International Trade in Manufactures Among the Developing Countries

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One important plank in the proposals for a new international economic order is the prospect of increased trade in manufactures among the developing countries themselves. In fact, the Lima Declaration for a target increase in developing countries' share in world production of manufactures from the present 8 to 25 percent by the year 2000 must be based on a significant increase in intra-developing countries trade.[1] Contemporary discussions of developing countries' trade in manufactures have tended to concentrate on problems of "access" to industrial markets, while prospects of increased trade among themselves have received only modest attention. This emphasis seemed natural in view of developing countries' traditional preference for "hard currency" exports with a view to increasing their import capacity for capital goods and technology. This preference can be traced largely to the absence of complementarity in production structures among the group of developing countries. However, the structure and the "equity" of the current international division of labor are being increasingly challenged by events and superseded by developing countries' policy objectives. As the basic parameters of this struc-

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1 For a critical evaluation of the Lima Declaration and for its implications for mutual trade in manufactures among the Group of 77, see Ahmad (1977).

ture begin to change, not the least by the desire for a greater mutual interaction among the economies of the developing countries, there has emerged an acuter sense of possibilities of mutually beneficial trade among themselves.

The purpose of this paper is two-fold: firstly, to offer a set of propositions about the likely trends in intra-developing countries' trade in manufacturers, and secondly, to propose a scheme of preferential trading designed to bring about "trade creation" and "trade diversion" benefits to the developing countries.

I

Recent changes in the international structure of production suggest that developing countries' preference for hard currency exports (and hence for hard currency imports) may be softening up. The most important change that warrants this conclusion is that a number of developing countries are gradually emerging as important sources of supply of manufacturers. Vigorous import substitution efforts during the past two decades have enabled a number of developing countries to build up a wide spectrum of industrial capacity frequently operating at less than full capacity. Despite many production bottlenecks that remain, many of these countries are efficient producers of industrial goods, as witnessed by their competitive pressure on industrial markets for textiles, electronics and steel products. Moreover, there is increasing evidence of at least a limited degree of complementarity between the semi-industrialized and the rest of the developing countries. A recent econometric study of trade flows among the developing countries by Amsden (1976) discovers complementarity more often than competitivensss among a selected group of developing countries.[2] This sort of complementarity, clearly accentuated by uneven domestic development as well as a differential response to international economic conditions, is to be expected in a group of countries as large and heterogenous as the Group of 77.

Developing countries' total exports of manufacturers (SITC 5-8 less 68) amounted to $29.5 billions in 1976. Of this, fully two-thirds, i.e. $20.5 billions, were destined for the industrial coun-

2 Amsden's results suggest a positive correlation between exports of manufactures of the semi-industrialized developing countries and the degree of industrialization (manufacturing/GDP ratio) in the importing developing countries. This supports the positive outlook for an expansion of trade in manufactures among developing countries as industrialization progresses.

tries, while only $9.0 billions' worth were sold to other developing countries.[3] Nevertheless, intra-developing countries exports of manufactures more than doubled in value between 1972 and 1976. As shown in Table I, a sizable proportion of exports of manufactures from a number of developing countries are sold to other

Table I

EXPORTS OF MANUFACTURES FROM SELECTED DEVELOPING COUNTRIES TO OTHER DEVELOPING COUNTRIES AND TO THE WORLD

Exporting Country	Total Manufactures' Exports		
	Developing Countries	World	Share of Exports to Developing Countries
	($ million)		(%)
El Salvador	261	268	97.3
Costa Rica	94	100	94.0
Brazil	1470	2114	69.5
Chile	53	81	65.4
Argentina	317	509	62.3
Indonesia	34	56	60.7
Singapore	1594	2903	54.9
Colombia	102	195	52.3
Pakistan	243	683	35.6
India	1015	2866	35.4
Thailand	51	145	35.2
Philippines	97	306	31.7
Mexico	541	2043	26.5
Korea	1175	6273	18.7
Hong Kong	1177	6951	16.9
Yugoslavia	399	3241	12.3
Total	**8623**	**28734**	**30.0**

Source: UNCTAD, *Trade in Manufactures of Developing Countries and Territories*, and United Nations, *Commodity Trade Statistics*, various years.

3 Developing countries' exports to the socialist countries in 1972 amounted to $1.2 billions, a mere 4 percent of the total.

Table II

REGIONAL DISTRIBUTION OF INTRA-DEVELOPING COUNTRIES' TRADE IN MANUFACTURES
($ millions, fob)

Exports to / Exports from	Developing countries	Developing Countries in Africa	Asia	Americas Total	LAFTA
Developing countries					
1968	2215	342	1323	550	283
1972	4390	699	2420	1271	750
1976	9087	1354	4772	2961	1748
Developing countries in					
Africa					
1968	147	105	40	2	1
1972	299	245	40	14	8
1976	536	440	46	50	26
Asia					
1968	1577	229	1279	69	36
1972	2984	425	2410	149	59
1976	6139	983	4973	183	73
Americas					
1968	491	3	6	482	246
1972	1107	7	18	1082	687
1976	2412	16	41	2355	1531

Source: UNCTAD, *Trade in Manufactures of Developing Countries and Territories,* and United Nations, *Commodity Trade Statistics,* various years.

developing countries. The two important variables in the expansion of intra-developing countries' trade are its geographical distribution and its commodity composition. Table II shows that the largest part of developing countries' mutual trade is concentrated in Asia, followed by Latin America, while Africa accounts for a negligible proportion. Most of this trade is "regional" in the sense that the largest proportion of exports from the three continents are sold within the continent. This geographical concentration is undoubtedly influenced by distance as well as by existing

Table III

COMMODITY COMPOSITION OF INTRA-DEVELOPING COUNTRIES' TRADE IN MANUFACTURES

($ million fob)

SITC	Description	Value and Per Cent of Exports						Per cent Change
		1968		1972		1976		1972-76
		($)	(%)	($)	(%)	($)	(%)	
5	Chemical Products	325	.15	690	.16	1501	.16	117.5
7	Machinery and Transport Equipment	375	.17	1060	.24	2997	.33	182.7
6, 8	Other Manufactured Goods	1515	.68	2640	.60	4654	.51	76.3
	Total	2215		4390		9152		108.4

Source: United Nations, *Commodity Trade Statistics*, various years, supplemented with national sources.

preferential arrangements, such as LAFTA. Table III provides available information on the disaggregation of trade by SITC. Close to half of intra-developing countries' trade in manufactures in 1976 was in a wide variety of miscellaneous products under SITC 6 and 8, a third in machinery and equipment, while chemical products account for one-sixth of the total. However, the largest percentage growth of exports has occured in SITC 7, while there is a relative decline during 1972-76 of the relative weight of predominant category SITC 6 and 8 in the total. The other notable feature of such trade is the fact that nearly three-fourths of total exports of manufactures among the developing countries are accounted for by 25 countries.

II

Mutual gains in static and dynamic efficiency result when countries with disparate endowment of resources and patterns of demand trade with each other. The neo-classical, two-factor model of trade suggests that the dissimilarity of capital-labor ratios between the developing countries should lead to some specialization and exchange of products. In addition, a sizable proportion of trade in manufactures takes place between countries with broadly similar patterns of demand and incomes (Linder 1961). On both these counts, developing countries offer promising opportunities for increasing the volume of their mutual trade. The Group of 77 comprises of a large and heterogenous collection of countries with widely different endowment of resources in a way that their individual modes of specialization are likely to complement and mutually reinforce each other. On the other hand, developing countries often have a uniform and overlapping pattern of demand for manufactures which affords an important opportunity for producing and supplying each other's demand.

The prospects of developing countries' trade with each other are closely allied with their current commercial policies. The development of a broadly similar range of domestic industries behind protective walls has been a pervasive element of trade policy in most developing countries for the past two decades (Little, Scitovsky and Scott 1970, Balassa 1974, Ahmad 1978). This has meant that potential exports of industrial goods to each other frequently face formidable trade barriers. Such patterns of protection have also meant production for thin domestic markets within national borders, with consequent inefficiency and inadequate utilization of capacity. More intensive trade among themselves will, therefore, go a long way toward rationalizing their own production structures, and a correspondingly lesser reliance on protection for future industrial development. It is obvious, therefore, that an important precondition for an enlarged trade within the developing countries is a change in their tariff and non-tariff policies with respect to each other. This change should aim at achieving a preferential treatment of industrial products originating in and traded between the developing countries. In order to increase the range of potential products that could be traded, it is also necessary that trade preferences should be non-discriminatory between 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 CACM. A program of general preferences among the developing countries as a group will have to be dovetailed into a framework of existing or incipient integration schemes in the Third World. Practical possibilities exist for retention of existing free trade areas and common markets within the larger framework of preferential trading arrangements extending to all developing countries. In free trade areas, for instance, where intra-union trade is wholly or substantially liberalized, the preferential tariffs extending to developing countries outside of the free trade areas could be higher than the rate applicable to partner countries but lower than the MFN rate applicable to non-developing countries. For common markets where intra-union trade is wholly liberalized, the preferential rate applicable to developing countries outside of the common market could lie anywhere between zero and the height of the common external tariff.[4] These and other such devices would ensure that general preferential arrangements extending to all developing countries do not erode existing or incipient integration tendencies among them. This may be desirable for promoting regional solidarity and cohesion, even though the current integration schemes among the developing countries are not exactly models of success.

Given the existing structure of developing countries' trade policies with respect to each other and the possibilities of preferential trading outlined above, the following propositions may be advanced.

4 The problem of non-tariff barriers in general may prove to be more intractable, but devices such as differential heights of QRs, selective safeguards, uniform customs valuation procedures and product standards are possible.

Proposition I. Initially the major proportion of increase in intra-developing countries' trade would come from *trade creation*, i.e., through a switch in the source of supply from domestic producers to other developing countries, and will represent a net increase in world trade. This will have two major consequences. Firstly, trade creation will lead to an improvement in the static allocative efficiency within their domestic economies, and its consequent favorable effect on economic growth is likely to further increase their imports from each other, as well as from the developed industrial countries. Preferences among themselves should, however, be designed in a way that they promote both inter-industry and intra-industry specialization. The former should aim at curbing the tendency toward "proliferation" of a wide range of manufacturing industries in individual developing countries regardless of cost and efficiency considerations. The broad range of industrial production in the group of developing countries could remain the same (or in fact, even increase), but its distribution could become more optimal if locational decisions are governed by intra-developing countries' comparative cost ratios. Intra-industry substitution, by contrast, should aim at diversifying the locus of production among the group of developing countries of the various stages of fabrication in a vertically integrated industry, e.g. steel, as well as of production products in consumer goods industries, e.g. textiles which runs through a whole chain of man-made fibers and fabrics to made-up garments. The natural advantage of the larger, semi-industrialized developing countries may lie in fibers or textiles which are relatively less labor-intensive, while other developing countries may specialize in apparel making-up which is more labor-intensive. Similarly, in the garment sector there are significant possibilities of specialization in types and sizes of garments e.g., childrens clothing according to intra-developing countries' comparative advantage. Both types of substitution will have the effect of reducing the real cost of a given degree of industrialization for each of the developing countries.[5]

Secondly, the reduction of internal trade barriers due to preferential arrangements is likely to stimulate industrial competition among the developing countries, leading to the emergence of larger and more specialized firms better able to take advantage of economies of scale in production and marketing. This will have the effect of increasing their capacity to export to the rest of the world,

5 This expected result was highlighted by Cooper and Massel (1965) in a similar context.

and paradoxically, to the developed countries as well. This leads us to

Proposition II. Increasing intra-developing countries' trade will have the effect of increasing their exports to the developed countries. There is, of course, the possibility that an expansion of the preferential market for the group of developing countries may induce a diversion of their current exports to the developed countries to other developing countries. While increasing the volume of trade among the developing countries, this diversion does not represent a net increase in world trade; neither does it signify a net increase in developing countries' domestic production of manufactures. Moreover, this diversion will clearly reduce their capacity to import from the industrial countries, and thus could adversely affect the process of capital formation and economic growth. But in a dynamic, long-run context, preferential arrangements among developing countries may work through reduction of imports from the developed countries, as a sort of import substitution process at the level of the entire set of developing countries. This suggests

Proposition III. In a dynamic context, the developing countries' sources of supply of imports may be switched increasingly to other developing countries: This diversion, as before, will not represent a net increase in world trade. However, it will not only increase trade among the developing countries but, more significantly, will increase domestic industrial production in the developing countries as they start trading with each other industrial goods that were previously imported from the developed countries. The effect on the trade balance between the developing and the developed countries would be neutral only in the special case where two forms of trade diversion exactly equal each other. In other words, if the fall in developing countries' exports to the developed is matched by a fall in their imports from the latter, there would be no change in the trade balance and an equilibrium would obtain at a lower volume of trade. On ther other hand, if the fall in exports exceeds the fall in imports, the trade balance will worsen, while it will improve if the opposite happens.

The possibilities of trade diversion, viz., the switch in the source of supply of existing imports away from the developed countries, may be initially quite limited. However, the switch from developed to other developing countries as sources of supply and demand is relevant for most developing countries in a dynamic setting. The temporal sequence envisaged in the above three propositions will mutually and cumulatively reinforce each other toward enhancing developing countries' aggregate industrial capacity. This sequence will profit from the uneven structural developments in the developing countries and will perhaps accentuate it even further to the extent that industrial capacity will be strengthened and upgraded at a faster rate in the relatively more industrialized of the developing countries. This sequence has a added plausibility due to two additional factors. Firstly, the scale and learning effects reflected in lower average cost of industrial production as a result of increased mutual trade are likely to be more pronounced in the semi-industrialized developing countries, and make them more competive vis-a-vis the developed countries. The semi-industrialized developing countries would thus acquire the potential to displace imports from the developed countries into non-industrial developing countries, and accentuate the process of trade diversion. For instance, general preferential trading arrangements among all developing countries may allow semi-industrialized developing countries to displace developed countries' exports to ACP countries under the Lome Covention.[6] Whether actual displacement takes place or not will crucially depend on the growth of demand. If the demand in the totality of developing countries were to rise sufficiently rapidly - a process certain to be helped along by increased mutual trade - there may be no actual fall in developing countries' current imports from the developed world. However, as demand continues to grow, the size effect will work to change the comparative advantage in certain lines in favor of the structurally more viable developing countries, and trade diversion may begin to take place. Secondly, trade diversion away from the developed countries will increasingly take place as "protect differentiation" in developing countries' industrial output increases. In the real world where trade takes place in non-homogeneous products, the possibilities of specialization in narrow and differentiated products increase geometrically.

III

A future task of some priority should, therefore, be the initiation of a forum where the developing countries could undertake trade liberalization among themselves, either through rounds of negotiations or any other suitable modality. Such efforts would initially require a large amount of preparatory work in order to identify the trade flows most likely to benefit from trade liberali-

6 The ACP countries are some 40 small African, Carribean and Pacific countries that have signed preferential trading arrangements with the EEC in 1975.

zation within the developing countries' preference area, as well as to devise ground rules and modalities of negotiations. Initially, a loose form of trade liberalization agreement involving a limited number of products may be preferable to more general techniques of trade liberalization such as the Concertina Method. Across-the-board reductions in tariffs popular in rounds under the auspices of GATT will not be suitable for initial liberalization attempt among the developing countries, since they will trigger widespread fear about the survival of many nascent industries and sectors. The recent treaties involving limited trade concessions among ASEAN may serve as useful examples.[7*] Such negotiations among the developing countries should preferably be undertaken outside of the GATT framework, since the provisions of the General Agreement with respect to MFN, the "major supplier" and the "escape mechanisms" are unduly restrictive and have outlived their utility in the contemporary trading world. They are typically inadequate to deal with developing countries' problems, since they were never meant to deal with them anyway.

At the same time, attention will have to be paid to building the infrastructure for supporting the increased mutual trade among developing countries. One prominent reason why trade among developing countries is a small proportion of their total trade is that most of the financing and credit arrangements have historically been established to finance the trade between the developed and the developing countries (Stewart 1975). It would, therefore, be necessary to create or remodel the existing financial institutions and intermediaries for facilitating the exchange of goods and services among the developing countries. In this respect, the developed countries with their financial resources and institutions can provide valuable assistance to developing countries in financing and underwriting their mutual trade. These "services" should not cost real resources to the developed countries, and may in fact earn them foreign exchange through exports of "invisibles". Possibilities of increasing intra-developing countries trade also open up challenging possibilities for designing novel payments arrangements. These can range from pure barter arrangements to developing countries' payments unions and common currency areas for trade.[8]

7* A preferential trade agreement for members of the Association of South East Asians Nations, covering 71 primary and manufactured goods, went into effect on January 1, 1978, *IMF Survey*, January 9, 1978.

8 A number of developing countries, most notably India, have made extensive use of barter arrangements for increasing their exports to the socialist countries.

IV

Quite apart from the favorable efficiency effects of increased intra-developing countries trade in manufactures as outlined above, such arrangements would permit greater independence to developing countries in formulating their trade and development policies.[9] This is clearly an area where developing countries can take unilateral initiatives and no agreement on the part of developed countries is necessary. It is true that the larger and the semi-industrial developing countries will continue to look to the markets of the rich industrial countries, despite immediate problems of "access". For other developing countries, however, possibilities of trading with each other may mean that they have to be less dependent on exports to rich countries for their development. Further, increased trade among the developing countries is likely to have an important by-product: it will open up greater possibilities of mutual trade in primary commodities as well. To the extent that intensive trade in manufactures broadens the outlet for primary commodities for processing within the group of developing countries, it will help further reduce the dependence of the developing countries on rich industrial countries as monossonistic buyers of raw materials.

Finally, the increased mutual trade among the developing countries will force the international economy into effectively transfering a larger proportion of value-added in world production of manufactures to the developing countries. In order words, preferential trading arrangements would lead to a greater tendency toward the shift of the locus of industrial production to the developing countries – a circumstance which is consistent with the Lima Declaration. In 1976, the rich industrial countries' (U.S., the EEC and Japan) exports of manufactures to the developing world totaled roughly $103 billions, while their imports from the latter at $30.23 billions are only one-third of their exports.[10] Even a modest succes in "diverting" part of the developed countries' exports of manufactures to developing countries would appear to be a promising avenue of increasing the latter's share in world industrial production. The proposals for a direct transfer of industry to the developing countries in a "new international division of labor", as frequently advanced by RIO and The Club of Rome, appear to

9 Diaz-Alejandro (1974) suggests that the altered policy responses in developing countries inevitably weigh on the side of "non-intrusiveness" and "independence".

10 see "From Free Trade to Adjustment", *The Economist,* London, December 31, 1977, p. 76.

have a low probability of success, since it would be difficult to convince many in the rich countries that such transfers would benefit them. On the contrary, they would be perceived as inimical to their economic interests, and would be dubbed as instruments of "exporting" jobs out of the developed countries. The experience with the off-shore assembly operations of the U.S. multinationals and the subsequent clamor for trade restrictions and stringent tax provisions leave little room for optimism on this score. It is quite clear that such a transfer of industries primarily producing for domestic markets in industrial countries, even if possible, will give rise to the same problems as encountered in permitting freer entry of manufactured exports from the developing countries. It is also important to note that if the transfer of industries to developing countries is limited to slow-growth, low value-added, and polluting industries (as is often suggested), the resulting transfer may be more harmful to the developing countries than their own limited industrialization efforts.

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