, it means setting and following target rates of monetary expansion. The rates of growth of liquidity in different countries would not have to be the same in order to be consistent with the desired rate of world inflation and stability of exchange rate markets. Countries with higher rates of growth of income, for example, would or even should have more expansionary monetary policies compared with countries with rather lower growth rates.

It must be said that in recent years a number of industrialized countries, the United States, Germany, Canada and lately Switzerland, have adopted monetary targets. These decisions have been taken, however, without much of international co-ordination and they may yet prove to be inconsistent in the context of the world economy.

Clearly the task of reducing and stabilizing world inflation rests mainly with developed countries. Therefore co-ordination of monetary and fiscal policies could be done within a small group of countries. Then, with monetary and inflation targets being known to all members of the international community, the remaining countries could adjust their domestic policies accordingly.

There is one area, however, where developing countries must share in the task of bringing down inflation, and where direct co-ordination of economic policies between the North and the South is required. The behaviour of the price of oil is an important element in the inflationary process and also plays a role in determining the level of economic activities in industrialized and developing countries alike. Hence excessive oil price increases could rekindle inflation and throw industrialized countries into yet another recession. The consequences of this for the North-South trade would be obvious. Lower rates of growth, real income and balance of payments difficulties of industrialized countries would be detrimental to exports of developing countries.

To summarize the conclusions of this section: Under present conditions of structural distortions and imbalances, demand-management policies can not be counted on as a major policy tool to accelerate real growth which is needed for expansion of international trade. Fiscal and monetary policies have their comparative advantage in affecting inflation. Inflation is, as we have been so painfully reminded during the last decade, a global problem which calls for co-ordination of national demand-management policies. Given the share of developing countries in the world aggregate demand, this co-ordination could involve only industrialized countries, or in fact only some of them. There exists however, an urgent need for co-operation between OECD and OPEC countries to contain the danger to the world economy that would result from excessive increases of oil price. The forum for the latter form of co-ordination is yet to be found.

Reduction of negative effects of risk and uncertainty

It may be useful to begin the discussion by investigating the relationship between the openness of an economy and risk. Does the involvement of a particular country in the international economic system increase or reduce the risk to which the country is exposed.

Compare two extreme situations: that of complete autarky with that of free trade. Assume that there are only two goods, X and Y, which in the absence of trade will be produced in quantities X_0 and Y_0 . The real income of the country under consideration when measured in terms of good Y, is equal to:

$$(1) \quad J_0 = \left(\frac{P_X}{P_Y}\right)^0 X_0 + Y_0$$

where $\left(\frac{P_X}{P_Y}\right)^0$ is the relative price under autarky, and J_0 is real income. Income will be fluctuating randomly if either the relative price and/or the quantities produced of the two goods are subject to random disturbances. For the sake of simplicity assume that only the relative price is a random variable with $E\left(\frac{P_X}{P_Y}\right)^0 = \left(\frac{P_X}{P_Y}\right)^0$ and $\text{Var}\left(\frac{P_X}{P_Y}\right)^0 = \sigma_0^2$. In that case the variance of income under autarky, $\sigma_{J_0}^2$, is given by:

$$(2) \quad G_{J_0}^2 = G_0^2 X_0^2$$

Now let us suppose that the country engages in international trade, and that pattern of production under free trade is such that the home country becomes an exporter of X and importer of Y. Income attained in the free trade situation is equal to:

$$(3) \quad J_1 = \left(\frac{P_x}{P_y}\right)^1 X_1 + Y_1$$

where J_1 , $\left(\frac{P_x}{P_y}\right)^1 X_1$ and Y_1 refer to income, the relative price and the levels of production of X and Y under free trade. It should be obvious that $X_1 > X_0$ and $Y_1 < Y_0$, and also that $\left(\frac{P_x}{P_y}\right)^1 < \left(\frac{P_x}{P_y}\right)^0$. The variance of income depends crucially on the variance of the relative commodity price that will rule when free trade prevails. Suppose that it is $\text{Var} \left(\frac{P_x}{P_y}\right)^1 = G_1^2$, and hence it follows that:

$$(4) \quad G_{J_1}^2 = G_1^2 X_1^2$$

Has the risk that the country faces increased after it opened up to trade? It all depends on the relative randomness of the autarky terms of trade compared to the randomness of the free trade terms of trade. If there were a lot of random fluctuations of the domestic prices under autarky, and the international commodity prices were relatively stable, then the country could reduce the risk by joining the international economic system. In that case two birds could be killed with one stone; the risk to which the country is exposed could be reduced and its expected income increased by integrating with the world market.

It is of course possible that joining the international market increases the risk as measured by the variance of income. One would even tend to think that this would be the usual case. The rationale is following: International trade leads to specialization in production so that even if $\text{Var} \left(\frac{P_y}{P_x}\right)^0 = \text{Var} \left(\frac{P_y}{P_x}\right)^1$, the variance of income would be higher under free trade since the country would be putting more eggs into one basket.

Even if it were always true that international trade increased the risk exposure, it must be realized that a higher risk has been compensated by a higher income. There may be a degree of involvement in international trade associated with risk which is unusually high for a particular country. The normal attitude towards risk is not to eliminate it completely but to reduce it to an acceptable level. The reduction of risk is often, but not always, costly in that it requires foregoing some income.

The very existence of risk in any particular economic activity in itself does not constitute a basis for intervention or any sort of compensation. A part of return from engaging in economic activities is a reward for taking risk. This is why the rate of profit in the oil industry usually exceeds the rate of return on an investment in public utilities. For the same reason, profits from smuggling normally exceed profits made on legitimate trade.

Generally speaking there are two reasons for intervention: first, when elimination of risk does not cost anything, the relevant cost being social cost; second, when a community, be it a country or the world as a whole, wishes to reduce the risk below the level which is tolerable for private sector.

In recent years there has been a major concern expressed by the international community about the role and fluctuations occurring in the world economy, and particularly as they affect developing countries. We now turn to the question of the degree to which the international community should get involved in reducing risk and fluctuations and the need and scope for co-ordination of various policies and schemes. At this point it is useful to distinguish different kinds of risk:

1. risk due to randomness of production
2. risk stemming from policy behaviour
3. risk resulting from the absence of international rules of behaviour.

The first of this categories has attracted the most attention, particularly in the context of international commodity agreements.

In our simple example illustrating the connexion between the risk and the openness of the economy, production was assumed to be a non-stochastic variable. It is clear, however, that in reality variations of output occur even for processes and experiments that are conducted in laboratory conditions. This must be even more so for products that are supplied by developing countries. Agriculture and mining are perhaps the best example of sectors where random influences are particularly strong. Returns in those sectors should compensate for additional risk involved, yet the international community may wish or feel obliged to intervene in those markets. The basis for the intervention must be the existence of social benefits not captured by private returns.

If markets are flexible, as they often are for commodities supplied by developing countries, randomness of production should express itself in random fluctuations in the relevant commodity prices. This is, indeed, what happens. The international community has been for years concerned with erratic movements of commodity prices. The present discussions on buffer stocks and the Common Fund conducted within the framework of the UNCTAD clearly testify to this concern. The question, however, arises whether it is desirable to stabilize commodity prices. There must be two elements involved in the justification of the commodity programmes. First, that the welfare of the world as a whole, and particularly the welfare of developing countries will increase when commodity prices are stabilized. Second, that the intervention should take place at the level of the world economy, rather than the level of a particular country or even a particular sector of the economy.

What the international community in its own interest should be concerned with is not a reduction of price fluctuations but rather a reduction of negative effects that are inflicted on the world economy by fluctuations of commodity prices. Only then here is a case for an international intervention. A strong case can be built on detrimental effects that fluctuations in export revenue of developing countries have on the welfare of the world economy. Note that the concern here is not with variations of export prices but rather with variations of export revenue.

It is worth remembering that changes in prices may or may not result in changes in revenue. If the elasticity of demand with respect to price is one, then the revenue will be constant, whatever the price. When demand is relatively elastic, a higher price will result in a smaller revenue; and just the opposite will happen when demand is inelastic.

Practically speaking, it can be safely assumed that all price fluctuations will result in fluctuations in export earnings. One may expect that fluctuations in export revenue would be detrimental to the growth of developing countries. They necessitate an adjustment, lead to a reduction of imports, force reversals of economic policies, and create uncertainty about the overall performance of the economy. These costs are social in their character. Moreover, the consequences of fluctuations in export earnings can almost never be internalized within an individual country but spill over into the world economy. A reduction of exports lead to balance of payments difficulties, which require cutting down on imports, or devaluation or imposition of controls. Whatever the policy tool will be applied, the adjustment process will also affect trading partners of the country experiencing the difficulties. This transmission of the initial disturbance makes it an international problem, and calls for a joint action on the part of all members of the international community. There are gains to be had for the world economy as a whole from stabilizing export earnings of developing countries that stem from randomness of production processes. The size of this fund should be related to the aggregate cost of adjustment of developing and industrialized countries which would have to be incurred in the absence of such a fund. It is worth repeating that only random reductions in the earning power should call for international assistance. In practice, it may be difficult to distinguish between a random drop in income from exports and one resulting from, say, an expansionary policy which causes domestic producers to supply for the domestic market rather than the international market.

As for institutional arrangements in this regard, there already exists, at the IMF, the so-called Compensatory Financing Facility. This facility was created in 1963 with the specific purpose of extending loans to countries facing balance of payments difficulties brought about by a shortfall in their export earnings. Until December 1975 the facility played a rather limited role, however, and only with the liberalization of the conditions of access the drawings have increased dramatically, reaching SDR 2,3 billion in 1976. A similar scheme was established by the European Economic Community at the 1975 Lomé Convention. The access to STABEX, the conventions facilities to stabilize export earnings of certain primary commodities, is limited to 52 countries, and compensations are made in relation to shortfalls of export earnings of specified commodities supplied to the European Economic Community.

It would seem most desirable to further co-operation between developed and industrialized countries in the area of stabilizing the latter's export earnings. The need for this co-operation exists particularly now when prospects for buffer stocks and the Common Fund do not seem too bright. In fact, it is rather a compensatory financing facility than commodity agreements that is the first best policy. Negative effects of risk are reduced or compensated for, with minimum intervention in the market and with minimum administrative apparatus required to handle the problem.

The kind of risk and uncertainty introduced into international functioning of economics by nature is not the only type of risk and uncertainty to be encountered in reality. Mankind has demonstrated an ability to produce its economic risk. The behaviour of policy-makers can easily introduce uncertainty into the economy. The reasons for this may be either the ignorance of policy-makers or their trying to mislead the public on purpose. The first reason is self-evident and it does not require any examples. The best example of the second case is unanticipated inflation. From the perspective of the last ten years, it appears clear now

that one can generate real effects in the economy to the extent that inflation itself is not perceived by economic agents. The experience shows that it is very tempting for policy-makers to increase the rate of inflation in order to reduce the unemployment rate. The temptation often becomes irresistible at the periods immediately preceding elections. As soon as inflation becomes fully anticipated, positive employment effects disappear. The next step is to try to escalate the inflationary pressure even further or return to the initial situation. In any case, one tends to observe a great deal of fluctuations and reversals in the way macro-economic policies are conducted. The net effect of it all is general uncertainty and increase in risk associated with engaging in economic activities.

From the point of view of international trade and capital movements, risk and uncertainty concerning inflation and exchange rates impose a real cost on the world economy. It should be pointed out that elimination or at least reduction of risk stemming from behaviour of policy-makers often does not involve any social cost. All that is usually required in this regard is to have policies publicly announced and then follow them through. The scope for co-operation between developed and industrialized countries is, in this case, enormous. Developing countries could themselves make an important contribution to this co-operation by stabilizing their even economic conditions, as well as setting consistent and uniform policies in regard to foreign investment and foreign trade. The Bonn Summit of July 1978 addressed this issue concluding: "The co-operation of the developing countries in creating a good investment climate and adequate protection for foreign investment is to play its effective role in generating economic growth and in stimulating the transfer of technology".

The last type of risk and uncertainty that may impair North-South relations stems from the absence of international rules of behaviour. The grey areas of international relations where there are no clear-cut, or universally accepted, principles of conduct is rapidly growing. As countries attempt to solve their economic problems on the individual basis, they erode the existing international order. The consequences of this process are quite obvious. What seems important to remember, however, is that the world economic system with no rules of behaviour, tends to favour stronger countries. An example that demonstrates this point with a particular force concerns Article XIX of the General Agreement on Tariffs and Trade (GATT). The article recognizes the need for safeguard restrictions on the part of a country which has suffered an injury to its industry; and stipulates conditions under which safeguard actions can be taken. In recent years Article XIX has become practically inoperative as countries have tried to resolve the issue of safeguard procedures outside the framework of the GATT. Voluntary Exports Restrictions and Orderly Marketing Agreements have sprung into being. These types of agreements favour industrialized countries which have much stronger bargaining power than developing countries.

The social cost of eliminating risk and uncertainty that result from the lack of rules of behaviour should be negligible. Of course, it is political cost that makes the process of rebuilding the international economic order so difficult.

Adjustment to structural changes

The pattern and the level of international trade reflect the competitiveness of trading countries, their relative factor endowments, demand conditions, and other structural factors. In addition, commercial policies, and other economic policies may also have bearing on the intensity with which countries trade or even directions of the trade flows. The structural factors are the fundamental determinants of international trade; economic policies are only distortions. With the passage of time, structural factors tend to change - countries grow at different rates, there are changes at differential speeds. In the dynamic context, both the pattern of international trade and the intensity of trade may change. There is no such thing as the natural comparative advantage.

Structural changes occur all the time, but sometimes the pace of the process quickens. One has an impression that during the last decade or so the process of change has accelerated. The most profound structural change that has taken place is the emergence of a number of developing countries as extremely efficient producers of industrial goods. One hopes that this process is just the beginning of the rapid industrialization of the Third World. The table below is intended to show the magnitude and the dynamics of the problem.

Table 2: Export performance of developing countries classified according to the value of manufactures (excluding petroleum products).

Value of exports 1976 (million dollars)	Number of countries	Value of exports (million dollars)		Growth rates (percentage) 1976 - 1970
		1976	1970	
More than 1,000	8	20,339	4,382	29
500 to 4,000	3	1,829	585	21
100 to 500	15	3,252	871	25
50 to 100	9	660	357	11
30 to 50	12	470	165	19
20 to 30	14	339	145	15
10 to 20	10	143	117	3
5 to 10	8	56	14	26
1 to 5	19	46	24	11
Less than 1	15	7	4	10
Total	113	27,145	6,703	26

Source: Review of Recent Funds and Developments in Trade in Manufactures and Semi-Manufactures, UNCTAD, TD/B/C.2/190, Geneva, March 1978.

The data clearly shows a rapid increase in the value of manufactures exported by developing countries to industrialized market-economy countries. The average rate of growth during the 1976-1970 period was 26 per cent. What is even more striking is that there is by now a substantial number of developing countries with sizeable exports of manufactured goods.

There were 26 countries whose value of exports of manufactures exceeded \$100 million in 1976. Industrial exports from the South are no longer limited to a few "lucky" countries.

In discussing exports of manufactures by developing countries, one must not lose the sense of proportions. Though there has been a remarkable performance, the share of the South in industrial trade remains on the low side. In 1976, the share of developing countries in the world trade of manufactures amounted only to 7 per cent. Even more revealing is the fact that industrialized countries satisfy only 2 per cent of their consumption of manufactured goods through imports from less developed countries.

The resistance that industrial exports from the South encounter in the markets of the North suggests that developed countries are not prepared to accept ongoing changes in their comparative advantage.

Space limitations do not permit a detailed discussion of factors which have contributed to the change in the relative competitive position of developing countries. Broadly speaking, however, these factors can be divided into two groups. The first group embraces developments which have increased efficiency with which certain products can now be produced. Most of these positive developments have taken place in the South and include the abandonment of import substitution policies, a greater reliance on the market, adoption of modern technology, increase in the quality of the labour force. Most of the negative developments have taken place in industrialized countries, and these are basically the structural factors discussed earlier in connection with the determinants of high rates of unemployment. Distortions in the labour, commodity and capital markets have led to a substantial loss of efficiency in industrialized countries.

The difficulties of sectors such as footwear, steel, and shipbuilding industries have been self-inflicted, and only at the margin can they be linked with exports from developing countries. In other words, the structural problems in industrialized countries would have existed even if there were no international trade. It follows that protection of the domestic market can not be a solution in these problems. In any case, that developing countries have become more efficient producers can be only viewed as benefiting the world economy. The change in comparative advantage means that the world resources, when re-allocated, can produce more. In the long-run, developing and industrialized countries must benefit as a result of this change.

The problem of reallocation of world resources should constitute a major area of co-operation between the North and the South. While the long-run benefits to all are obvious, one must also see short-run costs. The short-run costs of adjustment constitute a legitimate concern for policy makers in industrialized countries. Although, given enough time, labour and capital can be moved from one industry to another, in the short-run factors of production are specific. The specificity of factors of production means in the extreme that, when a particular industry reduces its scale of production, the factors of production which are released in the process are not employable elsewhere. For this reason trade adjustment assistance programmes have been used by many countries. While the legitimacy of these programmes can not be questioned, it must be born in mind that their dual purpose should be to reduce hardship resulting from increased imports, but at the same time they should lead to a

structural adjustment. If the latter objective is not fulfilled, adjustment assistance becomes a tool of protection rather than an instrument of promotion of orderly international trade.

It goes without saying that a degree of co-ordination of the relevant policies between industrialized and developing countries would be desired in order to ease the adjustment process. One of the critical elements of this co-ordination should be matching the speed of expansion of industrial exports from developing countries with the speed of dismantling inefficient industries in industrialized countries. This procedure should prevent excessive over-supply of the product during the transition period and eliminate unnecessary price fluctuations. One way of achieving this goal would be through specifying the duration of adjustment assistance programmes and linking the eligibility for the assistance with the progress in moving out of the industry in question. To give a concrete example, a programme could be at the outset designed to last five years, and only those firms which cut production every year by 20 per cent of the base-year level would continue to be eligible for assistance. The contribution of developing countries in this case would consist of "holding back", i.e. limiting their exports expansion during the transition period.

In the context of restructuring North-South trade, there is also need for co-operation among developing countries. It is evident that the resistance of industrialized countries towards export expansion from developing countries has something to do with the abruptness of changes. Bearing this in mind, but also for other reasons, developing countries should avoid moving all into the same industry, but rather specialize in different products.

Balance of payments adjustment and monetary disequilibrium

The analysis of economic relations between the North and the South usually focuses on structural changes and trends in real variables. As a general proposition, one knows that developments and disturbances in the real sector lead to changes in the monetary sector. Monetary disequilibria usually signify real disequilibria. It may be useful to turn now to the monetary aspects and implications of the problems discussed earlier, and also investigate the possibility of co-operation in the monetary sphere between the North and the South.

Disequilibrium in the balance of payments of developing countries often constitutes a binding constraint on growth of these countries. The figures in Table 3 show that since 1973 the current account deficit of most of developing countries has deteriorated rapidly. When all developing countries are taken together, the balance of payments position of the whole group is distorted by the spectacular increase in the earning power of the oil-exporting countries. As far as non-oil-exporting countries are concerned, the current account deficit increased from \$11.2 billion in 1973 to \$29.0 billion in 1974 and then to \$40.5 billion in 1975. Difficulties in equilibrating the current account have been also encountered by fast growing exporters of manufactured products.

Table 3: Balance on goods, services and private transfers, 1971-1976, Billions of U.S. dollars

Groups of countries	1971	1972	1973	1974	1975	1976
All developing countries	-12.9	-12.0	-6.6	+38.3	-2.6	+14.2
Major petroleum exporters	+1.5	+0.2	+4.6	+67.3	+37.9	+44.1
Non-oil exporting developing countries	-14.4	-12.2	-11.2	-29.0	-40.5	-29.9
Fast growing exporters of manufactures	-3.7	-2.9	4.1	-9.8	-11.3	...

Source: Handbook of International Trade and Development, Supplement 1977, United Nations, New York, 1978, p.178.

One of the important causes of the disequilibrium stems directly from the oil crises. It is, however, not the only cause or perhaps not even the most important one. The balance of payments difficulties of developing countries have been greatly magnified by the economic slow-down and the emergence of protectionist tendencies in industrialized countries.

The immediate result of the North-South disequilibrium with regard to payments was a very substantial buildup of the external debt of developing countries. At present the outstanding debt of the South is approaching \$300 billion. It is most revealing that some of the fastest growing and most successful developing countries are among the major debt owners. Brazil and Mexico account for about 20 per cent of the total external debt of the non-oil producing developing countries. In the case of the industrializing developing countries, the increase in the debt reflects not only the export difficulties which these countries are facing in industrialized countries but also increased imports which were often necessary for the process of industrialization.

It must be said, that in general there is nothing wrong with a country becoming a net debtor. At any given time, the financial position of a country should be a function of its present stage of economical development, future prospects, time preferences, capital market conditions and so on. It is quite logical that at the early stage of development, there is a natural tendency for developing countries to become importers of capita. In fact, many of the new industrialized countries were in the past capital importers.

If markets were functioning smoothly, then a country would change from a debtor to a creditor if it so decided. It is the ease with which countries may change their external financial position that raises questions with regard to present circumstances.

The only way in which developing countries may pay their external debt is through expansion of trade. The expansion of trade can only materialize if the rest of the world is willing to accept increased exports from developing countries. If there is no supply constraint on the part of the developing countries, it is the degree of the openness of the market in the North that will determine the ability of the South to pay off its debts.

As Harald Mangren puts it "... the debt problem is really a different problem from what it is usually thought to be. It is not so much a financial problem as it is a trade-creation problem".

In recent years a number of industrialized countries have given debt relief to developing countries. Holland was the first country to take the initiative; Sweden, Canada and Switzerland soon followed. It seems very likely that other countries will cancel at least part of the debt of developing countries. While the debt cancellation is often a great relief to countries in need, it does not address the problem at hand. It is much more preferable that developed countries be given export opportunities. It is only through the opening of the markets in the North that the real cause of the monetary disequilibrium will disappear. The co-operation between the North and the South should concentrate on ways of expanding trade, rather than on finding measures compensating for restrictiveness of trade.

One can not of course make a claim that if only international trade were liberalized there would be no problem of balance of payments adjustments. Even if completely free trade prevailed, there would still be room for persistent balance of payments surpluses and deficits. Nevertheless it is important to distinguish between long-run imbalances which are a result of structural changes and short-run disequilibria which may be a result of random shocks or aggregate demand policies. With regard to co-operation between the North and the South to eliminate short-run balance of payments fluctuations, two issues assume particular importance at the present time:

1. The asymmetry in sharing the burden of adjustment
2. Fluctuations of exchange rates

The international monetary system, even as it stands now, has a very strong built-in bias, which imposes the burden of adjustment on deficit countries to a much greater extent than it does on surplus countries. This bias comes from two sources. First, foreign exchange reserves of any country are finite; second, the IMF may have some influence on the course of economic policy in deficit countries, and no influence whatsoever on surplus countries. Thus, in as much as a deficit country is forced to ask for financial assistance from the IMF, the adjustment usually involves a reduction in aggregate demand and income in the deficit country. It would much benefit developing countries if their share in the burden of adjustment would be reduced through expansionary aggregate demand policies in industrialized countries. One must however recognize that this approach to the balance of payments adjustment contains an inflationary bias. Clearly, in some cases a monetary or fiscal expansion in developed countries would result in a higher real income with no or little inflationary pressure. In other cases, however, the stimulus would lead to inflation without much of real growth. Perhaps, the optimal policy is to maintain the level of aggregate demand in surplus countries and apply expenditure switching policies. Changes in relative prices; brought about by tariff reductions, elimination of subsidies and so on, would shift domestic demand towards foreign goods.

The question of fluctuations in exchange rates is related to the problem of risk and variations in export earnings. Given our earlier discussion, the implications of instability in foreign exchange markets for developing countries should be obvious. Erratic movements of exchange rates are also detrimental to industrialized countries. It is in the

interest of the world economic system to eliminate excessive movements of exchange rates. The major effort in this area should be made among developed countries in close collaboration with the OPEC countries.

We have now identified and discussed in some detail four major areas where co-operation of economic policies between the North and the South would be beneficial. One must ask, however, what form should this co-ordination take, how detailed it should be and how much of countries' freedom in economic decision making must be surrendered in the process.

Any involvement in international trade reduces the scope for independent economic policies, and forces trading countries to accept certain rules of conduct. Co-operation between the North and the South should aim at establishing rules according to which individual members of the international community would formulate and execute their economic policies. In that, the North-South co-operation constitutes a limitation to national policies.

Individual countries do not easily give up their independence in economic policies, not even when there are obvious benefits to be had. The experience of economic integration among developing countries, as well as among developed and socialist countries has taught us this lesson. Even the present drive of the OECD countries to co-ordinate their economic policies raises the question of how effective these efforts can be.

It can be taken for granted that the difficulties encountered among small groups of countries would be only magnified if the co-ordination of economic policies were to be done at the world level. The implication that follows is that only very loose co-ordination of national policies is feasible. An important element of this effort would be making national economic policies known. This is a minimum that should be achieved. Under present circumstances, there is a visible tendency in a number of countries to move in this direction for domestic reasons alone. One observes, particularly in industrialized countries, a general dissatisfaction with the performance of governments, and one of the ways in which this dissatisfaction surfaces is through demands of general public that the governments be more open in accounting for their policies. Economists have been arguing for a long time that stability of domestic economy requires stability of economic policy. By making economic policies known, the governments could also learn whether their policies were consistent with intentions and plans of other countries. Lack of consistency would call for some process of reconciliation of national policies to avoid tensions and disturbances in the world. Co-ordination of economic plans would be particularly important with regard to demand management policies and also structural and industrial policies.

Another lesson to be learnt from the experience of economic co-operation is that the effectiveness of efforts to dismantle barriers is much greater than the effectiveness of efforts to establish a joint policy. While it may be next to impossible to have a food policy for the world as a whole or an energy policy, it is probably feasible to formulate policies that aim at elimination of barriers to international trade and investment. Indeed, the success of post-World War II economic co-operation among nations lies precisely in this area. The time has come to get this process going again.

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PROSPECTS FOR FURTHER INDUSTRIALISATION OF DEVELOPING COUNTRIES
THROUGH EXPORTS OF MANUFACTURES

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TABLE OF CONTENTS

	<u>Page</u>
<u>CHAPTER 1: THE GROWTH OF WORLD TRADE IN MANUFACTURES</u>	159
<u>CHAPTER 2: THE EFFECT OF EXPORTS OF MANUFACTURES ON INDUSTRIAL GROWTH</u>	167
<u>CHAPTER 3: THE EFFECTS OF ECONOMIC DEVELOPMENT ON THE STRUCTURE OF TRADE IN MANUFACTURES</u>	170
<u>CHAPTER 4: A PROJECTION OF TRADE PATTERNS IN THE YEAR 2000</u>	172
<u>CHAPTER 5: SCOPE FOR EXPORTS OF PARTICULAR TYPES OF MANUFACTURES TO THE DEVELOPED COUNTRIES</u>	177
<u>CHAPTER 6: SOME POLICY IMPLICATIONS</u>	186
<u>Annex 1: Estimated Regression Equations</u>	188
<u>Annex 2: The Implication of the Trade Projection for the Achievement of the Lima Target</u>	189

LIST OF TABLES

	<u>Page</u>
Table 1: Network of Trade in Manufactures (M goods), 1960, 1970 and 1974	160
Table 2: Network of Trade in Labour-intensive Manufactures (L goods), 1960, 1970 and 1974	162
Table 3: Network of Trade in Capital-intensive Manufactures (C goods), 1960, 1970 and 1974	163
Table 4: Share of Developing Countries as Suppliers of M, L and C Goods to each Importing Area, 1960, 1970 and 1974	164
Table 5: Major Exporters of Manufactures in 1974. Classified by per capita GDP in that year.	165
Table 6: Rates of growth of exports of manufactures and of manufacturing output, selected developing countries, 1967-73	168
Table 7: L/M ratios for imports and exports by per capita GDP levels. Groups of countries, 1974	171
Table 8: Trade project for Group 4 countries in year 2000	172
Table 9: Trade projection for Groups 1, 2, 3 and 4 in year 2000	176
Table 10: Imports of Manufactures from Developing Countries as a percentage of Apparent Consumption in Major Developed Market Economy Countries, 1959-60, 1967-68, 1969-70, 1973-74 and 1975	178
Table 11: Imports of Manufactures by OECD Countries from Developing Countries per \$1,000 of GDP in all OECD Countries Combined, by Product Groups, 1967 and 1975	181
Table 12: Imports of Manufactures from Developing Countries by Selected Developed Countries per \$ 1,000 of GDP in each Importing Country, 1967 and 1975	184
Table A.1. Alternative estimates of shares in manufacturing value added in 2000	191

CHAPTER 1: THE GROWTH OF WORLD TRADE IN MANUFACTURES

During the past 30 years the volume of world trade has grown at an unprecedented rate. Between 1948 and 1978 the volume of exports by market economy countries rose by a multiple of 7.5, equivalent to an average rate of increase of nearly 7 per cent per annum. Although world trade suffered a setback in 1975, following the sharp rise in oil prices, the volume of world exports has resumed its previous rate of increase during the past three years. Over the thirty-year period the volume of world exports of manufactures has risen even faster than the total volume of exports. Between 1948 and 1978 the volume of exports of manufactures by market economy countries increased more than tenfold, equivalent to an average rate of increase of more than 8 per cent per annum.^{1/} As in the case of total exports, exports of manufactures have also resumed their previous upward trend since 1975, although with slightly less buoyancy.

Exports of manufactures by developing countries^{2/} began to grow at a brisk pace during the 1960s, the volume increasing by 186 per cent between 1960 and 1970 (equivalent to 11.1 per cent per annum), and by a further 99 per cent between 1970 and 1975 (equivalent to 14.8 per cent per annum). The rate of increase between 1960 and 1970 was about the same as for the exports of manufactures by developed market economy countries; but in the period since 1970 developing country exporters of manufactures made considerably greater progress than the industrialized countries. Between 1970 and 1976 the volume of exports of manufactures from developing countries to developing and developed market-economy countries more than doubled, while exports of manufactures from the developed market-economy countries to the same two groups of countries rose by a little more than 50 per cent.^{3/}

Some more detail about the network of trade in manufactures is given in tables 1-3. Since trade flows in these tables are measured in US dollars at current prices and current exchange rates, they reflect price and exchange rate movements as well as changes in the volume of trade. In Table 1, the definition of manufactures excludes iron and steel (SITC 67) and non-ferrous metals (SITC 68), since exports of these products from developing countries usually contain only a small proportion of manufacturing value added.^{4/}

^{1/} Manufactures are here defined as SITC Nos. 5+6+7+8.

^{2/} For the sake of brevity, the term "developing countries" is used to cover both developing countries and territories. The definition of this group varies slightly in different sets of published statistics. In this section, which is based on standard United Nations statistics of foreign trade, developing countries exclude all countries of southern Europe.

^{3/} These estimates are derived from the United Nations Monthly Bulletin of Statistics, June 1978, Special Table G. If exports of non-ferrous metals are excluded, the volume of exports of the remainder of SITC Nos. 5-8 by developing countries rose by nearly 150 per cent over this period.

^{4/} On a wider definition of manufactures, as used by the Committee on Manufactures of UNCTAD, many processed primary products could reasonably be included from other sections of the SITC than sections 5-8, such as canned foods, drink and tobacco products and refined petroleum products. In that case iron and steel products and non-ferrous metals would also logically be included.

Table 1: Network of Trade in Manufactures (M goods),
1960, 1970 and 1974^{1/}

A. Value of trade

(\$ billion, f.o.b., at current prices and exchange rates)

From	To	World	DMEC	DC	CPE	CPA
World	1960	58.48	33.31	17.13	5.90	1.21
	1970	173.11	118.81	35.86	16.05	1.33
	1974	411.52	277.61	92.11	35.82	3.74
DMEC	1960	48.91	31.35	15.34	1.18	0.17
	1970	147.24	110.87	30.15	4.59	0.66
	1974	347.48	252.67	77.42	13.10	2.50
DC	1960	2.49	1.34	1.08	0.06	0.03
	1970	9.17	5.69	3.05	0.40	0.03
	1974	29.16	18.52	9.62	0.85	0.10
CPE	1960	6.42	0.62	0.53	4.21	1.00
	1970	15.65	2.05	2.08	10.84	0.67
	1974	32.22	5.45	3.87	21.42	1.15
CPA	1960	0.70	0.05	0.19	0.46	-
	1970	1.04	0.23	0.60	0.22	-
	1974	2.68	1.02	1.20	0.46	-

B. Rates of growth of value of trade

(average percentage per annum)

World	1960-70	11.46	13.56	7.67	10.53	0.95
	1970-74	24.17	23.64	26.60	22.23	29.50
DMEC	1960-70	11.65	13.46	6.99	14.55	14.53
	1970-74	23.94	22.87	26.59	29.98	39.51
DC	1960-70	13.92	15.56	10.94	20.89	0.00
	1970-74	33.54	34.32	33.27	20.74	35.12
CPE	1960-70	9.32	12.70	14.65	9.92	-3.93
	1970-74	19.79	27.69	16.79	18.56	14.46
CPA	1960-70	4.04	16.49	12.19	-7.11	-
	1970-74	26.70	45.12	18.92	20.25	-

Source: UNCTAD, Handbook of International Trade and Development Statistics,
and 1977 Supplement, United Nations, New York.

^{1/} M goods are defined as SITC Nos. 5+6+7+8-(67+68).

The products covered by Table 2 (SITC Nos. 6+8 - (67+68)) are predominantly labour-intensive manufactures, such as textiles, footwear, clothing, precision instruments, and toys and games, in the export of which countries with low labour costs and a limited knowledge of advanced technology are especially competitive. Table 3 covers the other products (SITC Nos. 5 and 7), which are predominantly capital-and-technology intensive, namely chemicals, machinery and transport equipment.^{1/} For convenience, these three categories of manufactured goods will be referred to below as M goods, L goods and C goods respectively. Developing countries' shares in world exports of each of these categories to each group of countries are given in Table 4.

In 1960, out of world exports of M goods valued at \$58.5 billion, the developed market-economy countries supplied \$48.9 billion, the centrally planned economies of Europe \$6.4 billion, and the developing countries only \$2.5 billion. Hence, the developing countries' share of world exports of M goods in that year was only 4.3 per cent. From 1960 to 1970 the value of developing countries' exports of M goods to the world rose at an average rate of nearly 14 per cent per annum, and from 1970 to 1974 at 33.5 per cent per annum.^{2/} These rates of growth were significantly higher than the corresponding rates of growth of exports from other groups of countries, and by 1974 the developing countries' share of world exports of M goods had risen to 7.1 per cent.

Although the greater part of developing countries' exports of M goods has always gone to the developed market-economy countries, exports to other developing countries have also been substantial. Indeed, the developing countries' share of world exports to developing countries was higher in each of the years 1960, 1970 and 1974 than their share of world exports to the developed market-economy countries. Not only is intra-trade in M goods between developing countries already important, but it is likely to become of increasing importance in the future.^{3/} On the other hand, developing countries' exports of M goods to the centrally planned economies are still of very small absolute value (less than \$1 billion in 1974) and the developing countries' share of world exports to these countries is much smaller than the corresponding shares of exports to the other groups. This suggests that in the future there should be considerable scope for expansion of exports of manufactures from developing countries to the centrally planned economy countries, especially to the more highly industrialised members of this group.

1/ There are several exceptions to this description of the products covered by SITC Sections 5 and 7. Chemical exports from developing countries are sometimes only simply processed primary products, such as vegetable extracts. Others, such as aluminium oxide from bauxite are capital-intensive but have a low proportion of manufacturing value added. Vehicle assembly is often a labour-intensive activity, although it requires a high level of organisational technology to be successful. Some kinds of machinery, especially small electrical and electronic machines and appliances, require a great deal of semi-skilled labour for their assembly, and this part of the operation can be carried out competitively in developing countries. Recent rapid growth in exports of these products from developing countries account for most of the increase in the export values for developing countries shown in Table 3. It should also be noted that part of the developing country exports of items in Section 7 consists of second-hand machinery and transport equipment which is being shipped back to its country of origin or elsewhere for repair or reconditioning.

2/ These rates of growth of trade values exceed the corresponding rates of growth of trade volumes because of price increases, which were especially great after 1972.

3/ As will be seen below, exports of manufactures from developing countries are likely to grow at a faster rate than exports of manufactures from industrialised countries. Since the GDP of the developing countries will also grow more rapidly, their share of exports from other developing countries is unlikely to fall. Hence intra-trade will increase in relative importance.

Table 2: Network of Trade in Labour-intensive Manufactures
(L goods), 1960, 1970 and 1974^{1/}

A. Value of Trade

(\$ billion, f.o.b., at current prices and exchange rates)

From	To	World	DMEC	DC	CPE	CPA
World	1960	23.19	14.12	6.45	2.19	0.29
	1970	61.56	44.99	11.22	4.94	0.26
	1974	141.92	105.26	25.50	10.01	0.77
DMEC	1960	18.52	12.75	5.29	0.28	0.05
	1970	49.20	39.24	8.34	1.40	0.13
	1974	111.59	88.85	18.28	3.79	0.50
DC	1960	1.97	1.10	0.82	0.05	0.02
	1970	6.89	4.56	1.97	0.35	0.01
	1974	19.06	13.02	5.22	0.73	0.05
CPE	1960	2.07	0.25	0.18	1.42	0.22
	1970	4.62	1.05	0.42	3.00	0.14
	1974	9.07	2.61	0.97	5.10	0.23
CPA	1960	0.65	0.04	0.17	0.44	-
	1970	0.85	0.17	0.50	0.19	-
	1974	2.22	0.80	1.02	0.39	-

B. Rates of growth of value of trade

(average percentage per annum)

World	1960-70	10.26	12.29	5.69	8.47	-1.09
	1970-74	23.22	23.68	22.78	19.31	31.18
DMEC	1960-70	10.26	11.90	4.66	17.46	10.03
	1970-74	22.72	22.67	21.68	28.27	40.04
DC	1960-70	13.33	15.28	9.16	21.48	-6.70
	1970-74	28.97	29.09	27.59	20.17	49.53
CPE	1960-70	8.36	15.43	8.84	7.77	-4.42
	1970-74	18.37	25.56	23.28	14.19	13.21
CPA	1960-70	2.72	15.57	11.39	-8.05	-
	1970-74	27.13	47.29	19.51	19.70	-

Source: As for Table 1.

^{1/} L goods are defined as SITC Nos. 6+8-(67+68).

Table 1: Network of Trade in Capital-intensive Manufactures
(C goods), 1960, 1970 and 1974^{1/}

A. Value of trade

(\$ billion, f.o.b., at current prices and exchange rates)

From	To	World	DMEC	DC	CPE	CFA
World	1960	35.29	19.19	10.68	3.71	0.92
	1970	111.55	73.82	24.64	11.11	1.07
	1974	269.60	172.35	66.61	25.81	2.97
DMEC	1960	30.39	18.60	10.05	0.90	0.12
	1970	98.04	71.63	21.81	3.19	0.53
	1974	235.89	163.82	59.14	9.31	2.00
DC	1960	0.52	0.24	0.26	0.01	0.01
	1970	2.28	1.13	1.08	0.05	0.01
	1974	10.10	5.50	4.40	0.12	0.05
CPE	1960	4.35	0.37	0.35	2.79	0.79
	1970	11.03	1.00	1.66	7.84	0.53
	1974	23.15	2.84	2.90	16.32	0.92
CFA	1960	0.05	0.01	0.02	0.02	-
	1970	0.19	0.06	0.10	0.03	-
	1974	0.46	0.22	0.18	0.07	-

B. Rates of growth of value of trade

(average percentage per annum)

World	1960-70	12.20	14.42	8.72	11.59	1.52
	1970-74	24.68	33.61	28.23	23.46	29.08
DMEC	1960-70	12.43	14.43	8.06	13.49	16.01
	1970-74	24.55	22.98	28.32	30.70	39.38
DC	1960-70	15.93	16.76	15.30	17.46	0.00
	1970-74	45.08	48.53	42.07	24.47	49.53
CPE	1960-70	9.75	10.45	16.84	10.88	-3.91
	1970-74	20.36	29.82	14.97	20.12	14.78
CFA	1960-70	14.28	19.62	17.46	4.14	-
	1970-74	24.74	38.88	15.83	23.59	-

Source: As for Table 1

^{1/} C goods are defined as SITC Nos. 5+7.

Table 4: Share of Developing Countries as Suppliers of M, L and C Goods to each Importing Area, 1960, 1970 and 1974^{1/}
(imports from DC as percentage of total imports of each category of goods by each area)

<u>Importing area</u>		<u>1960</u>	<u>1970</u>	<u>1974</u>
World	M goods	4.26	5.30	7.09
	L goods	8.50	11.19	13.43
	C goods	1.47	2.04	3.75
DMEC	M goods	4.02	4.79	6.67
	L goods	7.79	10.14	12.37
	C goods	1.25	1.53	3.19
DC	M goods	6.30	8.51	10.44
	L goods	12.71	17.56	20.47
	C goods	2.43	4.38	6.61
CPE	M goods	1.02	2.49	2.37
	L goods	2.28	7.09	7.29
	C goods	0.27	0.45	0.46
CPA	M goods	2.48	2.26	2.67
	L goods	6.90	3.85	6.49
	C goods	1.09	0.93	1.68

Source: As for Table 1.

^{1/} M goods: SITC Nos. 5+6+7+8-(67+68).
L goods: SITC Nos. 6+8-(67+68).
C goods: SITC Nos. 5+7.

From Tables 2 and 3 it can be seen that the larger part of developing countries' exports of manufactures (M goods) consist of labour-intensive (L) goods. In 1960 capital-intensive (C) exports from developing countries were valued at only \$0.5 billion (part of this being lightly processed chemical products and second-hand machinery and transport equipment) compared with nearly \$2 billion of L exports. By 1974, however, the relative importance of C exports had increased substantially. In that year total C exports from developing countries were valued at \$10.1 billion, compared with L exports of \$19.1 billion. A large part of this increase in C exports consisted of electrical and electronic machines and appliances assembled in developing countries.

The developing countries' share of world exports of L goods is very much larger than their share of world exports of C goods: 8.5 per cent as against 1.5 per cent in 1960, rising to 13.4 per cent and 3.8 per cent respectively in 1974 (see Table 4). These differences in the shares of L and C goods imported from developing countries exist for each importing area, but they are especially large in the case of imports by the centrally planned economies of Europe. The developing countries' share of C imports by these countries in 1974 was less than 0.5 per cent.

Because economic development and industrialisation are related characteristics, most developing countries have only recently become significant exporters of manufactures. But there is now a substantial number of developing countries which have made some progress in this

direction. Table 5 lists all countries which exported at least \$100 million of M goods in 1974, grouped according to their per capita GDP in that year. In Group 1, which covers countries with a per capita GDP of less than \$500 in 1974, there were eight developing countries; and in Group 2, which covers countries with a per capita GDP of \$500-\$1,200 in 1974, there were a further eight developing countries, on the usual definition, and one country, Turkey, which is sometimes classified as industrialised. The per capita GDP range of Group 3 is wider, rising up as far as \$3,000. Within this group there are eight countries which are usually counted as developing, or nine if Yugoslavia is included. If countries in Group 4, having a per capita GDP in 1974 of \$3,000 or more, are all treated as developed, there were in 1974 at least 24 developing countries with exports of M goods valued at \$100 million or more, while the total number of countries in Groups 1, 2 and 3 with this level of exports of M goods was 32.^{*/} There remains, of course, a large number of developing countries which are not yet significant exporters of manufactures. Most of these are either small in population or have started from a very low level of per capita income. But it is probable that, within the next 20 years, the majority of these countries will become exporters of manufactures to the rest of the world. (The remaining columns of Table 5 will be discussed in section 3 below.)

Table 5: Major Exporters of Manufactures in 1974.
Classified by per capita GDP in that year^{1/}

Country	Exports of M goods in 1974 ^{2/} (\$ million)	Exports of L goods in 1974 ^{3/} (\$ million)	L/M ratio (per cent)	GDP <u>per capita</u> in 1974 \$
<u>Group 1: Countries with per capita GDP less than \$500 in 1974</u>				
Bangladesh	229	229	100.0	205
Egypt	379	341	90.0	295
India	1,930	1,587	82.2	144
Korea (Rep.)	3,318	2,555	77.0	484
Morocco	200	145	72.3	362
Pakistan	569	543	95.4	164
Philippines	263	213	90.4	355
Thailand	341	308	90.5	325
<u>Group 2: Countries with per capita GDP \$500-\$1,200 in 1974</u>				
Brazil	1,769	898	50.7	1,017
Chile	105	46	43.5	756
Colombia	391	286	73.2	528
Costa Rica	105	57	54.1	865
Lebanon ^{4/}	333	166	49.8	-
Malaysia	539	340	63.1	779
Mexico	1,065	497	46.7	1,120
Tunisia	189	64	33.7	637
Turkey	322	274	85.0	769

^{*/} On a broader definition of manufactures, which includes processed primary products from Section 0-2 of the SITC, but excludes refined petroleum products and unwrought non-ferrous metals, the number of developing countries which exported more than \$100 million of manufactures in 1974 would be considerably greater.

^{1/} The countries included in the table are those with total exports of M goods in 1974 valued at \$100 million or more (except Angola, a large proportion of whose exports of M goods were precious and semi-precious stones, SITC 667).

^{2/} M goods: SITC Nos. 5+6+7+8-(67+68).

^{3/} L goods: SITC Nos. 6+8-(67+68).

^{4/} Exports in 1973.

Table 5 (continued)

Country	Exports of M goods in 1974 ^{1/} (\$ million)	Exports of L goods in 1974 ^{2/} (\$ million)	L/M ratio (per cent)	GDP per capita in 1974 \$
<u>Group 3: Countries with per capita GDP \$1,200-\$3,000 in 1974</u>				
Argentina	824	314	38.1	1,988
Bahrain	171	48	28.0	-
Greece	691	534	77.5	2,099
Hongkong	4,320	3,556	82.3	1,631
Iran	262	190	72.6	1,454
Ireland	1,216	710	58.4	2,208
Italy	22,710	9,904	43.6	2,754
Jamaica ^{5/}	415	21	5.0	1,396
Portugal	1,571	1,088	69.3	1,496
Singapore ^{6/}	2,240	672	30.0	2,318
South Africa	1,163	719	61.8	1,301
Spain	4,258	2,148	50.4	2,472
Trinidad and Tobago	108	30	27.5	1,801
Venezuela	118	43	36.6	2,234
Yugoslavia	2,223	956	43.0	-
<u>Group 4: Countries with per capita GDP \$3,000 or more in 1974</u>				
Australia	1,842	514	27.9	6,470
Austria	5,166	2,814	54.5	4,358
Belgium-Luxembourg	16,270	7,301	44.9	5,489
Canada	13,648	3,757	27.5	6,755
Denmark	4,171	1,527	36.6	5,973
Federal Republic of Germany	68,069	17,958	26.4	6,139
Finland ^{7/}	3,896	2,717	69.7	4,773
France	28,366	9,782	34.5	5,037
Israel ^{8/}	1,374	963	70.1	4,099
Japan	40,509	11,208	27.7	4,130
Kuwait ^{9/}	526	64	12.1	12,526
Netherlands	16,806	5,578	33.2	5,226
New Zealand	273	151	55.6	4,431
Norway	3,324	974	29.3	5,888
Sweden	10,559	3,661	34.7	6,884
Switzerland	10,465	3,997	38.2	7,355
United Kingdom	29,166	9,940	34.1	3,420
United States	59,481	12,502	21.0	6,639

Sources: Trade data derived from UNCTAD, Handbook of International Trade and Development Statistics, Supplement 1977, United Nations, New York 1978, Tables 4.1 and 4.2. Estimates of per capita GDP from 1977 Statistical Yearbook, United Nations, New York 1978, Table 193.

- ^{5/} Exports of M goods mainly aluminium oxides or hydroxides, i.e. processed bauxite.
^{6/} The figures include substantial quantities of re-exports, especially to Malaysia.
^{7/} More than half of exports of L goods were paper and paperboard.
^{8/} Two-thirds of exports of L goods were pearls and precious and semi-precious stones (SITC 667).
^{9/} Exports of M goods were mainly petrochemical products.

CHAPTER 2: THE EFFECT OF EXPORTS OF MANUFACTURES ON INDUSTRIAL GROWTH

Exports of manufactures stimulate the process of industrialization in three main ways. First, there is the direct effect of an increase in the output of goods for export on the industries which produce those goods. These industries include not only the final processors, but also the industries which produce inputs for use by the final processors. An increase in exports of a single type of manufactured product may, therefore, stimulate activity in a wide range of industries which supply inputs for that produce either directly or indirectly.^{1/}

Secondly, an expansion of manufacturing activity, whatever its original cause, tends to promote further expansion of manufacturing. This is because the firms whose markets have grown improve their technical capacity (through learning-by-doing), and at the same time receive a flow of additional profits, which both encourages and facilitates an expansion of their productive capacity. Thus technical progress, profitability, investment, and more efficient production through economies of scale advance hand in hand, and reinforce one another. In this manner, industries which have gained a foothold in foreign markets strengthen their position in the domestic market; and vice versa.

Thirdly, an expansion of any kind of exports normally improves a country's balance of payments, thus providing some relaxation of the balance-of-payments constraint on increases in domestic demand, as well as improving the country's creditworthiness as a future borrower of foreign funds for investment.

Although it is possible for a large country to develop its industry to a certain level without relying on the export market, this path of development is not open to small countries (which constitute the majority of the developing countries), nor is it a path which can be pursued indefinitely with satisfactory results even in a large country. Sooner or later, all countries turn their attention to the export market in order to obtain the benefits of division of labour, specialization and economies of scale. A developing country which establishes itself at an early stage as a significant exporter of manufactured goods is more likely to grow rapidly and to industrialize efficiently than one which tries to isolate itself from the outside world.

These general propositions may be tested empirically by examining the relation between the rate of increase of exports of manufactures and the growth of manufacturing output in a sample of developing countries. Table 6 lists twenty countries with per capita GDP of less than \$800 in 1967 for which suitable data are available. The period covered by the export data is 1967-72, when exports of manufactures from developing countries were making better progress than in the early 1960s but prices had not yet begun the steep rise which has persisted since 1973. On the average, unit values of exports of manufactures (SITC Nos. 5-8) by all market economy countries rose by less than 2 per cent per annum over this period, so that changes in the value of exports of manufactured goods - other than lightly processed primary products - can be taken to indicate approximately the changes in export volumes of those goods.

^{1/} These repercussions in the manufacturing sector will be less important where a primary product is only lightly processed for export. But, where the local processing of a primary product is an essential condition for selling that product on the world market, an increase in exports of the processed product helps to stimulate activity in the primary sector.

Table 6: Rates of growth of exports of manufactures and of manufacturing output, selected developing countries, 1967-73

Country ^{1/}	Average percentage rate of growth per annum		
	Exports of manufactures ^{2/}	Manufacturing output ^{3/}	
	1967-72 (1)	1967-72 (2)	1968-73 (3)
Argentina	26.9	7.71	7.85
Brazil	35.6	12.65	12.81
Colombia	26.5	7.82	8.45
Egypt	15.7	6.58	5.41
El Salvador	7.3	3.29	4.80
Guatemala	16.3	3.68	6.75
India	10.9	5.73	4.70
Iran	24.5	13.73	12.63 ^{5/}
Kenya	14.4	3.54	9.05
Korea (Rep.)	44.8	19.85	20.37
Malaysia	19.6 ^{4/}	11.50 ^{4/}	13.34
Mexico	27.4	7.42	7.42
Morocco	23.0	5.43	6.62
Pakistan	3.0	7.80	6.75
Philippines	13.6	5.86	5.90
Portugal	15.0	9.26	9.26
Singapore	25.4	18.24	18.04
Syrian Arab Republic	12.3	7.61	8.45
Tunisia	8.1	5.92	6.09
Yugoslavia	14.8	9.10	9.14

Sources: Exports of manufactures: Yearbooks of International Trade Statistics, United Nations United Nations, New York. Manufacturing output: 1976 and 1977 Statistical Yearbooks, United Nations, New York.

1/ Countries included are those with the following characteristics: (a) exports of manufactures in 1967 worth at least \$15 million; (b) GDP per capita in 1967 less than \$800; (c) having an official idea of manufacturing output. The following three countries were excluded for special reasons: Greece, because its per capita GDP in 1967 was only slightly less than \$800; Chile, because its exports of manufactures during 1967-72 were predominantly processed mineral products; South Africa, because it has most of the characteristics of a developed rather than a developing country.

2/ In this table manufactures consist of SITC Nos. 5+6+7+8-(667+68). SITC 67 (iron and steel products) was included, because for the countries in the sample iron and steel products were not predominantly processed iron ore.

3/ Derived from published indexes of manufacturing output.

4/ 1968-72.

5/ Estimated.

Exports of manufactures may be expected to affect the level of manufacturing output of the exporting country both immediately and with some time lag, for the reasons given above. Column (2) of the table shows average rates of growth of manufacturing output for the same period as is covered by the export growth rates in column (1), while column (3) shows corresponding growth rates of manufacturing output in the period 1968-73. The correlation coefficient between column (1) and column (2) is 0.686, and that between column (1) and column (3) is 0.719. (Further details on these regression equations are given in annex 1). Although these results indicate that only about half of the variation in growth rates of manufacturing output can be explained statistically by this relation (the value of r^2 for the second regression is 0.52), this is quite a good result for a cross-section test on a sample of countries of such widely differing characteristics.

CHAPTER 9: THE EFFECTS OF ECONOMIC DEVELOPMENT ON THE STRUCTURE OF TRADE IN MANUFACTURES

While exports of manufactures promote the growth of manufacturing industry in the exporting country, and hence the general level of economic development of that country, a rising level of economic development in turn affects the availability of skills, the level of real wages, and the level of technical capacity of the country, and hence the pattern of its international trade in manufactured goods. Countries in which skilled labour and management are scarce, and technical knowledge is relatively backward, cannot expect to produce efficiently a wide range of the more sophisticated manufactured products. Such countries must, therefore, largely confine their exports of manufactures to relatively simple labour-intensive products, which can be produced efficiently in small or medium-sized plants.^{1/} For the production of this type of product they have the considerable advantage of a plentiful supply of semi-skilled labour which, because of the generally low level of real incomes in the country, is available at a correspondingly low real wage.

The line of division between products which are (a) labour-intensive and require a relatively simple technology and (b) capital-and-skill-intensive and using a more advanced technology is not permanently fixed. As a result of new technical inventions, products which were previously considered labour-intensive may subsequently be produced by capital-intensive methods; and there are perhaps some examples of movements in the other direction. In recent years, with improvements in transport and communications, it has become practicable to divide up processes in the production of certain products, and to arrange for the labour-intensive parts of such processes to be carried out in countries with an ample supply of semi-skilled labour. In general, but with some exceptions, the products which can be produced most competitively in developing countries are those which are listed in Sections 6 and 8 of the SITC, while the products which it is most difficult for them to produce competitively are those listed in Sections 5 and 7 of the SITC.^{2/}

The conclusions drawn in the previous paragraph are supported by empirical evidence on the structure of international trade in manufactures of countries at different levels of per capita GDP. As can be seen from inspection of columns (3) and (4) of Table 5, there is a tendency for the ratio of export of L goods to exports of M goods (the L/M export ratio) to decline as the per capita GDP level rises across countries. Similar data on the L/M ratio for imports (not given in the table) show the opposite tendency: the L/M import ratio rises as the per capita GDP level rises. These results are summarised for countries in different groups of per capita GDP in Table 7. It will be seen that between groups 1 and 2 there is virtually no change in the L/M import ratio but a sharp fall in the L/M export ratio. In groups 2, 3 and 4, however, there is a more consistent inverse change in the two ratios as the level of per capita GDP rises.

^{1/} The main exception is the capital-intensive processing of local raw materials usually in plants designed and managed by foreign companies.

^{2/} Exceptions include paper and paperboard (SITC 64) and iron and steel (SITC 67) in Section 6, and certain types of electrical assembly in Section 7. Developing countries can also produce competitively many types of products based on locally produced primary products, e.g. food, drink and tobacco products, refined petroleum, vegetable extracts, and refined non-ferrous metals.

Table 7. L/M ratios for imports and exports by per capita GDP levels. Groups of countries, 1974

Country group <u>1/</u>	Mean per capita GDP (\$)	Mean L/M ratio for imports (%)	Mean L/M ratio for exports (%)
1	187	23.8	83.1
2	867	23.0	57.4
3	2,047	30.6	51.1
4	5,557	38.4	31.0

1/ The groups of countries are defined in Table 5, which also lists the major exporters of M goods in each group. The figures in this table give the averages for all countries in each group, including those not listed specifically in Table 5. The following petroleum-export exporting countries are excluded from the groups for the purposes of the estimates shown in this table: Bahrain, Brunei, Kuwait, Libya, Netherlands Antilles, Saudi Arabia and Trinidad and Tobago.

The great importance of this relationship between per capita GDP and the structure of trade in manufactures lies in its implications for the future pattern of trade between rich and poor countries. It can be expected that under normal conditions the real per capita GDP of almost all countries will rise substantially over the next 20 years. If the L/M ratios which were typical in 1974 at each level of per capita GDP apply to the same real per capita levels of GDP in the future, it will mean that the L/M import ratios for the richer countries will rise while the L/M export ratios for the same countries will decline. And this implies that, unless there is a most improbable reduction in the ratio of M imports to M exports in these countries, the balance of trade in L goods between these countries and the rest of the world must shift in the direction of an increasing net import of L goods from the rest of the world. Since the poor countries have a natural advantage in producing L goods, this shift in the pattern of trade will open up considerable opportunities for exports of L goods by poorer countries to richer countries.

During the next 20 years or so a number of the present group of developing countries, especially those which have already achieved a medium level of industrialisation, will reach levels of industrialisation and of per capita GDP which are similar to those of today's industrialised countries. As a consequence, their L/M import ratios will rise and their L/M export ratios will fall; the relative importance of the net L exports of these countries will decline; and consequently there will be more room for countries at a lower level of per capita GDP to supply L goods to the world market. This was the pattern of changes which was followed by the countries which were the first to industrialise. The same pattern can be observed in the history of Japan during the past 30 years; and there are signs of similar changes in the structure of trade of the developing countries which are currently growing at the greatest speed.

There is, therefore, no basis for the belief that, because exports of certain types of L goods from developing countries are now predominantly supplied by a few countries, this situation will continue indefinitely. The per capita GDP levels of the dynamic exporters are rising rapidly; and their real wage levels are growing in a similar fashion. They will, therefore, be forced gradually to yield some of their share of exports of L goods to other countries at a lower level of per capita GDP. Since, however, the level of technical expertise of these countries is increasing along with their general economic development, they will be able to make up for the decline in the proportionate importance of L goods in their export trade by an increasing proportion of C goods.

CHAPTER 4: A PROJECTION OF TRADE PATTERNS IN THE YEAR 2000

World trade in manufactures is dominated at the present time by the industrialised countries, especially by those in Group 4 (with per capita GDP in 1974 in excess of \$3,000); and consequently the prospects for future exports of manufactures by developing countries depend very greatly, although not entirely, on the future pattern of trade of the Group 4 countries. It is useful, therefore, to consider in the first instance the likely changes during the period ending in 2000 in the trade in manufactures of the Group 4 countries. Estimates for this projection are given in Table 8, and are discussed in detail below.

The 1974 figure, for GDP, population and trade used in the construction of this table are taken from standard sources, but the original trade figures, obtained by summation of the individual countries' data, have been slightly adjusted in order to make total exports and imports of M and L goods by market economy countries correspond to the aggregates shown in Tables 1 and 2. The L/M ratios for 1974 have already been given in Table 7.

Table 8. Trade projection for Group 4 countries in year 2000

	1974 data	Rate of growth 1974-2000 (per cent per annum)	2000 projection in 1974 prices
GDP per capita (\$)	5,557	3.0	11,984
Imports of M goods (\$ billion)	264	5.5	1,060
Exports of M goods (\$ billion)	320	5.5	1,286
Net export of M goods (\$ billion)	56	5.5*	226
L/M import ratio (%)	38.4	..	48
L/M export ratio (%)	31.0	..	25
Imports of L goods (\$ billion)	101	6.4*	509
Exports of L goods (\$ billion)	99	4.6*	322
Net export of L goods (\$ billion)	-2	..	-187
Net export of C goods (\$ billion)	58	7.8*	413

Sources: GDP per capita in 1974 derived from estimates of GDP and population for members of Group 4 in United Nations Statistical Yearbooks.

Imports and exports of M and L goods in 1974 derived from UNCTAD, Handbook of International Trade and Development Statistics, Supplement 1977, United Nations, New York 1978, Tables 4.1 and 4.2, adjusted to ensure that total imports and exports of M and L goods by market economy countries correspond to the data given in Tables 1 and 2 above.

Rates of growth, and L/M ratios in 2000: see text.

* Derived from the figures in the other two columns.

The crucial assumptions for the projection are those in respect of (1) the rate of growth of per capita GDP, (2) the rates of growth of imports and exports of M goods, and (3) the levels of the L/M ratios in 2000. A fairly low estimate has been chosen for the rate of growth of per capita GDP (3 per cent per annum) in order to illustrate how the pattern of trade will change even if real income levels in the developed countries rise at a moderate rate. A more rapid growth of per capita GDP, as a result of either a faster growth of GDP or a slower growth of population, would produce an even greater increase in net imports of L goods by the Group D countries. The assumed rate of growth of both imports and exports of M goods (5.5 per cent per annum) is also on the low side. If both the rates of growth of imports and exports were to be higher, with the same rate of growth of per capita GDP, net imports of L goods in 2000 would be even larger than the figure given in the table.^{1/} The only way in which net imports of L goods could be lower, with the same rate of growth of per capita GDP, would be if imports of M goods were to grow more slowly than exports of M goods. This would imply that the richer countries would have an even larger net export of M goods in 2000 than the \$226 billion shown in the table. But a movement in this direction seems unlikely to be acceptable to the developing countries, since it would imply an increasing degree of dependence on the industrialised countries for their supplies of manufactures. Moreover, it is inconsistent with the objective of substantially raising the share of developing countries in world output of manufactures.

The last two important assumptions required for the projection concern the L/M ratios in 2000. These have been derived from the relation between each L/M ratio and per capita GDP for Groups 2, 3 and 4 in 1974, extrapolated to cover the estimated per capita GDP level of Group 4 in 2000.^{2/} In view of the estimate that the per capita GDP of Group 4 will more than double to nearly \$12,000 by the year 2000 (even with a modest rate of growth of 3 per cent per annum) it is hardly surprising that the Group's L/M import ratio should rise from 38.4 per cent in 1974 to 48 per cent in 2000, while its L/M export ratio falls from 31 per cent to 25 per cent. Already in 1974 the L/M import ratio for the Federal Republic of Germany was over 49 per cent and for the United Kingdom and Switzerland over 45 per cent, while on the export side, as can be seen in Table 5, the United States had an L/M ratio in 1974 of 21 per cent and the ratios for Australia, Canada, the Federal Republic of Germany and Japan were all below 28 per cent. If anything, therefore, the assumptions that in 2000 Group D will still have an L/M import ratio below 50 per cent and an L/M export ratio as high as 25 per cent probably underestimate the degree to which Group 4 countries will become net importers of L goods in that year.

It seems likely, therefore, that by year 2000 Group 4 countries will have a net import demand for L goods of nearly \$200 billion in 1974 prices, an enormous increase in comparison with the net import demand for L goods in 1974 of only \$2 billion. In 1974 the centrally planned economies of Europe had a net import demand for L goods of nearly \$1 billion (see Table 2), and this figure may also be expected to grow considerably by 2000 if these

^{1/} For example, if the rates of growth of imports and exports of M goods were to be 6 per cent per annum, net imports of L goods in 2000, with the given L/M ratios, would be \$212 billion; and if the rates of growth were to be as high as 7 per cent per annum, net imports of L goods in 2000 would be \$272 billion.

^{2/} Details of the regression equations underlying these estimates are given in Annexe 1.

countries are playing their natural part in the international division of labour. Thus, net exports of L goods from the poorer countries in 2000 may well exceed \$200 billion in 1974 prices. Some part of these exports will be supplied by the centrally planned economies of Asia. If, as seems likely, China begins to play a much larger part in international trade than at present, a substantial share of the total may come from that country. But there will remain a large net demand for L goods from countries in Groups 1, 2 and 3. Some of these countries, especially those in Group 3, will soon be fully industrialised countries (some are already officially classified as such), and their structure of trade will move increasingly in the direction of eliminating any net export of L goods, or of creating a net demand for L goods. Hence, it may be expected that approximately the whole of the net import of L goods by Group 4 will be drawn either from the centrally planned economies of Asia or from the countries in Groups 1 and 2.

The implications of these expected changes in the pattern of trade are outlined in a full projection for all market economy countries in Table 9. A projection of this complexity is more likely to be subject to error than a projection for a single fairly homogeneous group of countries. Nevertheless, the projection serves the useful purpose of bringing together various strands in the argument and providing a check on their mutual consistency.

As in the case of the previous projection for Group 4, the results depend heavily on the assumptions made with respect to the rates of growth of per capita GDP and of imports and exports of M goods. There is more certainty, however, about the L/M ratios for Groups 1, 2 and 3, since the per capita GDP levels for these groups in 2000 fall within the range covered by per capita GDP levels of the four groups in 1974. The assumed rates of growth of GDP and of imports and exports of M goods must be reasonably consistent with one another, and with the prospect that there will be a large net import demand for L goods by Group 4 in year 2000. When all the relevant information is put together, it becomes clear that, if a major share of the net demand for L imports by Group 4 in 2000 is to be supplied by Groups 1 and 2, exports of manufactures by these groups of countries must grow at rapid rates, which are assumed to be 15 per cent per annum for Group 1 and 14 per cent per annum for Group 2. These rates of growth of exports of M goods imply, from the relation between columns (1) and (3) of Table 6, that manufacturing output in these two groups of countries must increase by about 8.5 per cent per annum and 8.3 per cent per annum respectively. These figures are approximately consistent with the assumed annual rates of growth of GDP in these two groups of countries of 7 per cent and 6 per cent respectively.^{1/}

The projection suggests that, of the net import demand for L goods by Group 4 in 2000 of \$187 billion, \$135 billion will be supplied by Group 1 and \$13 billion by Group 2. Group 3 will be roughly self-sufficient in L goods, an export of \$105 billion being offset by an import of \$107 billion. The balance of \$41 billion of net import demand for L goods by Group 4,

^{1/} Before applying the Table 6 relationship to the assumed rates of growth of exports of M goods, these were increased by 2 per cent to convert them approximately to the current value measure of exports which is used in Table 6.

plus some additional amount required by the petroleum-exporting countries listed in the footnote to Table 9, must be met either by supplies from the centrally planned economies of Asia or by additional supplies from Groups 1 and 2. The combination of a large net export of M goods by Group 4 (to pay for imports of primary products and services, as well as to represent the real counterpart of continuing financial outflows to the poorer countries) with a large net import of L goods implies that Group 4 will be exporting very large quantities of C goods, i.e. chemicals, machinery and transport equipment, the bulk of the net export of which will go to the poorest group of countries.^{1/}

Although there is a certain risk in making a numerical projection of events as far distant as the end of this century, the projection presented in Table 9 will have served its purpose if it illustrates the nature and magnitude of the probable changes in the pattern of trade which are implicit in the continued growth in levels of per capita GDP in all groups of countries.

^{1/} Implicitly, the net export of C goods by Groups 1, 2, 3 and 4 combined will be taken by the petroleum-exporting countries and the centrally planned economy countries, especially those in Asia.

Table 9. Trade projection for Groups 1, 2, 3 and 4 in year 2000^{1/}

<u>1974 data</u>	<u>Group 1</u>	<u>Group 2</u>	<u>Group 3</u>	<u>Group 4</u>
GDP per capita (\$)	187	867	2,047	5,557
Imports of M goods (\$ billion)	23.1	26.9	50.0	264
Imports of L goods (\$ billion)	5.5	6.2	15.3	101
L/M ratio (%)	23.8	23.0	30.6	38.4
Exports of M goods (\$ billion)	8.3	5.4	41.9	320
Exports of L goods (\$ billion)	6.9	3.1	21.4	99
L/M export ratio (%)	83.1	57.4	52.1	31.0
<u>Projected rates of growth 1974-2000</u> (Per cent per annum)				
GDP	7.0	6.0	5.0	3.75
GDP per capita	1.8	3.5	3.3	3.0
Imports of M goods	12.0	8.0	7.0	5.5
Exports of M goods	15.0	14.0	8.0	5.5
<u>L/M ratios in 2000 (%)</u>				
Import ratio	23	30	37	48
Export ratio	75	45	34	25
<u>Projection for year 2000 in 1974 prices</u>				
GDP per capita (\$)	633	2,121	4,761	11,984
Imports of M goods (\$ billion)	440	199	290	1,060
Exports of M goods (\$ billion)	314	163	310	1,226
Net export of M goods (\$ billion)	-126	-36	20	509
Imports of L goods (\$ billion)	101	60	107	509
Exports of L goods (\$ billion)	236	73	105	322
Net export of L goods (\$ billion)	135	13	-2	-187
Net export of C goods (\$ billion)	-261	-49	22	413

Sources: As for Table 8.

^{1/} The following predominantly petroleum-exporting countries have been excluded: Bahrain, Brunei, Kuwait, Libya, Netherlands Antilles, Saudi Arabia and Trinidad and Tobago.

CHAPTER 5: SCOPE FOR EXPORTS OF PARTICULAR TYPES OF MANUFACTURES TO THE DEVELOPED COUNTRIES

Up to this point emphasis has been laid on the greater competitive capacity of developing countries in the supply of L goods in comparison with C goods, especially in their trade with the industrialised countries. But it is also useful to look more closely at the types of goods which developing countries have shown that they can supply competitively, at the changes in their market shares over recent years, and at the differences in their market shares in different industrialised countries.

Because of the ready availability of statistics of imports into the industrialised countries, market shares are often expressed in terms of import shares. But this is an inadequate measure of the importance of supplies from developing countries to the final market. A more appropriate measure is the share of imports from developing countries in the apparent consumption of each commodity or group of commodities. Estimates of this type for selected categories of manufactures have been made by UNCTAD and they are reproduced in Table 10. The range of products included as manufactures in this table is wider than M goods, since it includes food, drink and tobacco products, refined petroleum products and ferrous and non-ferrous metals. The industrialised countries covered by the analysis are limited to the six original members of EEC, United Kingdom, United States and Japan.

The most striking figure in this table is the estimate that, even in 1975, the proportion of apparent consumption in all manufactures supplied to these nine countries by developing countries was no more than about 2 per cent. This was, however, an improvement over the position in 1959-60, when the proportion was 1.2 per cent. When the product groups are examined separately, it becomes apparent that the market share supplied by the developing countries varies widely. In clothing, their share in 1975 had reached 8.63 per cent, an impressive rise in comparison with the 1.02 per cent of 1959-60. Next in order in that year was petroleum and coal products, with 4.86 per cent; but this represented little change in comparison with the 4.39 per cent of 1959-60. The market share for ferrous and non-ferrous metals was 3.45 per cent in 1975, a modest increase over 1959-60, and a fall in comparison with certain years in the late 1960s and early 1970s. Despite much concern expressed about restrictions on imports of textiles by developed market economy countries, the developing countries' share of this market in the nine countries rose from 1.62 per cent in 1959-60 to 3.25 per cent in 1975. But the latter figure is still very small for a group of products which has considerable potential importance for developing countries.

The market shares for the other groups of products are all extremely small: 2.16 per cent for food, beverages and tobacco; 1.73 per cent for chemicals; 1.23 per cent for machinery and other manufactures; and less than 1 per cent for the remaining groups. But most of these low market shares have grown significantly since 1959-60, especially the share of machinery and other manufactures, which was only 0.14 per cent in 1959-60.

Table 10: Imports of Manufactures from Developing Countries as a percentage of Apparent Consumption in Major Developed Market Economy Countries, 1959-60, 1957-68, 1969-70, 1973-74 and 1975

Groups of products and importing countries ^{1/}	1959-60	1967-68	1969-70	1973-74	1975
<u>All manufactures</u>					
EEC (6)	1.46	1.36	1.49	1.62	1.78
United Kingdom	3.64	2.74	2.80	3.35	3.94
United States	0.73	0.93	1.09	1.93	2.01
Japan	1.16	1.17	1.40	1.80	1.81
All the above	1.20	1.21	1.37	1.91	2.01
<u>Food, beverages and tobacco</u>					
EEC (6)	2.06	1.63	1.72	1.63	1.57
United Kingdom	7.61	4.57	4.64	5.46	7.38
United States	1.29	1.24	1.24	1.69	1.53
Japan	3.08	1.50	1.87	2.20	4.06
All the above	2.11	1.63	1.70	1.96	2.16
<u>Textiles</u>					
EEC (6)	0.85	1.31	1.73	3.26	4.12
United Kingdom	5.16	4.52	3.88	6.36	5.41
United States	1.59	2.32	2.51	3.28	2.49
Japan	0.10	0.79	1.12	2.69	2.23
All the above	1.62	2.00	2.16	3.37	3.25
<u>Clothing</u>					
EEC (6)	0.56	1.34	2.16	4.15	6.41
United Kingdom	3.91	5.79	6.57	10.33	13.28
United States	0.77	2.27	3.80	6.19	9.98
Japan	0.71	1.12	2.80	8.50	9.13
All the above	1.02	2.19	3.39	5.84	8.63
<u>Wood products, paper and printing</u>					
EEC (6)	0.50	0.59	0.70	0.98	0.93
United Kingdom	1.29	1.28	1.34	1.84	1.58
United States	0.22	0.48	0.63	0.72	0.61
Japan	0.04	0.25	0.52	0.87	0.66
All the above	0.37	0.55	0.70	0.92	0.78
<u>Rubber</u>					
EEC	0.06	0.09	0.08	0.11	0.19
United Kingdom	0.14	0.31	0.54	0.17	0.18
United States	0.02	0.04	0.12	0.16	0.15
Japan	0.00	0.00	0.00	0.30	0.28
All the above	0.04	0.07	0.13	0.16	0.18
<u>Chemicals</u>					
EEC (6)	2.73	1.73	1.86	2.50	2.22
United Kingdom	2.85	2.36	2.84	3.44	4.02
United States	0.64	0.66	0.67	1.14	1.24
Japan	0.41	0.51	0.59	1.34	1.47
All the above	1.29	1.05	1.16	1.79	1.73

Table 10 (continued)

Groups of products and importing countries ^{1/}	1959-60	1967-68	1969-70	1973-74	1975
<u>Petroleum and coal products</u>					
EEC (6)	2.83	1.09	0.59	1.23	2.41
United Kingdom	19.63	8.56	6.62	8.58	7.86
United States	3.61	4.14	4.29	8.72	6.61
Japan	3.68	6.57	7.15	6.96	3.97
All the above	4.39	3.71	3.47	5.77	4.86
<u>Non-metallic mineral products</u>					
EEC (6)	0.03	0.03	0.03	0.06	0.14
United Kingdom	0.03	0.06	0.06	0.10	0.18
United States	0.10	0.19	0.24	0.36	0.43
Japan	0.00	0.00	0.02	0.14	0.15
All the above	0.07	0.10	0.12	0.19	0.25
<u>Ferrous and non-ferrous metals</u>					
EEC (6)	5.01	7.13	6.94	5.29	4.60
United Kingdom	6.63	8.08	8.14	6.69	6.74
United States	0.97	1.77	1.50	2.11	1.76
Japan	4.30	7.21	8.16	6.69	5.82
All the above	2.87	4.24	4.47	4.05	3.45
<u>Transport equipment</u>					
EEC (6)	0.13	0.08	0.07	0.22	0.22
United Kingdom	0.10	0.13	0.21	0.25	0.53
United States	0.00	0.01	0.04	0.17	0.20
Japan	0.34	0.21	0.11	0.07	0.07
All the above	0.05	0.06	0.07	0.18	0.21
<u>Machinery and other manufactures</u>					
EEC (6)	0.09	0.16	0.24	0.44	0.77
United Kingdom	0.77	0.79	1.17	1.56	1.96
United States	0.07	0.37	0.68	1.43	1.71
Japan	0.04	0.07	0.15	0.43	0.61
All the above	0.14	0.32	0.54	0.95	1.23

Sources: UNCTAD, Handbook of International Trade and Development Statistics 1972, United Nations, New York, 1972 and 1977 Supplement; United Nations, New York, 1978.

^{1/} Definitions of the products included in each category are given in the sources. Apparent consumption is defined as domestic output plus imports minus exports.

A comparison of market shares in the four separate markets shows that throughout the 1960s the developing countries' share of the United Kingdom market was more than twice as great as their share of the other markets, and even in 1975 their share of the United Kingdom market was still much greater than their share of any of the other three markets.^{1/} But the developing countries' share of the United Kingdom market has grown very little since 1959-60 while their shares of the United States and Japanese markets have improved considerably. The United Kingdom is more dependent on imports of primary products than many of the other industrialised countries, and this perhaps partly accounts for the higher shares of developing countries in the United Kingdom markets for food, drink and tobacco, wood products, paper and printing, chemicals, petroleum products, and ferrous and non-ferrous metals. Commonwealth economic relations may account for the higher shares of other product markets, such as textiles and clothing. But the developing countries' shares of the markets for the latter two groups of products in the other industrialised countries have grown very considerably; and there should be much scope for even further growth in the future.

The groups of products shown separately in Table 10 are rather broad; but more detailed estimates of apparent consumption are not available at present on a comparable basis for a substantial number of developed countries. The best alternative is to express detailed data on imports as a proportion of GDP for each of the industrialised countries. This ratio reflects two influences: the average propensity to consume each product; and the developing countries' market share. While it is not possible to use such ratios for comparisons between the developing countries' market shares for each product, they can be used to indicate where the developing countries have already achieved important successes, and especially the product groups for which the rate of growth of developing countries' exports has been most rapid in relation to total GDP in the importing countries.

A breakdown of imports of manufactures to the two-digit level of the SITC is given in Table 11, imports of each product group by all OECD members being expressed as so much per \$1,000 of GDP for the same group of countries.^{2/} In 1967, imports of goods in Section 6 (after excluding non-ferrous metals) represented nearly half of total imports of manufactures from developing countries; and nearly half of Section 6 imports were textiles. Clothing and non-metallic mineral manufactures n.e.s. were the next two most important two-digit groups of imports. But in the following eight years there was an important shift in the pattern of imports from developing countries. By 1975 the share of Section 6 in total imports of manufactures from developing countries had fallen to 28 per cent and the share of textiles to little more than 10 per cent. Non-metallic mineral manufactures were the least successful group in Section 6, their imports increasing in value at approximately the same rate as GDP. The only product groups in this section which rose rapidly in relation to GDP were rubber manufactures n.e.s., paper, paperboard and manufactures thereof, and manufactures of metal n.e.s.

^{1/} As will be seen below, there are considerable differences in this respect between the six original EEC countries, with low figures for France and Italy and higher figures for the other four countries.

^{2/} Because Australia, Finland and New Zealand were not yet members of OECD in 1967, their imports have been omitted in both years.

Table 11: Imports of Manufactures by OECD Countries from Developing Countries per \$1,000 of GDP in all OECD Countries Combined, by Product Groups, 1967 and 1975

<u>SITC No.</u>	<u>Description</u>	<u>Imports in US cents per \$1,000 of GDP in all OECD 1/</u>		<u>Average percentage change per annum</u>
		<u>1967</u>	<u>1975</u>	<u>1967-75</u>
5	Chemicals	29.23	43.22	5.01
51	Chemical elements and compounds	16.19	26.31	6.26
52	Crude chemicals from coal, petroleum and gas	0.24	0.30	2.83
53	Dyeing, tanning and colouring materials	1.01	0.74	-3.81
54	Medicinal and pharmaceutical products	3.62	5.06	4.28
55	Perfume materials, toilet and cleansing preps.	3.30	2.66	-2.66
56	Fertilizers, manufactured	1.88	3.63	8.57
57	Explosives and pyrotechnic products	0.29	0.31	0.84
58	Plastic materials, etc.	0.45	1.46	15.85
59	Chemical materials and products n.e.s.	2.14	2.75	3.18
6-68	Section 6 less non-ferrous metals	118.08	160.28	3.89
61	Leather, leather manufactures and dressed fur skins	7.78	11.43	4.93
62	Rubber manufactures n.e.s.	0.58	2.68	21.08
63	Wood and cork manufactures, excluding furniture	12.23	19.68	6.13
64	Paper, paperboard and manufactures thereof	0.77	2.37	15.09
65	Textile yarn, fabrics, made-up articles etc.	50.00	60.73	2.46
66	Non-metallic mineral manufactures n.e.s.	31.96	30.27	-0.68
67	Iron and steel	10.97	21.47	8.76
69	Manufactures of metal n.e.s.	3.15	11.94	18.12

1/ The countries covered are those which were members of OECD in 1967. Data for Australia, Finland and New Zealand are omitted in both years.

Table 11 (continued)

SITC No.	Description	Imports in US cents per \$1,000 of GDP in all OECD 1/		Average percentage change per annum 1967-75
		1967	1975	
7	Machinery and transport equipment	20.97	129.21	25.52
71	Machinery other than electric	5.02	29.93	25.00
72	Electrical machinery, apparatus and appliances	12.09	84.17	27.45
73	Transport equipment	3.85	15.10	18.63
8	Miscellaneous manufactured articles	73.60	242.32	16.06
81	Sanitary, plumbing, heating and lighting fixtures	0.93	1.40	5.25
82	Furniture	2.27	5.40	11.44
83	Travel goods, handbags and similar articles	2.26	8.18	17.44
84	Clothing	38.89	143.61	17.74
85	Footwear	4.77	23.02	21.74
86	Scientific, control instruments, photo goods, clocks	1.71	12.65	28.42
89	Miscellaneous manufactured articles n.e.s.	22.78	49.06	10.06
	Total of the above	241.82	575.03	11.43

Sources: Import values from Trade by Commodities, Series C, Imports, OECD, Paris. Imports by Canada and United States were increased by 8 per cent to adjust to c.i.f. value. GDP estimates from National Accounts of OECD Countries 1976, Vol. I, OECD, Paris 1978.

Imports of Chemicals (Section 5) from developing countries rose somewhat faster than imports of Section 6 products. But two groups in the chemicals section were especially sluggish - dyeing, tanning and colouring materials and perfume materials, toilet and cleansing preparations - and there was only one group - plastic materials - which showed a dynamism comparable with some of the product groups in later sections.

The most remarkable gains in this period were made by products in Sections 7 and 8. Total imports of machinery and transport equipment (Section 7) from developing countries rose six-fold in relation to GDP, from less than 21 cents per \$1,000 of GDP to \$1.29. The rate of growth was rapid in all three two-digit product groups, but the most important gains were made in imports of radios, televisions and parts thereof (included in SITC 724) and thermionic valves and tubes and transistors (included in SITC 729). By 1975 office machines (SITC 714) were also an important category of imports from developing countries.

In Section 8 the outstanding product group was clothing, imports of which rose from 39 cents per \$1,000 of GDP in 1967 to \$1.44 in 1975. But rapid growth occurred in almost all two-digit groups of Section 8, especially in scientific and control instruments, photographic goods and clocks, in footwear, and in travel goods, handbags and similar articles in addition to clothing. Total imports of Section 8 goods from developing countries increased more than threefold in relation to GDP over the period.

In spite of this surge of imports of manufactures from developing countries, total imports of manufactures (on the definition employed in Table 11) from developing countries in 1975 were still worth only \$5.75 per \$1,000 of GDP in the importing OECD countries. This ratio had more than doubled over a period of eight years; but it was still very small. For some specific goods, however, from developing countries had become of major importance in some importing countries. For example, in 1975 imports from developing countries supplied 55 per cent of the EEC domestic market for men's woven shirts, and 45 per cent of the market for women's blouses, while in the United States they supplied about half of the market for women's sweaters, about a quarter of the market for certain other items of clothing, and about half the market for radios and monochrome television sets.^{1/}

A cross-country comparison of the level of imports of manufactures from developing countries is made in Table 12. In each of the developed countries listed (which includes all OECD members with a per capita GDP in 1974 of \$3,000 or more, except Iceland and New Zealand) there was a significant increase in the ratio of imports of manufactures from developing countries to GDP. The proportionate increase was smallest for the United Kingdom and Norway which started from exceptionally high ratios in 1967. But in most other markets the ratio doubled or more than doubled in this period. The rate of growth of the ratio was especially rapid in the United States and France, both of which started from a rather low figure in 1967. Even in 1975 the ratios for Finland and France were still very low, and the

^{1/} See H. B. Chenery and D. B. Keesing, "The Changing Composition of Developing Country Exports", World Development Report 1978 Background Paper No. 5, mimeo, World Bank, 1978, p. 41.

Table 12: Imports of Manufactures from Developing Countries by Selected Developed Countries per \$1,000 of GDP in each Importing Country, 1967 and 1975^{1/}

	<u>Imports per \$1,000 of GDP</u>		<u>Average percentage change per annum 1967-75</u>
	<u>1967 (\$)</u>	<u>1975 (\$)</u>	
Australia	-	7.70	-
Austria	2.57	5.71	10.5
Belgium-Luxembourg	3.89	6.54	6.7
Canada	2.19	5.15	11.3
Denmark	2.48	5.03	9.2
Federal Republic of Germany	2.70	7.30	13.2
Finland	-	2.26	-
France	1.15	3.46	14.8
Japan	1.78	4.45	12.1
Netherlands	3.36	8.39	12.1
Norway ^{2/}	6.19	9.75	4.2
Sweden	2.93	6.15	9.7
Switzerland	4.17	6.58	5.9
United Kingdom	6.49	8.46	3.4
United States	2.08	6.45	15.2
Total above countries ^{3/}	2.39	5.91	12.0

Sources: Import values from Trade by Commodities, Series C, Imports, OECD, Paris. Data for Australia, Canada and United States were increased by 8 per cent to adjust to c.i.f. value.

GDP estimates from National Accounts of OECD Countries 1976, Vol. 1, OECD, Paris 1978, p.132.

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- ^{1/} Manufactures are defined in this table as SITC Nos. 5+6+7+8+-68.
- ^{2/} A large proportion of Norway's imports of manufactures from developing countries consists of aluminium oxides and hydroxides.
- ^{3/} Excluding Australia and Finland in 1967.

ratio for Japan was lagging behind in comparison with the ratios for other industrialised countries. For this group of countries as a whole, imports of manufactures from developing countries had reached a level of nearly \$6 per \$1,000 of GDP in 1975, the average ratio having more than doubled in eight years.

If all countries in this group had allowed their 1975 imports of manufactures from developing countries to rise to the same ratio to GDP as that obtaining in the Netherlands and United Kingdom in that year (about \$8.5 per \$1,000 of GDP), imports of this type by the group as a whole in that year would have been worth over \$30 billion, an increase of 44 per cent.

CHAPTER 6: SOME POLICY IMPLICATIONS

The main conclusion of this study is that, if the natural economic tendencies towards international specialisation and division of labour are allowed to continue, the pattern of trade in manufactures will move in a direction favourable to the growth of exports of manufactures from developing countries.^{1/} More specifically, the projection of these tendencies to the year 2000 suggests that exports of manufactures from developing countries could increase over this period at an average rate of 13 per cent per annum without causing insuperable difficulties to the industrialised countries.^{1/} An expansion of exports of manufactures of this magnitude would help to stimulate, by both its direct and its indirect effects, a rapid expansion of manufacturing output in the developing countries.^{2/}

But, if this encouraging prospect is to be realised, it will be necessary to ensure that the natural tendencies towards specialisation and trade are not inhibited, and even encouraged. This will require sustained efforts on the part of all countries and international agencies.

The first requirement is that developing countries should clearly recognise the importance to them of maintaining an export-oriented strategy and, more specifically, of developing their capacity to export manufactures. Some of the poorest countries are still near the beginning of this road; but the sooner the goal is accepted, the sooner results will follow. Some of the more advanced developing countries are still in the process of transition from a highly protected import-substitution strategy to an export-oriented strategy. These countries have the most to gain by expediting this transition.

A heavy responsibility falls on the industrialised countries to co-operate to the maximum of their ability in maintaining a steady process of restructuring the pattern of their trade relations with developing countries. Serious problems of internal adjustment, especially for the workers engaged in the labour-intensive manufacturing industries, may be eased to some extent by measures of adjustment assistance. Structural adjustments of the magnitudes involved will be facilitated if they proceed at a moderate speed and under orderly arrangements. It will be in the best interests of the group of developing countries as a whole if some restrictions are placed on over-rapid inflows of imports of particular products from a few suppliers.

The restructuring of manufacturing industry in the developed market economy countries will be more readily accepted by their workers and employers if those countries are able to maintain a high level of employment. One of the essential conditions for maintaining full

^{1/} The 13 per cent rate is an average of 15 per cent for Group 1, 14 per cent for Group 2 and somewhat more than 8 per cent for those countries in Group 3 which are classified as developing countries.

^{2/} The question whether this will be sufficient to achieve the Lima target is discussed in Annex 2.

employment is a reduction in the rate of inflation. This requires concerted efforts by governments, employers and trade unions in the developed market economy countries; but suppliers of important raw materials, especially petroleum, can also help to keep economic progress on a steady path if they adopt a responsible pricing policy.

The more developed among the centrally planned economy countries could provide a rapidly expanding market for exports of manufactures from developing countries. But this requires that the centrally planned economy countries should be willing to open their internal markets more widely to imports of labour-intensive products and processed primary products from the developing countries. Such a policy would be in the economic interests of both groups of countries.

Developing countries already engage in substantial volumes of trade in manufactures with one another; and this type of trade has been growing almost as rapidly as the exports of developing countries to other markets. There is enormous scope for further development of intra-trade in manufactures between developing countries, not only in labour-intensive goods but also in resource-based goods, chemicals and machinery. It is perhaps unfortunate that so much emphasis was placed at an earlier stage on the creation of regional trading blocs. Experience has shown that such blocs are not very helpful to trade and many of them have ceased to have any practical significance. It would be more useful if all developing countries would strive towards a lowering of tariffs and other barriers to trade with one another, preferably on a MFN basis.

Apart from their role in providing facilities for international discussion and negotiation, the international agencies can perform a most important function in improving channels of information about all matters relevant to trade. More detailed and up-to-date statistics could be collected about exports of manufactured goods from developing countries to each market, and about the degree of import penetration already achieved. Developing countries could be given more information about product designs and manufacturing techniques appropriate for exports and about methods of trading in each market. It would be useful to organise exhibitions in developing countries of the products which are sold successfully in other markets, especially but not exclusively the products supplied by other developing countries. A valuable form of technical assistance would be the establishment of reference libraries in developing countries, where trade and technical journals from all parts of the world could be freely consulted by potential exporters.

With a view to giving more emphasis to the practical role of the United Nations in promoting world trade in manufactures along lines which will benefit all countries, but especially the developing countries, an appropriate United Nations agency could be given responsibility for detailed monitoring of (1) current developments in trade in manufactures, (2) changes in trade policy, (3) changes in domestic policy relevant to trade (such as policies for export promotion and adjustment assistance) and (4) changes in product design or production technology which might affect the ability of developing countries to compete successfully in the supply of particular products. Relevant and up-to-date information on these and other matters could be published in a quarterly bulletin, designed for widespread dissemination to governments and interested firms in both developing and industrialised countries.

Annex 1Estimated Regression Equations1. Relation between change in manufacturing output and change in exports of manufactures

The data for these regressions, relating to 20 countries, are given in Table 6. If X denotes the average annual percentage change in exports of manufactures in the period 1967-72, Q_1 the average annual percentage change in manufacturing output in the period 1967-72, and Q_2 the average annual percentage change in manufacturing output in the period 1968-73, the estimated regression equations are:

$$(1) \quad Q_1 = 3.167 + 0.297X \quad r = 0.686 \\ (1.605)^+(0.074)$$

$$(2) \quad Q_2 = 3.462 + 0.300X \quad r = 0.719 \\ (1.481)^+(0.069)$$

r is the correlation coefficient and the figures in parentheses are the estimated standard errors of the corresponding regression coefficients.

2. Relation between L/M ratios and GDP per capita

The data for these regressions, relating to the three groups of countries 2, 3 and 4, are given in Table 7. If Y denotes the logarithm of GDP per capita, L_1 the logarithm of the L/M ratio for imports, and L_2 the logarithm of the L/M ratio for exports, the estimated regression equations are:

$$(1) \quad L_1 = 0.562 + 0.275Y \quad r = 0.994 \\ (0.101)^+(0.030)$$

$$(2) \quad L_2 = 2.773 + 0.336Y \quad r = -0.955 \\ (0.350)^-(0.105)$$

As before, r is the correlation coefficient and the figures in parentheses are the estimated standard errors of the corresponding regression coefficients.

Annex 2The Implication of the Trade Projection for the
Achievement of the Lima Target

The projection of exports of M goods in Table 9 is given for each of four groups of countries, classified by their per capita GDP in 1974. But the Lima target relates to the share of developing countries in world manufacturing output in the year 2000. Hence, the first step in exploring the implications of the trade projection for the achievement of the Lima target is to derive from Table 9 a projection of exports of M goods by developing countries. Developing countries comprise the whole of Groups 1 and 2, part of Group 3, and the petroleum exporters listed in the footnote to the table. The partitioning of the projected exports of Group 3 can be done only approximately, because the developing countries in this group are not representative of the whole group. But, on reasonable assumptions, the average projected rate of growth of exports of M goods by all developing countries which are members of Groups 1, 2 and 3 is about 13 per cent per annum. It is assumed below that this rate can also be applied to the whole range of developing countries, i.e. including the predominantly petroleum-exporting countries.

According to regression equation (2) in section 1 of Annex 1, a rate of growth of exports of M goods of 13 per cent (equivalent for the purpose of the equation to 15 per cent, to allow for the price increases operating during the period to which the equation relates) is consistent, on the average, with a rate of growth of manufacturing output of about 8 per cent.^{1/} But a somewhat higher rate is also possible. For example, a rate of 8.5 per cent or more would occur with a probability of 0.3, i.e. with nearly one chance in three.^{2/} Hence, with a moderate degree of optimism about the prospects for the growth of manufacturing output in developing countries, the rate of growth which is consistent with a 13 per cent rate of growth of exports of M goods may be assumed to be in the range of 8.0-8.5 per cent per annum.

While the rate of growth of manufacturing output in developing countries is one important factor determining the prospect for achieving the Lima target, it is not the only factor. The Lima target is assumed to mean that 25 per cent of world value added in manufacturing in 2000 will be produced in the countries which are at present classified as developing countries, with the centrally planned economy countries of Asia, of which the Peoples Republic of China is by far the most important, being excluded from both terms in the ratio. The share of the developing countries in this aggregate in 2000 will, therefore, depend on: (1) the respective shares of the developing countries (DC), the developed market economy countries (DMEC) and the centrally planned economy countries of Europe (CPE) in their combined value added in manufacturing in a base year, and (2) the average rates of growth of manufacturing over the period from the base year to 2000 in each of these groups of countries.

1/ $3.462 \times (.3 \times 15) = 7.962$.

2/ $Q_2 = 8.5$ per cent, with the intercept unchanged and $X = 15$, the coefficient on X rises to 0.036 which is 52 per cent of the estimated standard error of the coefficient. An increase of that amount or more can, on the usual assumptions, occur with a probability of 0.3.

Since the trade projections made in this paper start from the base year 1974, the same year has been chosen as the base for projecting changes in shares in manufacturing output. Estimates of the respective shares of the DC, the DMEC and the CPE in their combined value added in manufacturing in 1974 are given in the footnote to Table A.1. The same table also shows the effect on the DC share in 2000 of various alternative combinations (scenarios) of growth rates of manufacturing output.

It has been suggested above that the most likely rate of growth of manufacturing output in the DC is in the range of 8.0-8.5 per cent per annum. But it is now also necessary to consider what rates of growth of manufacturing output will obtain in the other two groups of countries. For the purpose of the trade projection it was assumed that in Group 4, which covers most of the DMEC, the average rate of growth of GDP over the period 1974-2000 would be 3.75 per cent per annum, while the average rate of growth of both imports and exports of M goods would be 5.5 per cent per annum. With the inclusion of additional DMEC from Group 3, comprising Ireland and the countries of Southern Europe, the corresponding projected rates of growth for all DMEC should be slightly increased. With these assumptions, the most probable rate of growth of manufacturing output in the DMEC seems to be in the region of 4.5 per cent per annum, but with the possibility that it might be as small as 4.0 per cent per annum.^{1/}

It is more difficult to make similar estimates for the CPE. During the past one or two decades the average rate of growth of manufacturing in these countries has exceeded 8 per cent; but there has been some sign of slackening in recent years and this trend will probably continue. It seems unlikely, however, that the average rate over the period 1974-2000 will fall below 5.5-6.0 per cent.

The implications of these projections of growth rates of manufacturing output for the three groups of countries for the achievement of the Lima target may be seen in Table A.1. If the DC growth rate is only 8.0 per cent and the DMEC and CPE rates are 4.5 per cent and 6.0 per cent respectively (scenario 1), the DC share in 2000 will be 16.4 per cent. A rise in the DC growth rate to 8.5 per cent, without any change in the other two growth rates (scenario 2), raises the DC share in 2000 to 18.2 per cent. If the DC growth rate is at the top of its expected range (8.5 per cent) and the other two groups of countries are at the bottom of their expected ranges (4.0 per cent for the DMEC and 5.5 per cent for the CPE), the DC share in 2000 will be 20.1 per cent. Our assumptions suggest that scenario 4 is the scenario which combines realism with a reasonable degree of optimism. Only if the DC growth rate were to rise to 9.5 per cent (scenario 7) would the Lima target be close to being achieved. But such a rate of growth, sustained over a quarter of a century, seems distinctly improbable.

^{1/} It is not appropriate to employ regression (2) of section 1 in Annexe 1 for making this estimate, since the regression was based on data for countries in Groups 1, 2 and 3, most of which are developing countries. The relation between growth of exports of manufactures and growth of output of manufacturing in the DMEC over the past two decades has consistently shown that the former rate tends to exceed the latter, while the rate of growth of manufacturing output normally exceeds the rate of growth of GDP, even if only by a small and diminishing margin.

Table A.1. Alternative estimates of shares in manufacturing value added in 2000^{1/}

	<u>Annual percentage rates of growth of manufacturing output, 1974-2000</u>			<u>Percentage shares of DC in</u>
	<u>DC</u>	<u>DMEC</u>	<u>CPE</u>	<u>2000</u>
Scenario 1	8.0	4.5	6.0	16.4
Scenario 2	8.5	4.5	6.0	18.2
Scenario 3	8.5	4.0	6.0	19.4
Scenario 4	8.5	4.0	5.5	20.1
Scenario 5	9.0	4.5	5.5	20.6
Scenario 6	9.0	4.0	5.5	22.1
Scenario 7	9.5	4.0	5.5	24.2
Scenario 8	9.5	4.0	5.0	24.9

^{1/} 1974 shares in manufacturing value added are assumed to be as follows:

DC 8.5 Per cent
DMEC 68.7 Per cent
CPE 22.8 Per cent

These shares are derived from the LIDO estimate of the DC share in 1975 of 9 per cent and the UNCTAD estimate of the CPE share in 1975 of 25.3 per cent. See "UNIDO World Industry Co-operation Model: The LIDO Scenario Generation Model", p. 10 and UNCTAD, "The dimensions of the required restructuring of world manufacturing output and trade in order to reach the Lima target", TD/185/Supp. 1, Table 1.

09634

BILATERALISM AS A POLICY OPTION

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TABLE OF CONTENTS

	<u>Page</u>
<u>CHAPTER 1: INTRODUCTION</u>	195
<u>CHAPTER 2: THE ANALYTICAL ISSUES</u>	196
<u>CHAPTER 3: THE EAST/SOUTH EXPERIENCE</u>	199
<u>CHAPTER 4: THE SOUTH/SOUTH POSSIBILITIES</u>	202

CHAPTER 1: INTRODUCTION

There can be little doubt that unrestricted multilateral trade reinforces the direction of international trade flows in their present form, and makes it difficult to attain the objective of South/South trade. On the other hand, regional economic integration among developing countries in its various forms - whether free trade areas, customs unions or common markets - has a considerable potential for promoting trade between developing countries (DCs). However, attempts at such integration in the developing world have had very little success so far. The failures can be attributed largely to national interest conflicts which arise at economic and political levels. In this context, bilateral trade arrangements are, at first sight, a promising alternative: restrictions on trade with partners can be relaxed or removed selectively while, at the same time, the opportunities of multilateral trade with the rest of the world, on an independent national basis, can be retained. Thus bilateralism deserves careful consideration as a policy option. The following discussion is divided into three sections: the first is devoted to an analysis of the issues at a general, or theoretical, level; the second examines the recent experience of bilateral trade between the centrally planned economies of Eastern Europe and the USSR on the one hand and DCs on the other; and, in the light of this experience, the third section explores the possibilities of promoting trade between developing countries on a bilateral basis.

CHAPTER 2: THE ANALYTICAL ISSUES

Little attention has been paid to bilateral agreements in the theory of international trade. Bilateralism is generally subsumed in the set of non-optimal trade policies that diverge from free trade. However, under certain conditions, even orthodox economic theory allows for bilateral trade arrangements. The first exception relates to a situation where import restrictions are widely practised: the hypothesis is that a country which applies import restrictions on a non-discriminatory basis could improve its welfare through bilateral trade adjustments. Although, in such analysis, multilateral free trade is the optimum policy, if, for some reason, the import restrictions cannot be dispensed with, bilateralism does provide a second-best solution. It has been shown that a bilateral trade adjustment would bring about an improvement in economic welfare if the prices of commodities so traded are higher in the importing country as compared with the exporting country, i.e. before the introduction of bilateral trade import restrictions are used in both countries.^{1/} These conditions, it is worth noting, are often prevalent particularly among DCs. The second exception relates to a situation where a country has monopoly power in one of its exports: then, if the price elasticities of demand differ as between markets, it can benefit by charging discriminatory prices - as indeed any monopolist would to maximise profits. Bilateral trade agreements can be employed to divide the export market into two segments so that a higher price is charged where the elasticity of demand is relatively low and vice-versa, provided, of course, that the favoured market cannot re-export the goods to the discriminated market.^{2/} Needless to add, such conditions, where a single DC can exercise monopoly power, are somewhat rare.

Apart from these two special cases, orthodox economies would suggest that multilateral trade is always superior to bilateral arrangements. The rationale is straightforward. Multilateralism enables countries to buy their imports from the cheapest possible source and sell their exports at the highest possible price. In theory, the logic of the proposition is impeccable. In practice, however, multilateral trade in the open world market is not a feasible option for many DCs, or even socialist countries, whose economies are characterised by a significant shortage of convertible foreign exchange. If these countries adhere to the principle of multilateralism, beyond a point, they would simply not be able to avail of the opportunities in international trade. Under these circumstances, when the option might be no further trade, bilateralism would certainly enhance the possibilities of trade. In the context of industrialisation there is another point worth noting. Even if bilateral trade is inefficient at the time, or in the short run, it might well be efficient in the long run if we allow for intertemporal considerations such as those implicit in the familiar infant industry arguments.

^{1/} Cf. J.M. Fleming, "On Making the Best of Balance of Payments Restrictions on Imports", in *Essays in International Economics*, London, 1971.

^{2/} For a detailed analysis, see R.E. Caves, "The Economics of Reciprocity: Theory and Evidence on Bilateral Trading Arrangements", in W. Sellekaerts ed. *International Trade and Finance*, London, 1974.

It must be stressed that an expansion of trade per se does not ensure that the gains from bilateral trade are a foregone conclusion. After all, it is perfectly possible that a part of the increase in exports to bilateral agreement markets is illusory, in as much as it represents a diversion of exportable commodities from other traditional markets.^{1/} Alternatively, the prices received for exports may not be favourable. Even if they are, the real benefit of bilateral trade would also depend upon the choice of imports offered by partner countries and the import prices charged. In principle, therefore, an evaluation of the gains from trade must be based on some assessment of: (i) the net increase in exports, (ii) the composition of imports, and (iii) the terms of trade obtained.

Such an evaluation is, obviously, essential but it is important to go beyond conventional economic analysis. In doing so we shall emphasise the possible advantages of bilateralism, for its disadvantages (mentioned above) have been discussed at length in the literature. Consider, for instance, the following features of bilateral trade which might make it an attractive option in terms of policy.

(a) First, bilateral trade on a selective basis with some countries might improve the terms of trade with the rest of the world. The point is best explained through an example. Suppose a developing country exports a primary commodity and is an important supplier in the world market. Let us also assume that there are no close substitutes, that the short-term supply elasticities in competing countries are low and that the demand is price inelastic. Incidentally, these conditions are quite common in the world market for some commodities. Now, if partner countries buy a significant proportion of the DCs exportable output of the commodity, their entry into the market might push up prices and thereby improve the terms of trade for the exporter.^{2/}

(b) Second, bilateral trade might create greater export stability. Fluctuations in the level of prices and of demand are a common feature of world commodity markets. Developing countries dependent on the export of one or a few commodities are therefore particularly vulnerable. The reliance on a small number of traditional metropolitan markets, dictated by historical factors, often compounds difficulties. In such cases, bilateral economic relations with other DCs, or the socialist bloc, would give rise to

^{1/} There are two reasons why this might happen. First, if supply conditions are such that domestic production cannot be stepped up to meet all increases in demand, it is possible that a country meets part of its commitment under bilateral agreements by diverting exports from convertible currency markets to the new trading partners. Second, if partner countries are very short of foreign exchange, they might re-export these goods to the rest of the world simply to earn convertible currencies.

^{2/} Alternatively, the opening up of bilateral trade might prevent the terms of trade from worsening as much as they otherwise would. This is a weaker version of the same proposition.

significant benefits not only because they offer the possibility of long-term contractual agreements but also because they provide additional markets.

(c) Third, bilateral trade agreements might eliminate, or significantly reduce the risk and uncertainty of convertible currency markets in the North. In fact, partner countries might provide alternative markets for manufactured exports from DCs without the uncertainty, the sales efforts and the advertising expenses which would be unavoidable in convertible currency markets. This potential benefit is particularly crucial in the case of non-traditional manufactured exports wherein product differentiation, brand names and selling costs are an all important part of any successful export effort.

(d) Fourth, given the extreme shortage of foreign exchange in most DCs, the introduction of bilateralism might add to import capacity and, at the same time, underwrite an expansion in exports. This is particularly significant in view of the problems faced by developing countries attempting to promote export growth. If there are underutilised production capacities in the South, the emergence of additional markets would be particularly welcome and bilateral trade might provide a "vent for surplus".

CHAPTER 3: THE EAST/SOUTH EXPERIENCE

In recent years, economic relations between the European socialist countries and the developing world have become quite strong. A significant proportion of these ties has been developed since the late 1950s, when several newly independent nations emerged from the colonial era in Asia and Africa. Available evidence suggests that the relationship between the two groups of countries strengthened considerably in subsequent years. There was, for instance, a phenomenal expansion in trade between the centrally planned economies of USSR and Eastern Europe on the one hand and the developing market economies on the other.^{1/} It is worth noting, however, that trade as well as other economic ties were directed towards a limited number of DCs. This is hardly surprising given the fact that the remarkable growth in economic co-operation between the East and the South has taken place largely in a framework of bilateral agreements. Economic aid, development credits, technology transfer and trade are all incorporated into long-term agreements negotiated with individual governments. In fact, bilateralism is an integral part of the overall system of economic relations between communist countries and the less developed world. Although this framework is somewhat different from the usual modus operandi of international trade and commerce, it is to be expected that socialist economies would want to plan their economic relations with the rest of the world as a part of the process of planned production.

The principal features of such arrangements in the past (and to some extent even now) between the East and the South were as follows: (i) The agreements specified the objectives of economic co-operation for both partners and attempted to set out planned needs as accurately as possible; (ii) Trade balances outstanding at the end of each period were settled in exports and imports of mutually agreed products or in inconvertible currency; (iii) Aid as well as debt repayments were automatically converted into trade flows; credits extended to DCs, for instance, could be repaid in inconvertible domestic currency, traditional exports or the output of aid-financed projects; (iv) As far as possible, all transactions were carried out in terms of world prices, except that bilateral agreements sought to eliminate short-term fluctuations. This is a typical but by no means universal example. In a few cases, trade, along with other transactions was conducted in terms of hard convertible currencies. In that case, trade between the East and the South was no different from the usual international exchange of commodities between the North and the South. Special advantages, or disadvantages, arose only if the relationship had a bilateral character.

Obviously, it is difficult to generalise about the experience of East/South trade. Existing research on the subject does, however, show that trade between the Council for Mutual Economic Assistance (CMEA) countries and DCs, carried out in a framework of

^{1/} From 1952 until 1976, the turnover of trade virtually doubled every four years; cf. UN Yearbook of International Trade Statistics, several issues.

bilateralism, led to mutual benefits for both sets of partners.^{1/} For the South, the socialist countries provided welcome new markets for a large number of traditional commodity exports from the Third World which faced near saturated markets and rather low income elasticities of demand in the metropolitan countries. At the same time, an overwhelming proportion of DC imports from the socialist bloc were constituted by capital goods and intermediate products,^{2/} which were essential to their industrialisation programmes and not low priority goods which they were forced to import. And, as far as the DCs were concerned, the terms of trade offered by the East were sometimes better and, at any rate, no worse than those offered by the rest of the world.^{3/} For the East, trade with the South offered an opportunity to import goods which were either too expensive to produce at home or could not be produced at all. Under bilateral arrangements, such imports were financed through exports so that there was no need to part with scarce convertible currencies. Thus the socialist countries sold machinery and other manufactured goods in exchange for primary products and industrial raw materials.^{4/} Of course, such traditional patterns of trade neither transformed the structure of production in the South nor made for a new international division of labour. Admittedly, patterns of production and trade in the DCs which have evolved over a long period of time could not have been changed overnight. However, the diversification in the pattern of East/South trade, with the possible exceptions of India and Egypt, was not very significant. In the long run, such diversification is imperative for industrialisation in the Third World.

An analysis of East/South trade raises several interesting debatable issues, but it would digress too much to discuss these issues here. More important, at least for the future, are the two principal lessons to emerge from the experience.

First, in situations where the scarcity of foreign exchange is a constraint on international trade, bilateralism makes possible a much higher turnover of trade. Multilateral trade might, in principle, be superior but, during the period 1960-1975, it was not an option available to the COMECON countries nor was it a feasible option for

^{1/} For a detailed discussion of the issues, as also evidence from different countries, see D. Nayyar ed. *Economic Relations Between Socialist Countries and the Third World*, London, 1977.

^{2/} An examination of international trade statistics reveals that machinery and transport equipment account for nearly half the DC imports from the socialist world, while intermediate goods such as base metals, chemicals, fertilisers and petroleum products constitute a very large proportion of the remainder.

^{3/} Empirical evidence apart, if one thinks about this statement, it stands to reason. After all, socialist bloc trade with DCs is carried out on a commercial basis. State trading corporations from Eastern Europe and the USSR conduct transactions with local firms and traders in the Third World: there is no reason why individual exporters should sell for less than prices obtainable elsewhere or individual importers should pay more than the going price. On balance, available evidence provides confirmation: see D. Nayyar op. cit.

^{4/} Until as late as 1976, 78 per cent of East European and USSR exports to DCs were constituted by manufactured goods, whereas primary products and raw materials accounted for 88 per cent of Third World exports to the socialist bloc; calculated from the United Nations Monthly Bulletin of Statistics, June 1978, Table F.

many DCs. Although one cannot be certain, it is extremely unlikely that socialist countries would have increased their trade with the developing world to the extent they did, in the absence of special payments arrangements which eliminated the use of convertible currencies in trade. For DCs too, without bilateralism the socialist countries might not have emerged as an alternative source of technology, imports or finance and as an alternative outlet for their traditional exports.

Second, complementarities of demand between the two sets of countries were fundamental to the expansion in trade. To be more specific, the income elasticities of demand for imports from one another were rather high. 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 DCs were high: a sharp contrast with the near saturated markets in the North. At the same time, in the South, the needs of industrialisation meant that the income elasticities of demand for intermediate and capital goods exported by the centrally planned economies of Eastern Europe were high. 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 these existing complementarities were exhausted.

CHAPTER 4: THE SOUTH/SOUTH POSSIBILITIES

Agreements on trade between countries are not unique to East/South trade. In the past, developing countries have negotiated trade agreements with other market economies, particularly the less developed ones. However, most of them are no more than a gesture of political goodwill and economic co-operation between the signatories. Although a list of tradable commodities is generally incorporated into the agreements, nothing is specified and the pattern and volume of trade are determined by the usual considerations of international commerce. On the other hand, a genuine shift to bilateralism in trade requires an element of reciprocity, an attempt to plan the volume or even the composition of trade, and, if necessary, the use of special payments arrangements which use inconvertible accounting currencies. For bilateralism to be a viable policy option, however, this reciprocity should be flexible. In other words, each country must retain the freedom to determine the extent, the direction and the composition of its multilateral trade. Thus it needs to be stressed that the argument for bilateral arrangements is not intended to exclude the usual multilateral trade on the part of DCs. As an additional mechanism, however, bilateralism might enable developing countries to overcome some of the limits and obstacles to South/South trade discussed earlier. As a policy instrument, it might be superior to regional integration for two reasons. First, the potential for trade among DCs might transcend regions, and trade between regions or continents might be essential if this potential is to be realised. Second, the conflicts of national interest and the differences which arise over the distribution of gains from trade in a framework of regional integration would be less acute in bilateral arrangements between individual countries, simply because the reciprocity is flexible.

What, then, are the possibilities of increasing trade between developing countries through bilateralism? The lessons from the East/South experience are obviously crucial to any serious consideration of the South/South possibilities. To the extent that economies of the DCs are plagued by shortages of foreign exchange, bilateral arrangements would increase their ability to avail of international trade opportunities and, almost certainly, increase the volume of trade between them. What is more, at present, the levels of South/South trade are very low indeed - a situation similar to East/South trade circa 1960 - so that the potential for trade, on account of complementarities in demand, is probably substantial. The argument needs elaboration. Let us consider primary commodities and manufactured goods separately; within the former it might be worth distinguishing between food and beverages on the one hand and raw materials on the other.

(a) Food and beverages are an important constituent of Third World exports, which have thus far been sold largely in the North. But the markets in metropolitan countries are close to saturation, and imports of these commodities by the North are unlikely to increase any faster than population growth which, in turn, is insignificant. In contrast, the income elasticities of demand, for commodities such as tea, coffee and cocoa, in the South are very high; much higher than in the East two decades ago. Given the rather low levels of consumption the market potential is enormous. Even if there was no increase in per capita consumption in the South, the relatively high rates of population growth would ensure rapidly expanding markets for such exports from DCs.

(b) Many raw materials, particularly those originating in the agricultural sector, also face unfavourable demand prospects in the North because the development of synthetic substitutes and other technological changes economise on the use of these inputs. In such cases, bilateral trade among DCs might help new demands materialise, as it did in East/South trade. But there are other raw materials such as minerals and fuels which benefit from booming world markets. In both cases, however, the raw materials are essential for industrialisation in the Third World. To a significant extent, the exports of these commodities originate in the South. For the importing DCs it would be far better to purchase these directly from source on a bilateral basis, rather than through markets or firms in the North, as it would eliminate profits of intermediaries. The exporting DCs would also benefit if it enables them to establish processing industries and increase value-added before export. Bilateralism, if it can be used to circumvent traditional channels of international trade, would not only facilitate South/South trade but also promote industrialisation.

(c) Manufactured goods still account for a relatively small proportion of total exports from DCs. It has been particularly difficult to enter markets in the North - except where the access is provided by transnational corporations - for the simple reason that, in such goods, product differentiation, brand names and quality are rather important, and exporting involves marketing expenses in the form of advertising costs, export credits and after-sales service. At first sight, it appears that bilateral arrangements with other DCs would promote manufactured exports if they reduce such uncertainty, risk and marketing expenses. To an extent, the East/South experience points in this direction, but it also highlights the difficulties: after all, the diversification in the pattern of that trade did not proceed very far. The problems with South/South trade in manufactures are likely to be more acute for, in the early stages, industrialisation might be competitive rather than complementary - at least in the perception of individual countries. Policy-makers must therefore search for complementarities across countries in the process of industrialisation. The recent bilateral trade agreements between a few OPEC countries and the more industrialised DCs (e.g. Iran and India), which stipulate an exchange of petroleum products for other manufactured goods and contemplate joint industrial ventures, focus on these possibilities. At the moment, such examples are few and far between. But if complementarities can be identified, bilateralism would assist in surmounting the institutional obstacles to South/South trade in manufactures.

The preceding discussion has been devoted almost entirely to an analysis of bilateralism as a policy option, concentrating attention on its possible merits, on the presumption that its implementation would pose no serious problems. That assumption is not entirely correct for two reasons. First, in market economies the ability of governments to mould the direction of trade in accordance with their priorities is somewhat limited, as it is individuals or firms who trade and their decisions are determined by market forces rather than by planning authorities. Second, notwithstanding the principle of flexible reciprocity, some amount of planned economic integration is implicit in bilateralism, and this would pose problems. In the long run, a relaxation of restrictions on trade vis-à-vis

partners requires an adjustment of markets and an alignment of productive capacities; governments might not be able to achieve this in market economies. The reallocation of resources and a restructuring of production also imposes economic costs on certain groups in any country, in terms of income and employment foregone, so that governments might not be willing to implement the necessary policies.

09635

LIMITS AND OBSTACLES TO SOUTH-SOUTH TRADE

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TABLE OF CONTENTS

	<u>Page</u>
<u>CHAPTER 1: INTRODUCTION</u>	207
<u>CHAPTER 2: LIMITS TO SOUTH-SOUTH TRADE</u>	208
2.1 Economic Limits	208
<u>CHAPTER 3: OBSTACLES TO SOUTH-SOUTH TRADE</u>	210
3.1 Institutional Obstacles	210
<u>CHAPTER 4: POLICY PROBLEMS</u>	212

CHAPTER 1: INTRODUCTION

In recent years, there has been intensive discussion about the possibilities of a new international economic order, which has given rise to a number of prescriptions. Among other things, economists and policymakers have placed considerable emphasis on South-South trade, not only as a means of reshaping the division of labour between nations, but also as part of an industrialisation strategy. A priori, the case for an expansion of trade between countries in the underdeveloped world is attractive. The notion of collective self-reliance has an obvious political appeal insofar as it would reduce the age-old dependence on the rich countries, and improve the bargaining power of the South vis-à-vis the North. The complete rationale, however, is more positive. Economic co-operation between developing nations, particularly in the sphere of trade, should enable these countries to realise economies of scale, overcome the limitations of domestic market size, exploit complementary resources through regional specialisation, reduce the exposure to risks or cyclical fluctuations, and, in the long run, foster indigenous technological development. There can be little doubt that such potential benefits are in the realm of possibility but, in practice, any plans to extend South-South trade would face a number of difficulties. For the purpose of analysis, it would be useful to distinguish between the economic limits, the institutional obstacles and the policy problems. Consider each in turn.

CHAPTER 2: LIMITS TO SOUTH-SOUTH TRADE2.1 Economic Limits

The present levels of South-South trade are very low indeed. An overwhelming proportion of international trade in the world economy is either trade within the industrialised world, or trade between rich countries on the one hand and poor countries on the other. For instance, in 1977, North-North trade constituted 46 per cent of world exports, North-South trade accounted for 34 per cent, while South-South trade was responsible for a mere 6 per cent.^{1/} Starting from such a small base, it is obviously possible to expand trade between developing countries, but there are limits to the process.

In the first place, a very large proportion of purchasing power in the world economy is still located in the industrialised nations. During the mid-1970s, the high-income countries with 27.5 per cent of the population had as much as 80.7 per cent of the income in the world, whereas low-income countries with 57.7 per cent of the population had only 9.7 per cent of the income.^{2/} This distribution of income between countries is reflected in international trade flows the direction of which has changed little in the past two decades. Even as late as 1977, two-third of world exports were sold in the North compared to less than one-fourth in the South. The concentration on markets in the North is somewhat greater if we exclude the centrally planned economies, and consider exports from the North or the South separately: see Table 1. The recently acquired affluence of the OPEC nations, and the rapid industrialisation in some other developing countries during the past ten years, have probably enlarged the scope for South-South trade but the fundamental income constraint on its expansion remains.^{3/}

TABLE 1: THE DIRECTION OF WORLD EXPORTS: 1977

(in percentages)

Exports from	to the NORTH	to the SOUTH	to the EAST
World	67.1	22.7	9.2
North	70.9	23.7	4.7
South	71.8	22.2	3.7
East	27.8	17.5	54.3

Source: United Nations, Monthly Bulletin of Statistics, June 1978

Note: The percentages have been computed. The rows do not add up to 100 because the categories North, South and East are not exhaustive.

^{1/} Calculated from the UN Monthly Bulletin of Statistics, June 1978, p.xx.

^{2/} See World Bank Atlas, 1977; high-income countries are defined as those with a per capita income greater than \$2000 and low-income countries as those with a per capita income less than \$500. Middle-income countries, with a per capita income in the range of \$500-\$1999, accounted for the rest of the world's population and income.

^{3/} There is only so much - and no more - oil, copper, bauxite and iron ore, or tea, coffee and cocoa, or, for that matter, simple manufactures that developing countries can sell to one another, given the total size of their markets.

A second economic limit to South-South trade is the unequal distribution of income within developing countries. These are, after all, market economies in which the distribution of purchasing power and the consequent pattern of expenditure determine the structure of production and trade. To be more specific, income inequalities in developing countries give rise to consumption patterns that can be satisfied only with imports of products and technologies from the industrialised countries. The point is easily established in the context of luxury goods or differentiated products meant for final consumption. However, even if consumer goods are not directly imported the demand patterns and preferences of the rich in DCs necessitate imports of manufactured inputs or equipment from the North, rather than the South. Similarly, exports, whether primary commodities or manufactured goods, find limited markets in the South, where the majority of the people purchase nothing but the bare necessities, so much so that their consumption frontier seldom extends beyond food.

The third economic factor which might constrain the growth in South-South trade, ironically enough, is the development needs of poor countries themselves. The emphasis varies but industrialisation is a major goal of development planning in most DCs. And, in the early stages, any strategy of industrialisation generates a demand for raw materials, intermediate inputs and capital goods. While most raw materials can be procured in the developing world, which should be conducive to South-South trade, the ability of the South to meet its own demand for intermediate and capital goods is rather limited. It is not as if production abilities or capacities are non-existent. Many developing countries manufacture intermediate or capital goods; a few such as Brazil and India even export them, but it is important to place the magnitudes in perspective.^{1/}

^{1/} In a global context, exportable surpluses of intermediate or capital goods in the South fall far short of the demand for such goods in the South. However, even the existing export capacities are often under-utilised because manufacturers from DCs find it difficult to compete in the world market, with producers from the North, in terms of both price and quality.

CHAPTER 3: OBSTACLES TO SOUTH-SOUTH TRADE3.1 Institutional Obstacles

The existing pattern of trade in the world economy is neither an entirely natural development nor an accident. It is very much the outcome of concrete historical forces. The international division of labour between metropolitan and peripheral countries took shape in the colonial era when the world economy was dominated by imperialist powers. Trade and flag were inextricably linked together. Transport networks and port facilities in the colonies were established for the export of primary commodities or raw materials and for the import of manufactured goods. At the same time, shipping lines, insurance services and market communications were developed almost entirely to channel such trade between colonies and their metropolitan powers. The direction of trade flows was thus determined by the straitjacket of de jure or de facto colonial relationships.

Over a long period of time, these historical factors have come to be embedded in the system of international trade and commerce, and now constitute institutional obstacles in the path of expanding trade between nations. In the contemporary world, facilities for transport, shipping, insurance and banking as well as channels for communication and marketing remain oriented towards trade between the North and the South, and, of course, within the North. No comparable infrastructure exists for South-South trade. It is far easier for the continents of Asia, Africa and Latin America to trade with Western Europe or North America rather than with one another. Thus it is not surprising that there is hardly any international exchange of commodities between Latin America and Asia though there is a considerable potential. The limited South-South trade that does take place is mostly confined to regions and is not inter-continental. Even within continents, however, channels for trade are far from smooth. To cite an example: countries in north or west Africa find it simpler to buy Zambian copper at the London Metal Exchange, and Kenyan tea at the London tea auctions, rather than directly from source. Instances of this sort abound. The further development of economic ties between countries in the South obviously requires the infra-structure for trade which, in turn, needs substantial investment and extensive co-ordination.

It is worth pointing to a second institutional factor which also has historical origins: developing countries do not participate in international trade as completely independent buyers or sellers, because transnational corporations are responsible for a significant proportion of their trade. To some extent, of course, foreign capital has always been an important factor underlying the trade flows of DCs. For instance, foreign companies play a dominant role in the export of primary commodities, particularly

in those originating from mines, plantations or cash-crop agriculture.^{1/} This is no doubt the result of historical forces, and very much a legacy of the colonial era which has persisted in post-independence years. The past two decades, however, have witnessed an increasing incidence of private foreign investment in the manufacturing sector of DCs. To begin with, such investment was concentrated in import substitution but, in recent years, manufacturing for export has emerged as an important phenomenon. Available evidence suggests that transnational participation in the export of manufacturers from DCs is also significant though not as dominant as in primary commodities.^{2/} Whatever the origins of these investments - the exploitation of natural resources, the capture of local markets, or the use of cheap labour - production by transnational firms in developing countries generates trade flows between the South and the North, in both directions. But it does little to enhance the possibilities of South-South trade; on the other hand, it might even pre-empt such flows.

A number of other institutional obstacles to South-South trade in the world of today, should be noted. First, the tying of aid forces developing countries to import from the industrialised world. Second, the purchase of technology by DCs ties imports to the original source, and the terms of technology transfer from the North often restrict exports. Third, the import of manufactured goods depends on the availability of credit, and export credits are extended largely by the North.^{3/} Fourth, businessmen and vested interests in DCs might want to retain trade links with the North for a number of political or economic reasons: one such motive is to obtain convertible currencies abroad through underinvoicing of exports or overinvoicing of imports. It is no doubt possible to think of other such obstacles but these are mostly within the reach of policy and, in principle, surmountable.

^{1/} Cf. A. Maizels, "A New International Strategy for Primary Commodities", in G. K. Helleiner (ed.) A World Divided, Cambridge, 1976. For evidence on the importance of US firms in primary commodity trade, see G. K. Helleiner.

^{2/} See D. Nayyar, "Transnational Corporations and Manufactured Exports from Poor Countries", Economic Journal, March 1978.

^{3/} Countries in the South find it difficult to match the volume or terms of export credit offered by their competitors from the North because, in effect, it implies an export of capital.

CHAPTER 4: POLICY PROBLEMS

More fundamental problems would arise if there is a serious attempt to promote South-South trade in a cohesive and systematic manner. Such problems of policy are likely to stem from two sets of factors: first, the conflict of national interests within the South, and second, the inability of governments in DCs to influence the direction of trade flows.

To seek an expansion in South-South trade is, apparently, an attractive course of action, but discussion on the subject often circumvents an important question: who gains from the move towards collective self-reliance, and how much? The developing world is not a united political or economic entity; it is, after all, made up of nations whose relations with one another are characterised as much by contradiction as by harmony. Even more important, perhaps, countries in the Third World are at markedly different stages of development with the least developed as one end of the spectrum and the newly industrialised at the other end. In this context, attempts at organising co-operation on an international basis are likely to face many a conflict of national interests. The pattern of specialisation, the structure of production, or the share of markets - within the South - are potential sources of such conflict. In sum, the distribution of gains from South-South trade might be just as unequal as in the case of North-South trade. Thus countries which lose, albeit in a relative sense, would not want to pursue the objective of South-South trade with the same vigour as those who stand to gain relatively more. There would also be a legitimate fear that, in the long run, the unequal distribution of gains from trade might have cumulative consequences so as to widen the gap between the least developed and the more industrialised nations. The experience of the post-war era suggests that North-South trade has done little to reduce the growing disparities between rich and poor countries. Indeed, some scholars suggest that it might have reinforced the pattern of unequal development. Given this recent experience, it is perfectly possible that the promotion of South-South trade would also lead to uneven development among DCs. Therefore, the long term interests of the potential losers must somehow be protected.

The other set of policy problems arises from the ability and willingness of governments to mould the direction of trade in accordance with their priorities. It is reasonable to assume that centrally planned economies should be able to influence the direction of trade flows as part of the process of planned production. But an overwhelming number of developing countries are market economies where decisions about consumption, investment, production and trade are made largely through the price mechanism. What is more, it is not countries which trade; it is individuals or firms within countries who do. Hence the ability of governments in developing countries to induce the expansion of trade in a particular direction is bound to be somewhat limited. Even if the ability were somehow present, it is not certain that governments would be willing to press for South-South trade if vested interests with strong political influence oppose the move. It is worth illustrating the point with a concrete example. Most DCs have sought to industrialise behind protective trade barriers, and those at similar

stages of development protect a similar range of industries thereby choking potential trade flows. A growth in South-South trade would necessitate a reduction or removal of such restrictions on trade. This implies not only a reallocation of resources and a restructuring of production, both of which impose significant economic and political costs, but also a loss of income and employment for certain groups in the country, who would naturally exert all possible influence on the government in the opposite direction. Such difficulties can be overcome only if there is a serious commitment and resolve on the part of governments.

The preceding discussion has treated economic limits, institutional obstacles and policy problems separately only for the purpose of analysis. In the real world these factors interact and reinforce one another. While economic limits are in a sense fundamental, they do leave considerable room for manoeuvre. If the international co-ordination of policies reduces the impact of institutional obstacles, and a commitment on the part of governments reduces the problems of implementation, South-South trade could be extended much beyond its present levels.

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MARKET ACCESS FOR EXPORTS FROM DEVELOPING COUNTRIES

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TABLE OF CONTENTS

	<u>Page</u>
<u>CHAPTER 1: INTRODUCTION</u>	217
<u>CHAPTER 2: TARIFF BARRIERS TO TRADE</u>	218
2.1 Problems of Tariff Evaluation	218
2.2 Incidence of Tariffs on Developing Country Exports	219
2.3 Multilateral Tariff Liberalisation	220
2.3.1 Tariff Preferences	220
2.3.2 The Multilateral Trade Negotiations and the GSP	227
2.4 Future Progress on Tariff Barriers to market Access	228
<u>CHAPTER 3: NON-TARIFF BARRIERS TO TRADE</u>	229
3.1 Quantitative Import Restrictions	229
3.2 Licensing	230
3.3 Government Procurement	230
3.4 Technical Standards	231
3.5 Subsidies	231
3.6 Custom Classification and Valuation Methods	232
3.7 Variable Levies	233
<u>CHAPTER 4: METHODS TO REDUCE OBSTACLES TO EXPORTS FROM DEVELOPING COUNTRIES</u>	234
4.1 Group Trading and Regional Arrangements	234
4.2 Bilateral Trade Agreements	236
4.2.1 Historical Bilateralism	236
4.2.2 Publique Bilateralism	236
4.2.3 Bilateral Clearing	237
4.2.4 Bilateral Trade Controls	238
4.2.5 Prospects	239
4.3 Adjustment Assistance	239

CHAPTER 1: INTRODUCTION

The industrialised countries impose a variety of barriers to market access for exports from developing countries. Generally such barriers to trade fall into two categories - tariffs and all other measures, called non-tariff barriers to trade (NTBs). Following World War II, the major emphasis in lowering barriers to trade was through reciprocal tariff reductions under the General Agreement on Tariffs and Trade (GATT). In the early 1970's the developing countries were granted especially favourable, though limited, market access through the General System of Preference (GSP) schemes instituted by the developed countries and the socialist countries of Eastern Europe. Recently, the increase in the relative importance of NTB's as protective devices has led to intensified multilateral efforts to liberalise them. The importance of these developments to export market access of developing countries is discussed - together with questions of economic regionalism, bilateralism, and adjustment assistance - in the following sections.

CHAPTER 2: TARIFF BARRIERS TO TRADE

The guiding principle of the GATT is the administration of barriers to imports on a non-discriminatory, most favoured nation (MFN) basis. The tariff system of each Contracting Party to the GATT differs in its incidence across products, but in principle may not differ across source countries for the same imported product. Nonetheless, the product structure of MFN tariffs can be designed to discriminate against exports from certain groups of countries.

The tariff structures of the industrialised countries are relatively biased in favour of the importation of raw materials (with certain exceptions) and against the importation of semi-finished and finished manufactured products, especially those that utilise relatively labour-intensive production techniques and thus are of export interest to the developing countries.

2.1 Problems of Tariff Evaluation

Any evaluation of the level or effects of tariffs across products or across countries encounters many conceptual and measurement problems. First, the tariff structure itself is extremely detailed. To be of use, tariff rates must often be averaged (using weights) to some less detailed product or industry level of classification. The two major weighting methods are by imports or by domestic production. Most common is weighting by actual imports, a method usually considered to understate the protective influence of the tariff structure because high tariff rates result in low import levels and thus receive low weights in the average. In the extreme, prohibitive tariff rates receive zero weight in such an average. Another weighting method is by domestic production. This method also suffers from biases and is most relevant in analysing the domestic production effects of the tariff structure. Theoretically, many of the biases inherent in the weighting schemes could be overcome if hypothetical, free-trade values of imports or production are used.

Second, the analysis of the effects of tariffs on the level and sources of imports, domestic production, and prices of internationally traded goods is complex. Analyses of these effects encounter difficulties in both theoretical modelling of behavioural relationships, and in the empirical application of such models. For instance, the effect of a tariff system on the level of imports of a particular product depends both on the response of domestic consumption demand to changes in price due to the nominal tariff levied on the product and on changes in domestic production levels. Domestic production levels tend to be increased by the nominal tariff on the final product itself, but decreased by cost-raising tariffs on material production inputs. The domestic production effects of a country's tariff system are summarised in measures of the effective rate of protection (ERP), often defined as the maximum percentage increase in domestic value-added made possible by the tariff system. Although imperfect, the ERP is a measure of the relative strength of "resource-pull" into import-competing industries due to a nation's tariff system. Thus, an analysis of the effects of such a

tariff system on the level of imports should utilise both nominal and effective rates of protection, as well as certain behavioural responsiveness measures on both the demand and supply sides. Even at this level of complexity, nothing can be said about the differential effects of tariffs on the various sources of imports.

2.2 Incidence of Tariffs on Developing Country Exports

Both nominal and effective tariff rates in industrialised countries generally rise progressively with the stage of production or degree of fabrication of products, and tend to be directly related across products to the degree of labour-intensity - and especially unskilled-labour intensity - of production. The tariff structures of the industrialised countries therefore tend to offer the highest degree of import protection to those industries which produce goods of special export interest to the developing countries. It follows that the MFN tariff structures of the industrialised countries discriminate systematically against the developing countries as exporters. As an illustrative case, Table 1 demonstrates for the United States this general tendency of tariff escalation and its persistence following the Kennedy Round of tariff reductions, which had been fully implemented by 1972. The rather high nominal and effective tariff rates on primary products are due mainly to tariffs on agricultural products, especially temperate agricultural products. The nominal and effective tariff rates on non-agricultural primary products are essentially zero. In contrast, the nominal and effective rates on intermediate and consumer goods - the category of special export interest to the developing countries - exceeded in 1972 the rates on both non-agricultural primary products and capital goods. The latter are of less export interest to the developing countries because the production of capital goods is not yet generally within their comparative advantage on world markets. However, capital goods received the greatest relative nominal and effective tariff reductions during the Kennedy Round (1963-1967). In addition, these averages mask higher post-Kennedy Round tariff rates on particular products of export interest to the developing countries, such as apparel (20% nominal, 30% effective) and footwear and leather products (12% nominal, 20% effective). The nominal and effective tariff rates of other developed countries display a similar pattern.

TABLE 2 (1): Nominal and Effective Tariff Rates: The United States

<u>Product Group</u>	<u>Nominal Rates</u>		<u>Effective Rates</u>	
	<u>1964</u>	<u>1972</u>	<u>1964</u>	<u>1972</u>
Primary Products	.08	.07	.10	.09
Intermediate and Consumer Goods	.10	.07	.16	.11
Capital Goods	.11	.06	.16	.08
Average	.10	.06	.17	.10

Source: R. E. Baldwin, Montariff Distortions of International Trade,
Brookings, p. 165.

2.3 Multilateral Tariff Liberalisation

The recent Tokyo Round of multilateral trade negotiations (MTN), as the Kennedy Round on the 1960's, used a formula to calculate across-the-board tariff reductions on the part of the participating countries. The Tokyo Round formula is "harmonising" in that higher initial tariff rates receive proportionately larger reductions. Exceptions to the across-the-board reductions were then negotiated bilaterally. The average reduction in tariff rates attributable to the MTN is estimated to be about one-third. The developing countries had relatively little input into these decisions, however. The effects of the MTN on the developing countries are covered in the following section.

2.3.1 Tariff Preferences

It has already been stated that tariffs are generally levied on a "most favoured nation" (MFN) basis, institutionalised in the GATT, providing that the tariff rate applied on a particular product is the same for all countries supplying that product. Such countries are either contracting parties to the GATT or otherwise extended MFN treatment by the importing country. This is the principle of "horizontal equity" (equal treatment of equals) applied to international trade policy and has been a cornerstone in the development of liberal trade in the period since World War II. In recent years, the developing countries have argued that they are not "equals" in this sense, and that they should be afforded "vertical equity" (unequal treatment of unequals) in the tariff structures of the developed countries. That is, their exports should be given more favourable tariff treatment than the exports of competing industrialised countries in the major industrial-country markets both to overcome the sort of tariff escalation mentioned earlier and as a form of development assistance.

Development of the GSP

The concept of preferences was initially raised at the first session of the United Nations Conference on Trade and Development in 1964, and brought up again at the second UNCTAD in 1968 in the form of a resolution accepting the principle of temporary, non-reciprocal, non-discriminatory tariff preferences for developing countries. The purpose was (a) To increase their export earnings; (b) To promote their industrialisation; and (c) To accelerate their rates of economic growth.^{1/} A Special Committee on Preferences was set up in UNCTAD. After intensive negotiations and inclusion of the Generalised System of Preferences (GSP) in the United Nations International Development Strategy of the Second Development Decade, GSP schemes were progressively implemented by the European Economic Community (EEC) (1971), Japan (1971), the Nordic countries (1972), the United States (1976) and other industrialised nations. The GSP was made possible by a waiver of the MFN principles contained in the GATT. There are now 16 different

1/ For a discussion, see Review and Evaluation of the Generalised System of Preference; (UNCTAD document TD/232, January 1979).

GSP schemes involving 19 developed market economy countries and 6 socialist countries of Eastern Europe.

GSP beneficiaries include all developing country members of the Group of 77 and several others. Eligible products include all industrial goods with some exceptions, notably textiles, leather and petroleum products, and selected agricultural products. Product coverage has been increased since the beginning of the GSP under several of the schemes. Most schemes provide duty-free market access for eligible products, although in some cases reduced-rate tariffs are specified. The "margin of preference" is the difference between the MFN rate and the GSP tariff rate.

Evolution of the GSP

Preference margins would be expected to increase imports from developing countries, partly in response to reduced consumer prices in the preference-giving country and partly as a result of trade diversion from non-preference suppliers. Or, if the beneficiary developing countries have limited supply capabilities, the preferences should at least raise the prices they receive for their exports. Thus, the GSP was expected to improve both the balance and terms of trade of developing countries, as well as convey "dynamic" benefits associated with export-led growth and attraction of foreign investment.

Unfortunately, several aspects of the GSP have served to diminish significantly the benefits to developing countries. First, most preference donors have reserved the right to institute "escape-clause" actions - to withdraw, in whole or in part, preferential tariff treatment when the product in question is imported in such an increased volume that it causes or threatens serious injury to import-competing suppliers. The EEC instituted a priori "triggers" for the temporary suspension of preferences when imports reach pre-determined levels in the form of tariff quotas (sensitive products) tariff ceilings (special semi-sensitive products), ceilings (semi-sensitive and non-sensitive products), as well as maximum country limits. Japan imposes ceilings on preferential imports for virtually all industrial products based on past-year imports, and imports from any one beneficiary may not exceed 50% of the total. The United States instituted "competitive need" criteria, which generally suspend preferences when GSP imports from any single beneficiary exceed \$25 million or 50% of the total preferential imports of any particular product. A similar but less rigid scheme exists in Australia. In addition, "rules of origin" strictly limit eligibility for preferences to goods that have been produced or are "substantially transformed" in the country of origin and are "directly consigned" from an exporter in that country to an importer in the preference-granting nation. The rules of origin are often defined in such a way that it is impossible for products to qualify for GSP treatment even if substantial value-added is involved. The developing countries have argued that they should be considered as a group for purposes of the rules of origin.

Table 2 indicates the extent to which imports from the developing countries have actually benefitted from GSP treatment in the case of agricultural products (CCCN 1-2¹.)

and industrial products (CCCN 25-00), respectively, according to a recent study by the EAD secretariat. Imports by the developed market-economy GSP donor countries from the beneficiaries in 1976 were \$134 billion, of which \$55.2 billion were dutiable and hence relevant from the standpoint of the GSP. Of these, only \$26.3 billion were actually covered by the various GSP schemes, and an estimated \$10.5 billion actually received GSP treatment, mostly in the industrial products categories. UNCTAD secretariat estimates are that this would have been 50% higher in the absence of a priori limitations and competitive need exclusions. Moreover, growth in preferential imports is estimated to have exceeded the growth of non-GSP imports, and the GSP "utilisation rate" (imports actually receiving preferential treatment divided by eligible imports) is thought to be rising - indicating greater efforts on the part of traders to make use of the preferences.

TABLE 2 (2): Imports of Preference-giving Countries in 1976 from Beneficiaries of their Schemes
(millions of US dollars)

Preference-giving country and CCCN chapters	Total imports	MFN dutiable imports	GSP imports		Shares (per cent)	
			covered	preferential	(4)/(3)	(5)/(4)
(1)	(2)	(3)	(4)	(5)	(6)	(7)
1. <u>Australia</u> ^{a/}						
1-24	192.4	102.3	43.0	28.6 ^{b/}	42.0	66.5 ^{b/}
25-99	1 879.4	665.6	366.1	150.2 ^{b/}	55.1	41.0 ^{b/}
1-99	2 071.8	767.9	409.4	178.8 ^{b/}	53.3	43.6 ^{b/}
2. <u>Austria</u>						
1-24	311.6	256.7	179.8 ^{c/}	7.5	70.1	4.2
25-99	1 015.7	866.4	818.5 ^{c/}	118.6	94.5	14.5
1-99	1 327.5	1 123.1	998.3 ^{c/}	126.1	88.9	12.6
3. <u>Canada</u> ^{d/}						
1-24	561.2	278.4	84.4	56.2 ^{b/}	30.3	66.5 ^{b/}
25-99	4 027.3	925.8	602.2	246.9 ^{b/}	65.0	41.0 ^{b/}
1-99	4 588.5	1 204.3	686.6	303.0 ^{b/}	57.0	44.1 ^{b/}
4. <u>EEC</u> ^{d/}						
1-24	12 749.4	10 326.5	3 043.2	962.6 ^{e/}	29.5	31.6
25-99	65 263.1	11 415.3	10 124.8	3 483.5 ^{e/}	88.7	34.4
1-99	78 012.5	21 741.7	13 168.0	4 446.1 ^{e/}	60.6	33.8
5. <u>Finland</u>						
1-24	274.9	89.4	7.4	4.9	8.2	67.2
25-99	447.3	38.5	21.7	15.9	56.4	73.1
1-99	722.0	127.8	29.1	20.8	22.7	71.6
6. <u>Japan</u> ^{f/}						
1-24	4 031.1	3 051.6	391.5	366.2	12.8	93.5
25-99	9 426.8	3 317.7	3 059.3	1 423.4	92.2	46.5
1-99	13 457.9	6 379.3	3 450.8	1 789.5	54.1	51.9
7. <u>New Zealand</u> ^{g/}						
1-24	88.2 ^{h/}	44.7 ^{h/}	36.0 ^{h/}	23.9 ^{a/}	30.5	66.5 ^{a/a/a/}
25-99	529.5 ^{h/}	117.3 ^{h/}	115.2 ^{h/}	47.2 ^{b/}	98.2	41.0 ^{a/a/a/}
1-99	617.7 ^{h/}	162.0 ^{h/}	151.2 ^{h/}	71.2	93.3	47.1 ^{a/a/a/}

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
8. <u>Norway</u>			(15.9) ^{i/}				
	1-24	195.4	23.7	7.6	2.1	31.9	28.3
	25-99	976.4	71.3	36.7	20.2	51.5	55.1
	1-99	1 171.8	95.0	44.3	22.4	46.6	50.5
9. <u>Sweden</u>							
	1-24	569.4	462.6	32.9	28.8	7.1	87.6
	25-99	2 163.4	478.9	156.2	116.0	32.6	74.3
	1-99	2 732.8	941.5	189.1	144.8	20.1	76.3
10. <u>Switzerland</u>							
	1-24	499.8	410.1	36.3	26.2	8.9	72.1
	25-99	1,041.3	1,008.5	598.9	230.9	59.4	38.6
	1-99	1 541.1	1 418.6	635.2	257.1	44.8	40.5
11. <u>USA</u>							
	-						
	1-99	27 600.8 ^{h/}	21 076.8 ^{h/}	6 519.6	3 533.7	30.9	48.4
12. <u>Hungary (1975)</u>							
	1-24	220.4	164.6	158.6	158.6	96.4	100.0
	25-99	306.0	101.3	94.1	94.1	92.9	100.0
	1-99	526.7	265.9	252.7	252.7	95.0	100.0
13. <u>USSR</u>							
		6 215.9 ^{h/}	-	-	1 405.9 ^{h/}	-	-
I <u>DMEC Total</u> (minus Australia (1), Canada (3), EEC (4), New Zealand (7) and USA (11))							
	1-24	5 963.3	4 335.2	655.5	435.8	15.1	66.5
	25-99	15 559.0	5 889.3	4 691.3	1 924.9	79.7	41.0
	1-99	21 522.4	10 224.6	5 346.8	2 360.7	52.3	44.2

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
II <u>DMEC Total (1 to 10)</u>							
1-24		19 554.5	15 087.1	3 862.1	1 504.0	25.6	38.8
25-99		87 258.3	19 013.3	15 899.9	5 852.8	83.6	36.8
1-99		106 812.8	34 100.5	19 761.8	7 356.9	58.0	37.2
III <u>DMEC Total (1 to 11)</u>							
1-99		134 413.6	55 177.3	26 281.5	10 510.6	47.6	40.0
IV <u>Total Hungary and USSR</u> (12 and 13)							
1-99		6 742.6	-	-	1 658.6	-	-
V <u>GRAND TOTAL</u>							
1-99		141 156.2	-	-	12 169.2	-	-

Source: Data supplied by preference-giving countries and/or UNCTAD secretariat estimates.

a/ Fiscal year 1975/77 (ending 30 June).

b/ Estimated preferential imports for Australia, Canada and New Zealand are based on the average 1976 utilisation rates (66.5 per cent for CCCN 1-24, and 41.0 per cent for CCCN 25-99 - see total 1, column 7) for OECD preference-giving countries which supplied complete information (Austria, Finland, Japan, Norway, Sweden and Switzerland).

c/ Includes the imports of a number of important products, such as bananas, raw coffee and cocoa beans, and petroleum and petroleum products, on which MFN duties have been temporarily suspended. Since these products, although formally covered by the Austrian scheme, could not benefit from GSP treatment, the utilisation rates for Austria in column (7) are substantially understated.

d/ UNCTAD secretariat calculations.

e/ Source: TD/B/C.5 30/Add. 12. The value of preferential imports reported by EEC has been converted from EUR to US dollars at 1 EUR = \$1.27.

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2
1

- f/ Fiscal year 1976 (ending 31 March 1977); data supplied by Japan for total and dutiable imports do not include petroleum products falling within two tariff headings and one subheading - 27.09, 27.10-1 and 27.11 - of the Japanese customs tariff; secretariat estimates of these imports for the calendar year 1976 have been added and are shown within brackets. Totals have been adjusted to reflect these changes.
- g/ Fiscal year 1976/77 (ending 30 June).
- h/ The values of imports were reported in national currency.
- i/ The value of citrus fruits which received temporary duty-free treatment is shown in parentheses. Import figures for CCCN chapters 1-24, in both column (3) and column (4), have been reduced by this amount for the beneficiaries affected.

3.2 The Multilateral Trade Negotiations and the GSP

The recent multilateral trade negotiations represent a mixed blessing for the developing countries. On the one hand, they will erode the margins of preference attributable to the GSP by lowering MFN rates of duty on eligible products, thereby reducing some of the GSP-related benefits described above. On the other hand, the developing countries benefit from MFN tariff reductions on all products which they export and which are not subject to GSP advantages because of product limitations or quantitative restrictions and exclusions under the various schemes. A recent study - which assumes that no developing country exports benefit from GSP at the margin - concludes that developing country exports, excluding petroleum products and textiles, would have been \$1.8 billion greater in 1974 if MFN tariff reductions under the MTN had already been in force at that time.^{1/} Sixty per cent of this expansion would be in the manufactured goods sector.

In contrast, an UNCTAD study, which omits products benefiting from GSP, concludes that the expansion of exports from the developing countries due to MFN tariff reductions would have been less than \$1 billion based on 1976 trade flows and excluding textiles.^{2/} Whereas the former study may be biased to overstatement of export expansions by ignoring GSP, the latter may be biased to understatement of export expansion by overstating the importance of GSP at the margin. The UNCTAD study also concludes that developing country exports of GSP-covered products would have been reduced by at least \$2.1 billion in 1976 due to erosion of GSP preference margins. The UNCTAD conclusions are based on the view that developing countries exporting industrial products are likely to be adversely affected by the multilateral trade negotiations in that (a) Practically all industrial products covered by the GSP will be subject to MFN tariff cuts; and (b) Sensitive industrial products, which are excluded from the majority of GSP schemes, would also be placed on full or partial exceptions lists as a result of the negotiations - i.e., that there will be no MFN tariff cuts or only lower-than-average cuts on these products. In the first case there will be significant erosion of existing GSP margins and in the second case the developing countries stand to receive less-than-average or no MFN cuts on products not covered by the GSP. For these reasons, and because of the harmonising effect of the particular tariff-cutting formula used in the MFN, the GSP-erosion effect is thought to be greater than the positive trade effects of MFN tariff cuts on non-GSP products.

It is clearly difficult to argue the merits of these two opposing views, except to conclude that each will partially or wholly offset the other. In any case, the developing countries' export expansion attributable to the MFN is unlikely to exceed two or three per cent of their total non-oil exports, a large proportion of which are raw materials imported duty-free and hence unaffected by the MTN.

1/ W. R. Cline, et al., Trade Negotiations in the Tokyo Round (Washington, D.C.: Brookings Institution) 1978, chapter 7.

2/ United Nations Conference on Trade and Development, Manufactures and Semi-Manufactures, Review and Evaluation of the Generalised System of Preferences, Report by the UNCTAD Secretariat, to be presented at the Fifth session, Manila, 7 May 1979, Item 11 (c) of the provisional agenda.

2.4 Future Progress on Tariff Barriers to Market Access

In the light of the limited benefits the developing countries appear to have obtained both from the historical pattern of multilateral tariff liberalisation (frequently leaving tariff-escalation intact), the Generalised System of Preferences (with its serious limitations and exclusions), and the erosion of GSP margins of preference by the MTN, developing country spokesmen have proposed a number of further steps.

They have suggested that the principles of generalised, non-reciprocal and non-discriminatory system of preferences be reaffirmed, broadened, extended ten years beyond its scheduled expiration in 1981, and made more secure and stable. Furthermore, GSP product coverage should be extended ultimately to include all dutiable developing country industrial exports and substantial agricultural exports. Competitive need exclusions and a priori limitations should be abolished or limited only to the most "sensitive" products and using only liberal and generally non-binding ceilings. Rules of origin should be harmonised and liberalised, exports from the least developed among the developing countries should be accorded unlimited duty-free entry, and technical assistance should be provided for the developing countries to help them take advantage of the GSP.

With respect to broader MFN tariff reductions, the developing countries proposed that no products of special export interest to the developing countries should be exceptions to formula tariff reductions in the MTN unless these products are already generally covered under the GSP. Indeed, they proposed that MFN reductions on non-GSP products of special export interest to developing countries be deeper than the formula cuts, and that implementation of such tariff reductions be accelerated. Such deeper-than-formula cuts would tend to reduce the detrimental effect on developing country exports of escalation in the tariff schedules of the developed countries on products for which GSP has not already offset tariff escalation. The developing countries also proposed gradual implementation of those MFN tariff reductions which erode GSP margins, in order to reduce the detrimental impact of such erosion, as well as some form of "compensation" for export reductions due to the erosion of GSP margins. During the course of the Multilateral Trade Negotiations, little progress was made either in GSP liberalisation or in improving the MTN outcome for developing countries. Hence there remains considerable scope for future initiatives in the area of tariffs.

CHAPTER 3: NON-TARIFF BARRIERS TO TRADE

The recent trend toward a decrease in the importance of tariffs as trade-restrictive devices is likely to continue, and so the relative importance of non-tariff barriers to trade will increase. The often subtle effects of NTB's frequently fall disproportionately on exports from the developing countries. This is because the product-groups that are considered "sensitive" and thus subject to NTB protection are also the ones of serious export interest to the developing countries.^{1/} Therefore, the multilateral agreements and codes of the recent MTN designed to reduce NTB's are of special importance to improving the access of the developing country exports to industrialised country markets.^{2/}

3.1 Quantitative Import Restrictions

Quantitative trade controls represent an obvious alternative to tariffs as a trade restricting device. Unilaterally-imposed quotas are not permitted under the GATT, except for balance of payments purposes, in conjunction with domestic agricultural programmes, or to protect the national defense. The two most significant U.S. quotas, on oil and on sugar, have been eliminated within the last decade. At the same time political pressure has grown to impose additional quotas, but this pressure has so far been resisted in large measure. Quotas on various agricultural products exist in a number of developed countries, however.

The GATT has been rather successful in limiting the use of unilaterally-imposed quotas by the industrialised countries. In addition, the new framework negotiated as part of the MTN calls for GATT signatories to avoid trade measures, including quotas, in dealing with balance of payments problems.

In contrast to the limited use of unilaterally imposed quotas, the use of bilaterally and multilaterally negotiated quantitative restrictions on international trade has increased dramatically in recent years. These voluntary export restraints (VERs) and orderly marketing arrangements (OMAs) are often imposed to "safeguard" import-competing industries in the industrialised countries. Developing country exports of such manufactured goods as textiles, footwear, consumer electronics and steel are restricted. Individual developing countries, notably Taiwan, Brazil, Mexico, Hong Kong, and South Korea may be especially adversely affected in their drives to industrialise according to comparative advantage by producing for export. More generally, exports of manufactured goods from developing countries are increasingly likely to be subject to safeguard actions in the industrialised countries.

^{1/} See Ingo Walter, "Non-Tariff Barriers and the Export Performance of Developing Countries," American Economic Review, May 1971

^{2/} For a summary, see "International Trade Agreements," Federal Register, 8 January 1979, Part VIII.

A "safe-guards code" was negotiated under the MTN to re-establish GATT authority over safeguard actions in the industrialised countries. The code requires formal investigation which factually demonstrates actual or potential injury before a safeguard may be imposed. If feasible, the safeguard should be liberalised over its lifetime, to encourage economic adjustment by the affected industries. Selective safeguards may be imposed against the specific sources of substantially increasing and injurious imports. A multilateral Committee on Safeguard Measures must enter the negotiations over the imposition of selective safeguards. No other selective restraint agreements are permissible. The industrialised countries agreed insofar as possible both to refrain from imposing safeguard actions on products of special export interest to the developing countries, and to allow more favourable access under any safeguard to small developing country suppliers under any safeguards imposed. Overall, the code makes major improvements in the international regulation of the use of safeguards, and should improve to some extent the export market access of developing countries. However, the code contains only a weak commitment by the industrialised countries to adjust out of industries in which comparative advantage is shifting to the developing countries.

3.2 Licensing

The role of import licensing in international trade is the enforcement of policies which themselves may or may not restrict the international flow of goods. Nonetheless, the administration of licensing may distort trade by raising costs or increasing uncertainty. Licensing may be especially restrictive of imports from less sophisticated developing country exporters because of the often detailed information requirements and administrative conditions imposed by the licensing arrangement.

A licensing code was negotiated under the MTN covering both automatic import licensing (often for statistical purposes) and licensing to administer quantitative import restrictions. Automatic licensing procedures must be published and must not restrict imports nor penalise minor documentation errors. Licensing to administer quantitative restrictions is bound by similar procedural rules, and should permit the addition of new suppliers into the restricted market. Developing countries are likely to benefit from the simplification and liberalisation of licensing procedures as the code is implemented in the industrialised countries.

3.3 Government Procurement

Government purchasing is an area in which virtually all national and sub-national governments discriminate in favour of domestic and against foreign suppliers. Such discrimination has become increasingly important as the role of government activities in national economies expands. In the United States the discrimination is written into various "Buy American" legal provisions. In other industrialised countries - with the possible exceptions of the Federal Republic of Germany, Belgium, and the Netherlands - the practice is pervasive if usually not explicitly written into law. Discriminatory procurement both restricts imports and may provide a captive-market base for aggressive

export promotion through dumping. The developing countries may be particularly affected adversely because of their own relatively lower levels of government procurement and hence limited bargaining power in gaining access to foreign government contracts.

A code on government procurement was negotiated as part of the MTN in order to eliminate administrative discrimination against or among foreign suppliers in public-sector purchasing. It provides for non-discrimination or "national treatment" in bidding, awards and disclosure, as well as substantial "transparency" in the procurement process. In addition, the industrialised countries agreed to attempt to facilitate developing country exports by improving information dissemination, continuing GSP provisions, and providing technical assistance, especially to the least developed of the developing countries. They can negotiate special time-limited derogations from the "national treatment" provisions, and thus can avoid adhering to non-discrimination when this threatens to interfere with the development process. Although the developing countries argued for but did not receive additional special and differential treatment in this area, the code should, when implemented, substantially liberalise government procurement practices to the long run benefit of exports from the developing countries.

3.4 Technical Standards

The number of technical standards in existence has increased remarkably in recent years, and presents an obstacle to international trade to the extent that compliance costs or uncertainties are greater for foreign suppliers than for domestic suppliers. Technical standards may be disproportionately burdensome for developing countries because of their limited information-gathering, technical, engineering, marketing, and related supply capabilities.

A code on technical barriers to trade has been devised as part of MTN. The code requires signatory countries to avoid unnecessary standards and the unnecessary creation of trade barriers through technical standards. Advance publication of all technical standards is required. Certification methods should not discriminate against foreign goods, and testing and certification undertaken in the country of export should be accepted whenever possible. International standards should be adopted to the extent possible. Technical assistance is to be provided to developing countries on request, in order to promote compliance of their exports with the technical standards of the importing country. The exports of developing countries should benefit from the liberalisation and non-discrimination embodied in the code, and especially from the technical assistance provisions.

3.5 Subsidies

Both export subsidies and domestic production subsidies alter the pattern of international trade, the latter by tending to reduce imports or increase exports. In recent years the imposition of countervailing duties to combat or neutralise subsidised exports has increased in frequency, in part because the U.S. Trade Act of 1974 reduces

the flexibility of the U.S. Treasury in imposing such duties. In fact, U.S. law has never been in conformity with the GATT, in that U.S. law does not require the demonstration of domestic injury prior to the imposition of countervailing duties. The developing countries have often been the targets of actual or threatened countervailing action because of their heavy use of export subsidies, in part to neutralise domestic distortions or overvalued exchange rates.

A code on subsidies and countervailing duties, negotiated under the MTN, reaffirms the right to use domestic subsidies, although their trade-distorting consequences must be considered. Export subsidies are banned except on agricultural products or if used by developing countries for specifically development purposes. The imposition of countervailing duties against subsidised exports requires a factual finding that the subsidy exists and that injury due to the subsidised imports exists or is likely. Thus, the value of the right of developing countries to subsidise exports is reduced because no parallel special and differential treatment of developing country exports with respect to countervailing duties exists. Nonetheless, the code should benefit the developing countries, by a least requiring injury tests to be included in national countervailing duty laws. At the same time, developing countries should pursue alternatives to subsidies in expanding exports, such as the elimination of export-reducing domestic market distortions or the imposition of a compensatory devaluation.

Another problem not explicitly considered in the MTN is dumping-selling abroad below the price in the domestic market. The MTN participants have agreed to revise the Anti-Dumping Code of the GATT to conform it with the subsidies code described above.

3.6 Custom Classification and Valuation Methods

Customs practices may act as obstacles to trade indirectly by introducing unnecessary complexity and uncertainty, or directly by overvaluing imported commodities. Most developing country complaints against customs valuation practices in the industrialised countries are directed toward the United States, Canada, and New Zealand, the three principal countries not using the so-called Brussels Definition of Value. In particular, the developing countries argue that their exports are overvalued if either the domestic price in the importing country (as in the "American Selling Price" method of customs valuation) or the domestic price in the exporting country is used to value internationally traded goods.

A code on customs valuation was developed during the MTN to provide an explicit, simple, and universal valuation system based on actual prices of internationally traded goods or, as a last resort, on a computed cost of production. The code achieves the developing countries' objective of banning valuation based on domestic prices, but unfortunately applies only to valuation for ad valorem tariff purposes. Therefore, other more complex or discriminatory valuation methods may continue to apply in other cases.

3.7 Variable Levies

By setting a minimum duty-inclusive import price, variable levies act much like quotas in eliminating the ability of imports to compete for an expanded share of the domestic market. The most notable use of variable levies is by the European Economic Community in implementing the Common Agricultural Policy. In accord with the GATT tradition of exempting agricultural products from its provisions, little progress was made by the recent MTN toward altering the EEC variable levies. In addition, the U.S. trigger price mechanism on steel imports, although technically an anti-dumping provision, may eventually have effects similar to a variable levy. In contrast to a variable levy system, however, cost-efficient exporters are permitted to price below the trigger price if they can show that they are not dumping. A variable levy system was recently imposed on steel by the EEC.^{1/}

In total, the multilateral agreements of the recent MTN to liberalise NTBs should significantly improve the market access of developing country exports. The developing countries nonetheless are disappointed in the outcome in that very few substantial areas of special and differential treatment exist within the agreements. In addition, the actual implementation of the arrangements is not assured. They must still be approved and enacted by individual industrialised country governments in the face of sometimes powerful domestic special interests. Once enacted, monitoring must assure compliance. The developing countries can assist the monitoring by participation - as individual countries or through international organisations - in the multilateral committees established as an integral part of each of the codes.

^{1/} See Ingo Walter, "Sectoral Protection and International Trade: The case of Iron and Steel," The World Economy, April 1979.

CHAPTER 4: METHODS TO REDUCE OBSTACLES TO EXPORTS FROM DEVELOPING COUNTRIES

4.1 Group Trading and Regional Arrangements

Among the methods available to reduce the obstacles to increased developing country exports to the industrialised countries, regional, and perhaps eventually global trading arrangements offer major advantages. Negotiation of such arrangements are multilateral and, in contrast to the MTN under the GATT auspices, focus on specific problems of the developing countries.

To date, the most important regional arrangement is the Lomé Convention, which entered into force 1 April 1976 between the European Economic Community (EEC) and a group of African, Caribbean, and Pacific (ACP) states. The antecedents of the Lomé Convention include Part Four of the Treaty of Rome (1958) creating overseas associates, the Yaoundé Conventions (1964 and 1971) of Association between the EEC (of six) and the association states, and the Arusha Convention (1971) with Kenya, Tanzania, and Uganda. The Lomé Convention was spurred, following the accession of Great Britain to the EEC, by the need to incorporate the developing Commonwealth countries into the associated states. The ACP states originally totalled 46 and now are 56. The EEC has also signed a series of conventions with countries bordering the Mediterranean for preferences and assistance somewhat less generous than those under the Lomé Convention.

Although the Lomé Convention carried forward the role of its antecedents in granting preferential market access to ACP exports and administering an EEC financial aid programme, the Convention is a significant improvement. In contrast to its antecedents, it offers an integrated approach to the encouragement of development, contains considerable non-reciprocity to the developing member countries, offers comprehensive export market access, establishes organisations to promote industrial cooperation, focuses special efforts on the least developed countries, and establishes a programme to stabilise the export earnings attributable to certain commodities.

The Convention grants access to the EEC market free of tariffs and quantitative restrictions for all exports from the ACP states, with the exception of certain agricultural products. Access for these restricted agricultural products, which were 0.8 per cent of total ACP exports to the EEC in 1973, is also preferential and more favourable than the access of non-ACP suppliers. Rules of origin are cumulative over all ACP processing, and the absence of limitations together with the liberal origin rules make ACP access more favourable than access to the EEC market under the Community's GSP scheme. The Convention also establishes institutional arrangements to negotiate the reduction of other NTB's maintained by the EEC. The principal of unlimited market access received a setback in 1977, however, when the EEC took safeguard actions against Morocco and Tunisia on textile exports.

Among primary commodities, sugar receives special access provisions in that the EEC agrees to import a minimum annual quantity at a guaranteed minimum price. The

minimum price is adjusted annually to be within the range of EEC internal sugar prices. The sugar arrangement is, in effect, the first commodity price-indexing scheme.

The Convention includes a declaration of EEC willingness to offer financial and technical assistance to promote industrial cooperation between the Community and the ACP states. The Convention establishes a joint Industrial Development Centre, supervised by an Industrial Cooperation Committee, to spread information and facilitate contacts. The Convention stresses a number of areas to promote development and diversification of industry in the ACP states: manpower development, transfer and adaptation of technology, promotion of industrial trade, and the planning and implementation of industrial projects.

The Convention also includes a facility called "Stabex" to stabilise the export earnings of certain primary commodities, originally 12 and now 18, all but one of them agricultural. To be considered under Stabex, export earnings of the commodity must be at least 7.5 per cent (sisal 5.0 per cent) of an ACP member's total export earnings to all destinations the previous year. To receive a transfer, nominal export earnings from sales to the EEC must be at least 7.5 per cent lower than the average during the previous four-year reference period. For the least developed ACP countries, both percentages are reduced to 2.5. The transfer, which equals the full difference between actual and reference period earnings, must be repaid by the recipient country only if future market conditions are favourable. The least developed countries need not repay. Stabex differs from the Compensatory Financing Facility of the IMF in that it does not require a balance-of-payments deficit, operates commodity-by-commodity, and grants interest-free transfers. Transfers under Stabex totalled \$88 million in 1975 and \$44 million in 1976. The Lomé Convention represents a major step forward in promoting cooperation among the industrialised and developing countries to encourage economic development.^{1/}

The developing countries should in the future strive both to improve the Lomé Convention and to extend certain of its features into global arrangements. Improvement of the Lomé Convention could include its extension to additional developing countries, inclusion of meaningful limitations against the imposition of EEC safeguards, and extension of guaranteed minimum prices to other primary commodities. Stabex could be improved by extending it to cover additional commodities, increasing the size of its fund, and liberalising the rules determining transfers, especially through inflation indexation of reference period earnings and replacement of the abrupt 7.5 per cent cut-off points with sliding scales. At the same time, all developing countries would benefit by incorporating aspects of the Lomé Convention into global arrangements. The Convention offers the model for a global GSP scheme allowing unlimited market access, indexed and guaranteed pricing of certain primary commodities, and export earnings stabilisation schemes for other primary commodities.

^{1/} For a more detailed discussion of the Lomé Convention, see "The Lomé Convention and the Evolution of EEC-ACP Cooperation," Commission of the European Communities, Brussels, July 1978. Cooperation among developing countries to promote development is discussed in Section 4.5 of the Joint Study.

4.2 Bilateral Trade Agreements

There are a variety of types of bilateral trading arrangements between industrialised and developing countries, some of which may be highly supportive of export-driven industrial development, while others may seriously retard this goal. These include: (a) Historical trade ties and post-colonial supply relationships; (b) Rubrique trade facilitation agreements between pairs of industrialised and developing countries; (c) Bilateral-clearing trade agreements between developing countries and socialist countries of Eastern Europe; and (d) Bilateral trade agreements covering individual products under voluntary export restraints (VERs) or orderly marketing arrangements (OMAs).

4.2.1 Historical Bilateralism

Historically, the most important forms of bilateralism between industrialised and developing countries clearly involved trade relations under the Commonwealth Preference system and smaller but perhaps more intensive arrangements involving the Francophone countries. These often had an essentially multilateral political overlay, but for practical purposes functioned bilaterally with respect to international trade. The developing countries involved were given preferential access to the market of the industrialised country involved through tariff concessions and the relaxation of a variety of non-tariff barriers. The terms of such market access was often quite liberal, although they generally also required "reverse preferences" - i.e., that the developing country involved grant preferential market access to the respective industrialised country over other industrial country suppliers. This frequently meant preferential treatment in government procurement and for products subject to state trading.

The effects of such bilateralism on the developing countries involved were clearly mixed, combining rather clear export-volume and possibly export-price advantages with the necessity of substituting imports from high cost suppliers for lower-cost imports under the reverse preferences. The evidence suggests, however, that there were overall net benefits associated with at least the Commonwealth Preference system.^{1/} This form of bilateralism was, of course substantially eroded with the Yaoundé and Lomé agreements between the FEC and the ACP and the Generalised System of Preferences, both of which are discussed elsewhere in the Joint Study. Nevertheless, it seems likely that some vestiges of post-colonial bilateralism remain in the French, British and Portuguese cases, specifically with respect to non-tariff barriers, and that this confers some trade benefits on the countries involved.

4.2.2 Rubrique Bilateralism

Trade facilitation agreements between individual developing and industrialised

1/ Cf. UNCTAD, Operation and Effects of the Generalised Preferences Granted by the United Kingdom (Geneva: UNCTAD document TD/B/C.5/7, 1973).

countries (or the EEC as a whole) essentially serve as broad statements of intent. An agreement may be signed to double or triple bilateral trade between two countries over a given period of time, for example. In the manufactures sector, such agreements clearly cannot abrogate MFN, GSP or other multilateral commitments of the countries involved, and preferential treatment on both sides must be confined to non-tariff barriers, such as government procurement. These give ample scope for preferential treatment, but will be narrowed with the implementations of codes of conduct negotiated during the Tokyo Round. Scope for such preferences on both sides remains, of course, to the extent that the developing countries do not become signatories of codes on NTBs negotiated under auspices of the GATT, or receive special and differential treatment in the form of exclusions, derogations, and the like. The other important effect of bilateral trade facilitation agreements involves credits, often large-scale and on concessionary terms, by the industrialised country to finance developing country imports. Here again there is the danger of diverting trade to a high-cost supplier and hence deterioration in the terms of trade of the developing country involved, although this may be partly or wholly offset by concessionary financing terms.

In the primary-products area, where goods are generally not subject to duty (e.g., industrial raw materials), bilateral trade facilitation arrangements may improve market access for developing countries in cases where the raw material-using industries are nationalised or otherwise influenced on sourcing by government policy. The same may be true in the case of agricultural products which are subject to tight import controls, where for example preferential quota allocations may be granted to individual developing countries on the basis of bilateral trade facilitation agreements. In such cases there may be a net benefit to the developing countries involved. Overall, however, any benefits in market-access attributable to such arrangements depend fundamentally on the existence of an underlying structure of trade distortions. It is unclear whether the developing countries involved do better under this form of bilateralism than if they were able to compete freely in an open market.

4.2.3 Bilateral Clearing

Bilateralism and trade-clearing arrangements between centrally planned economies and developing countries are also the product of the lack of market-determined outcomes both in the structure of supply and demand for internationally traded goods and services, and as a result of exchange controls. Centrally planned economies may source imports according to other than market-determined criteria under state trading. These economies are generally characterised by very strong import demand and limited export supply which, when coupled with growing indebtedness and debt-service burdens and the absence of other forms of capital inflow, create conditions of chronic foreign-exchange shortage. Almost by definition, the developing countries face much the same conditions, and so the stage is set for bilateral trade-clearing.

This may involve varying degrees of formality including, for example, the creation of blocked (inconvertible) local-currency accounts in the centrally planned country

through developing-country exports, which may be drawn down to pay for imports produced in that country. Such bilateral arrangements may be of long duration, including guidelines on maxima and minima for the blocked-account balances. Alternatively, the bilateralism may be focused on specific products, such as coffee for tractors, or chemical plants for chemicals. A number of problems are common to all such arrangements, and include the prices of the traded goods or services, their quality and availability, forced purchase of unwanted merchandise and its subsequent resale, renegotiation of agreements, intrusion of political variables. By locking themselves into such bilateral arrangements, of course, there may be substantial opportunity costs to the developing countries involved. Prices and product qualities can change, and the bargaining leading to a bilateral trade agreement may be seriously biased against the weaker party.

Bilateralism of this sort has been defended on grounds of "additionality" - that market-access barriers and other factors hold actual developing country exports below their potential exports, and that bilateralism permits incremental exports whose marginal returns exceed the marginal costs even after all of the associated costs and risks are considered. They clearly represent a second-best alternative to market-driven exports, but in a world plagued by trade distortions such agreements can entail a real net benefit. Moreover, because conditions remain unchanged over the life of the agreement, the uncertainties and risk associated with the market are avoided, thereby raising the value of such arrangements and perhaps justifying them despite the inefficiencies involved.

4.2.4 Bilateral Trade Controls

Finally, recent years have seen the development of bilateralism under so-called "voluntary export restraints" (VERs) and "orderly marketing arrangements" (OMAs). Here the importing industrialised country finds its markets "disrupted" by rapid increases in imports and approaches the suppliers to "voluntarily" limit their shipments under threat of mandatory import quotas or other forms of protection. Normally these limits are set in terms of a roll-back of current import levels to some previous year's trade volume, and generally a growth factor is included - e.g., import growth may not exceed the rate of growth of domestic demand. Normally OMAs and VERs are straightforward bilateral arrangements but occasionally they are sanctioned multilaterally, as in the Multifibre Arrangement (MFA) covering textiles under the auspices of the GATT. It is always incumbent upon the exporting country to police its own shipments. Indeed, under certain conditions bilateral OMAs or VERs may be more restrictive than nominally equivalent tariffs or quotas.^{1/}

Such bilateralism is almost totally negative from the point of view of the

^{1/} See Tracy Murray, Wilson Schmidt and Ingo Walter, "Alternative Forms of Protection Against Market Disruption," Kyklos, Fasc. IV, 1978.

developing country, since by definition it is trade-distortive in nature. Exports may have to be diverted to other markets at lower prices, damaging the terms of trade. If these diverted exports are in turn disruptive in third markets, they may lead to additional trade restrictions there as well. Even so, developing countries have become heavily involved with VERs and OMs because they perceive them as the lesser of evils.

4.2.5 Prospects

It is clear that bilateral trade arrangements are intrinsically suboptimal, and may involve very significant opportunity costs in comparison with open-market transactions. Only when those markets are themselves distorted does bilateralism have any prospect of contributing to the economic interests of developing countries. In a world distorted by trade barriers, this clearly was the case with historical ties, but these are being eroded by global and regional preferences. It may be the case with rubrique trade agreements and bilateral clearing, but only if additionality holds and adverse terms of trade effects do not materialise. It is never the case with bilateral trade restrictions. A certain amount of bilateralism in an imperfect world is clearly inevitable, but it is not necessarily a panacea for the export problems of the developing countries.

4.3 Adjustment Assistance

In order for the developing countries to exploit their evolving comparative advantage in international trade, the structural adjustment upon which this is based must be matched by simultaneous structural adjustment in the importing countries. As the supply capabilities of developing countries in sectors such as textiles, leather goods, steel and shipbuilding grows and conveys a competitive edge on world markets, the advanced countries must progressively disengage from these same sectors and move resources into more technology-intensive, higher value-added industries where they in turn possess a comparative advantage. Only if such adjustments in economic structures are in fact undertaken can the traditional gains from international trade and rational resource allocation be fully realised, thus contributing to maximum global income and output. On a continuing basis, maximum economic growth in open economies requires a constant redeployment or "churning" of productive resources out of decaying or "senile" industries in which countries are losing their comparative advantage and into newly emerging and high-growth industries in which comparative advantage is strong or in the process of development. If such redeployment is impeded, and resources do not move freely from sectors where their marginal product is low to sectors where it is higher, economic growth will inevitably be retarded.

The static and growth benefits of liberal trade are thus important for both the industrialised and developing countries. But the adjustments required are not without cost, and fall most heavily on the workers and owners of capital in the declining industries whose production is displaced by imports. Workers may be jobless for varying periods (sometimes permanently), must learn new skills, and often must move to new

locations. Owners of capital must write down the value of their assets, and sometimes go bankrupt. Such adjustment costs, which are thought to be larger the more rapid is the causative pace of import-penetration, raise serious questions of equity. If society as a whole benefits from liberal trade, does it not follow that society as a whole should bear an appropriate part of the burdens of adjustment? And if society refuses to share this burden, is it not understandable that the affected individuals then turn to protectionism? It is important to point out that this problem is not unique to adjustment related to international trade - it is equally important with respect to technological change, for example. But it is perhaps somewhat different in that the impacted factors usually find it easier to halt adjustment to trade-related shocks via protectionist actions than for example to halt technical change or postpone adjustment by "feather-bedding" or similar actions. The consequences of non-adjustment for real national income now and in the future, however, are quite similar.

Alternative Policy Responses

Three choices can be identified as possible policy responses to the problems of trade-related adjustment: (a) Permanent protection, avoiding the adjustment costs but sacrificing all future gains; (b) Slowing the speed of adjustment via "safeguard" or related actions to reduce the associated costs to the factors directly affected and sacrificing gains temporarily but not permanently; or (c) Publicly-financed adjustment assistance that transfers some of the costs from the factors directly affected to society at large, requiring often significant income transfers but leaving intact the gains from trade and growth. A combination of the alternatives is, of course, also possible and indeed likely.

One of the factors underlying the recent surge of protectionism is that countries have not done a very effective job in the design and implementation of adjustment assistance measures. A review of adjustment assistance programmes in effect indicates the following:^{1/} Canadian adjustment assistance is not specifically related to import competition, although it can be used for this purpose. The Federal Republic of Germany does not have an adjustment assistance policy as such, although ad hoc subsidies or trade measures may be used when particular sectors encounter structural difficulties. Japan has tailored adjustment assistance measures mainly to smaller enterprises affected by international developments such as the GSP, changes in the value of the yen, and trade measures taken by other countries, covering both export and import-related shocks. The Netherlands has introduced adjustment assistance measures as part of an economic restructuring programme linked to development assistance policy, thus supporting adjustment to international competitive shifts in favour of developing countries. After introducing adjustment assistance provisions into the Trade Expansion Act of 1962 and

^{1/} See Adjustment Assistance Measures, Report by the UNCTAD Secretariat, document TD/B/C.2/198, 4 April 1978.

observing their poor performance: following the Kennedy Round of trade negotiations, the United States introduced liberalised adjustment assistance into the Trade Act of 1974. Eligibility has been increased, benefits enhanced, time lags reduced, and assistance allocated to entire communities affected by increasing imports. At this time it is too early to evaluate the administration of the new U.S. adjustment assistance provisions.

International Initiatives

Various international organisations have taken up the question of adjustment assistance. At its 1976 Tripartite World Conference, the International Labour Organisation laid down several general principles - that employment policies should be designed to create new job opportunities for trade-displaced workers, that adjustment assistance should reduce the burdens borne by the labour sector, that imports from the developing countries should be liberalised, that adjustment assistance is preferable to import restrictions, and that it should be "anticipatory" and made available before the adjustment costs are incurred.^{1/}

The European Economic Community has established the European Social Fund, which can be used in part for adjustment assistance purposes especially through vocational training and geographical mobility of workers. The Fund will subsidise 50% of the cost of vocational training programmes. Increased eligibility, more effective targetting on incipient labour market problems and improved administration have increased the Fund's usefulness for adjustment assistance, although it remains a general device to deal with labour-market adjustments rather than a specific tool aimed at adjustment to shocks related to international trade. Aid to affected industries, for example, is not included.^{2/}

The Organisation for Economic Cooperation and Development (OECD) has also examined the matter of adjustment assistance in a comprehensive research project. The conclusions document the importance of the displacement effects of imports from developing countries relative to overall structural change in OECD countries. They also note that no industrialised country has in fact implemented adjustment assistance policies specifically to promote imports from developing countries, although some have accelerated factor-disengagement from obviously uncompetitive sectors. Indeed, public policy was more often than not found to have served to delay such disengagement. Finally, the OECD concluded that structural, regional and employment policies must be integrated with international trade policy, and that the most effective factor in structural readjustment is a high level of overall employment.^{3/}

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- 1/ Declaration of Principles and Programme of Action (Geneva: International Labour Document E(5857), June 1976).
 - 2/ Review of the Social Fund (Improvement Proposed) (Brussels: Commission of the European Community, March 1977).
 - 3/ OECD Development Centre, Adjustment for Trade, Studies on Industrial Adjustment Problems and Policies (Paris: OECD Working Document CD&TI(75)3, 1975).

Finally, the General Agreement on Tariffs and Trade has focused on adjustment assistance mainly in connection with the operation of the Arrangement Regarding International Trade in Textiles (MFA), which states that its operation should not serve to impede "autonomous industrial adjustment" to shifts in international comparative advantage. It encourages textile firms pressed by competitive imports to move progressively into more viable lines of production of other sectors of the economy. Any safeguard action undertaken should assist in the process of adjustment and should only be used in exceptional circumstances. It does not, however, commit the signatory countries to underwrite the costs of adjustment assistance in the textile industry. In practice, the operation of the MFA and its predecessor, the Long Term Arrangement Regarding International Trade in Cotton Textiles (LTA), has frequently concentrated on impeding structural adjustment rather than promoting it.^{1/}

Guidelines and Prospects

As the efforts of the international organisations discussed here as well as those of UNCTAD and UNIDO show, a great deal of work remains to be done in securing the acceptance of policies designed to foster affirmative structural adjustment to trade-related shifts in firm and sector economic viability. Such assistance can, as we have noted, be clearly justified on both efficiency and equity grounds. Yet because fiscal disbursements are involved it is often easier to adopt protectionist measures of non-adjustment, whose costs are often disguised and widely disbursed in the form of the sacrifice of the gains from trade. Indeed, the measures adopted often generate fiscal revenues. Even when the principles of adjustment assistance is accepted and put into practice, it is important that these efforts promote "adjustment-out" rather than "adjustment-in" - that is, redeployment of productive factors into other, internationally competitive lines of production rather than modernisation and rejuvenation of existing production, which merely delays the adjustment that ultimately will be required and compounds the ultimate costs that must be borne. Evidence from the U.S. and European experience suggests that "adjustments-in" has been heavily used in such sectors as steel and textiles.^{2/} A valid criticism of the use of adjustment assistance, however, is that increasing import competition is sometimes caused by foreign export subsidies or dumping rather than underlying shifts in comparative advantage.

The developing countries have long argued in UNCTAD and elsewhere that adjustment assistance measures should be implemented in the advanced countries to facilitate market-access for their exports. The response of the industrialised countries has not been encouraging for such an argument related to developing countries' needs. The argument

^{1/} See UNCTAD document TD/B/C.2/170 for the eighth session of the Committee on Manufactures, Geneva, July 1977 for an assessment of adjustment in the textiles Sector.

^{2/} See, for example, Ingo Walter, "Sectoral Protection and International Trade: The Case of Iron and Steel", The World Economy, April 1979.

is valid, but it may be made differently. The industrialised countries should pursue adjustment assistance for their own benefit, to reap the very real static and dynamic gains from liberal trade, which inter-alia are attributable to a greatly improved and sometimes rapidly-changing division of labour between the industrialised and developing worlds.

