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Shifting Patterns of World Trade and Competition

SHIFTING PATTERNS OF WORLD TRADE AND COMPETITION

According to Professor Paul Samuelson, the first Nobel Prize winner in economics, "manufacturing industry is trying to leave North America and Western Europe. The basic comparative advantage is moving to the 'Gang of Four': South Korea, Taiwan, Hong Kong and Singapore".¹ This statement sounds surprising, considering that the industrial output of the ‘Gang of Four’ is about $80 billion today while that of the countries of North America and Western Europe is nearly $5 trillion, i.e., 60 times more. Perhaps the mouse-elephant analogy may be appropriate here.

But Professor Samuelson only articulated a malaise that has repeatedly found expression in newspaper articles and in popular writings. It has been claimed that manufactured imports from the developing countries have adversely affected industrial activity in the developed countries in recent years, and that these imports are bound to cause further harm in the future. The policy implication, expressed in particular in the writings of the so-called Cambridge Group in England, is that the developed countries should defend themselves against the onslaught of cheap goods from the developing world.

Other observers, in turn, have alleged that the manufactured exports of the developing countries have suffered as a result of increased protection in the developed countries, and that protection will compromise the prospects of these exports in the future. Correspondingly, so the argument goes, the developing countries should turn inward and spurn the advice offered by some, myself included, for outward orientation.

It is apparent that these claims are in conflict. In particular, if protectionism in the developed countries has sharply limited their imports of manufactured goods from the developing world, their exports of manufactured goods to the developing world should have suffered as well.

¹ World Business Week, December 1, 1980.
world, such imports could have done little harm to the industries of these countries. We need evidence, then, in order to choose between the conflicting claims — or reject both.

Trade in manufactured goods between developed and developing countries

Economic activity in the developed countries suffered from the adverse effects of the quadrupling of petroleum prices in 1973-74, the world recession in 1974-75, the 150% increase in petroleum prices in 1979-80, and the ensuing slowdown. Correspondingly, industrial production in these countries rose at an average annual rate of only 2% between 1973 and 1980. By contrast, their manufactured imports from the developing countries continued to increase rapidly, averaging 11% a year in volume terms.

These results should not be interpreted, however, as evidence that trade in manufactured goods with the developing countries has adversely affected developed country industries. This is because the rise in export earnings permitted the developing countries to expand their purchases of manufactured goods from the developed nations. In fact, financed in part by foreign borrowing, the non-OPEC developing countries increased their purchases of manufactured goods over and above those permitted by the growth of their manufactured exports. As a result, the export surplus of the developed nations in trade in manufactured goods with the non-OPEC developing countries rose from $25 billion in 1973 to $85 billion in 1980, to which should be added the increase in the developed nations' export surplus in manufactured trade with OPEC from $13 billion in 1973 to $82 billion in 1980.

The contention that trade in manufactured goods with the developing countries would have adversely affected industrial expansion in the developed countries can thus be rejected. Rather, with the existence of unused capacity in these countries during much of the period under consideration, their growing export surplus in manufactured goods permitted them a higher level of industrial output.

Nor do the data support the contention that increased protectionism in the developed countries has limited manufactured imports from the developing world in a major way. As just noted, these imports continued to rise at a rapid rate, notwithstanding the deceleration of economic growth in the developed countries. An increase was 8% a year even
in the imports of textiles and clothing, again expressed in volume terms, reflecting in part the rise (in terms of fiber-weight) allowed by the Multifiber Arrangement (MFA) and in part the upgrading of exports by the developing countries.

**Protectionist actions by the developed countries**

These results require explanation, given the widespread perception of increased protectionism in the developed countries. In fact, in the wake of the oil crisis and the world recession, protectionist actions multiplied and assumed new forms:

- non-tariff measures, such as import quotas, orderly marketing arrangements, and voluntary export restraint;
- government aids to particular industries and regions;
- and efforts made to establish international cartels.

Protectionist actions against developing countries culminated in 1977, when Western Europe experienced a recession and the U.S. balance of payments deteriorated as a result. The process has not continued, however, and, in some respects, has been reversed in subsequent years. This conclusion applies to tariff and non-tariff measures, to government aids, and to cartel-type arrangements.

To begin with, the Tokyo Round of Multilateral Trade Negotiations has been brought to completion. It has achieved an average one-third tariff reduction on industrial products of interest to the developing countries that has been offset only in small part by decreases in preferential margins under the General System of Preferences. Also, agreement has been reached on several codes for non-tariff measures, including subsidies and countervailing duties, customs valuation, import licensing, technical barriers to trade, and government procurement, all of which grant special and differential treatment to the developing countries. A significant exception is the safeguards code, protracted negotiations on which have not led to an agreement.

Furthermore, there have been fewer applications of non-tariff measures in the United States and in the European Common Market, and they have mostly affected the developed countries. At the same time, Japan has to a considerable extent liberalized the importation of manufactured goods from the developing countries, eliminating import quotas and improving access and credit terms.

Government intervention in the domestic economy is also on the decline in Japan. In the United Kingdom, the conservative government of Margaret Thatcher has set out to re-
duce the scope of government aids to industry. And, notwithstanding its decision in the spring of 1981 on automobile imports from Japan, the Reagan administration in the United States is not prepared to pursue the interventionist strategy proposed as "re-industrialization" by President Carter.

Finally, the government of Raymond Barre took steps to limit government intervention in France, although this may be reversed by the new socialist administration. It does not appear likely, however, that France's socialist government will espouse proposals for worldwide organized trade put forward, and then dropped, by its predecessor. At the same time, its espousal of Third World causes may lead to a more favorable attitude in France towards imports from developing countries. Finally, the defeat of Commissioner Etienne Davignon's scheme for establishing a synthetic fiber cartel in the European Common Market has discouraged attempts to set up cartels in other EEC (European Economic Community) industries.

The easing of protectionist pressures in the developed countries after 1977 has contributed to the acceleration of the growth of their manufactured imports from the developing world. While the volume of these imports rose by only 8% in 1977, the increase was 16% in both 1978 and 1979. According to preliminary data, these imports grew by 10% even in 1980, a recession year in developed economies.

Although the more restrictive rules on textiles and clothing imports from the developing countries adopted in the course of the revision of the Multifiber Arrangement have remained in effect, after stagnating in 1977, the imports of textiles and clothing have risen again. The increase was about 8% in volume terms in both 1978 and 1979, with only a slightly smaller rise in 1980.

It is noteworthy that the 1980 recession has not brought an aggravation of protectionist tendencies in the developed nations against the developing countries. Rather the fire of the protectionists has been directed against other developed countries, which can better defend their interests.

Prospective changes in trade in manufactured goods

But what does the future hold? I have examined possible future trends in making projections for trade in manufactured goods between developed and developing countries
on the assumption that present trade policies will continue. I will review the principal results of these projections and will return later to the question of desirable policy changes.

According to the projections, the manufactured imports of the developed countries from the developing world will grow during the 1980s at an average annual rate of 13%. But this will be accompanied by higher exports, so that the export surplus of the developed countries in trade in manufactured goods with the developing countries will triple during the period. The increase in their export surplus, in turn, will contribute to industrial growth in the developed nations, raising the rate of growth of their manufacturing output by one-tenth above that of the consumption of manufactured goods.

The developing countries will become increasingly important markets for the manufacturing industries of the developed nations, providing an outlet during the 1980s for one-fifth of the increase in their output and for three-fifths of the rise in their non-regional exports (i.e. excluding trade within North America and within Western Europe). In turn, the developing countries will supply one-tenth of the increase in the consumption, and one-half of the increase in the inter-regional imports, of manufactured goods in the developed nations.

Common interests

These results indicate the existence of common interests between developed and developing countries. While the rapid growth of manufactured exports would provide a basis for the pursuit of outward-oriented strategies in the developing countries, they would become increasingly important markets for, and contribute to industrial growth in, the developed nations.

At the same time, both groups of countries would benefit from specialization according to comparative advantage, entailing the exchange of products embodying sophisticated technology, high-level manpower, and physical capital for products utilizing unskilled and, increasingly, semi-skilled and skilled labor. This would be accomplished without a decline in the developed countries' output in any of the eight industrial categories for which separate projections have been made. In particular, their domestic production of textiles and clothing would continue to rise as the near-doubling of imports from the developing countries, projected on the assumption that the Multifiber Agreement will continue, would provide for only a small part of the increase of domestic consumption in the developed countries during the 1980s.
Intra-industry specialization between developed and developing countries

These conclusions conflict with the traditional view, according to which international specialization necessarily involves the expansion of some industries and the contraction of others. They reflect the effects of recent developments in intra-industry specialization between developed and developing countries, which much increased in importance during the 1970s.

Horizontal specialization

Intra-industry specialization may be "horizontal" or "vertical". Horizontal specialization occurs as different product varieties are traded between developed and developing countries. In turn, vertical specialization takes place in the framework of the international division of the production process through foreign processing and the exchange of parts, components, and accessories.

The U.S. textiles and clothing industry provides an example of horizontal (product) specialization. The data indicate a shift of domestic industry towards more sophisticated products having higher value added, accompanied by the growth of imports of relatively simple products having lower value added. In fact, average unit values per pound of fiber weight are two-thirds higher in U.S. production than in imports.

The process of upgrading may involve shifts between products made from different materials or between products made from the same material. To begin with, man-made fibers have increasingly gained at the expense of cotton. Furthermore, among cotton broad-woven fabrics, shifts have occurred from lower value-added sheeting, duck, and print cloth to higher value-added cotton fabrics, with knitted fabrics and stretch fabrics gaining in recent years. Finally, within the duck, sheeting, and print cloth category, there has been a shift toward finer fabrics as shown by the fact that unit values for U.S. exports are more than twice as high as for U.S. imports, with average unit values in domestic production being in between the two.

Vertical specialization

Much attention has been given in recent years to vertical specialization in the form of off-shore processing, where
domestic inputs are re-imported after processing abroad, with the duty applying only to foreign value added. These imports, however, represent only part of the trade that takes place in the framework of the international division of labor between developed and developing countries. Thus, while off-shore processing has been dominated by television apparatus and semi-conductors, there is increased trade in parts, components, and accessories of machinery and transport equipment.

To a large extent, this trade involves the importation of relatively simple, labor-intensive parts and components into the developed countries for domestic assembly. But, there is also a reverse flow; for example, Taiwanese firms buy technologically sophisticated as well as capital-intensive parts, components, and accessories in the United States and Japan for assembly in Taiwan. Finally, General Motors and Ford have established worldwide sourcing for automobiles, with plants producing particular parts, components, and accessories in some two dozen countries.

The role of foreign capital and technology

The automobile industry provides an example of vertical specialization in the framework of multinational firms. But, more often than not, vertical specialization occurs among independent firms. This is generally the case in Western Europe and, as far as imports from Hong Kong, Korea, and Taiwan are concerned, in the United States.

Also, horizontal specialization between developed and developing countries has rarely involved multinational firms. In earlier times, it often took the form of contractual relationships between large buyers, such as department stores, and the developed countries and domestic firms in the developing countries. As the more industrialized developing countries have improved product quality and established trading houses, the relative importance of these relationships has subsequently declined and arms-length trading has increased to a considerable extent.

Multinationals’ role overestimated

More generally, the importance of multinational firms in the exportation of manufactured goods from the developing
The share of majority-owned foreign affiliates of American companies in the exports of manufactured goods to the United States from the developing countries declined from one-sixth in the mid-1960s to one-tenth in the mid-1970s. And, while the relative importance of multinationals is somewhat underestimated by excluding exports by American companies with a substantial minority interest abroad, available information indicates that multinational firms have an even smaller share in the exports of the developing countries to European countries and Japan.

The low and declining share of multinationals in manufactured exports from the developing countries reflects the growing importance of Hong Kong, Korea, and Taiwan, which have followed the Japanese example of importing foreign technology rather than foreign capital in the form of direct investment. In recent years, domestic firms have assumed more importance in Latin America, where multinationals have traditionally played an important role.

While the importation of technology and foreign direct investment are to a certain extent substitutes, in industries characterized by rapid technological change the purchase of licences may not permit developing countries to keep up with changing technology. This explains why foreign firms play an important role in the Korean electronics industry.

Foreign direct investment

At the same time, foreign direct investment offers advantages over borrowing abroad. For one thing, foreign direct investment does not add to the debt burden and the debt service obligations of the host countries. For another, foreign direct investment brings with it technological and marketing know-how that contributes to the modernization of industry and the growth of manufactured exports in the developing countries.

These considerations favor creating a hospitable climate for foreign direct investment, with provision for the repatriation of capital and dividends. If dividends are earned through exports and efficient import substitution, there will be a net gain to the country concerned. However, foreign investors in highly protected industries may earn profits at the expense of domestic consumers, thereby adding to the cost of protection.

These considerations point to the need for outward-oriented policies with low protection—an issue that will be taken up in more detail later. At the same time, as long as the subsidiaries of foreign firms are established under protection, the
participation of domestic interests in these subsidiaries will be warranted. Such participation would also permit domestic producers to acquire technological and marketing knowledge.

The cost of adjustment

The increasing importance of intra-industry specialization also has implications for the cost adjustment in the developed countries to imports from the developing countries. In the case of horizontal specialization, adjustment takes the form of changing product composition within individual firms and can be accomplished at little cost. Increases in imports may in fact benefit the firm and its workers through a shift to higher-value items, the upgrading of the labor force, and the use of specialized machinery. Adjustment takes the form of changing product composition within individual firms and can be accomplished at little cost. Increases in imports may in fact benefit the firm and its workers through a shift to higher-value items, the upgrading of the labor force, and the use of specialized machinery. Adjustment costs associated with vertical specialization, too, are relatively low as firms may change over from the manufacture of one part or component to another and the skills used are transferable among firms within a given industry.

Shifting resources from one industry to another will, however, entail adjustment costs. But they should not be overestimated. In the clothing industry, which is most affected by competition from developing countries, I have estimated that in the United States the loss of employment due to productivity growth was more than six times higher than the loss due to increases in net imports in recent years. A similar result has been obtained for the European Common Market by José de la Torre.² And, while the EEC average is affected by the rising export surplus of Italy, it applies — among the larger countries — to the United Kingdom; in Germany, the employment loss due to productivity growth has been more than twice that due to increases in net imports; and there has been an improvement in the trade position of the clothing industry in France.

Furthermore, adjustment costs decline with the length of the period of adjustment. In this connection, the experience of New England provides an interesting example of successful adjustment.

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Transferability of skills

With the relocation of the clothing and shoe industries to the southern United States, New England has shifted to the production of high-technology products, such as computers, electronic equipment and instruments. Following the near-exhaustion of the labor supply, these industries have recently spread from the state of Massachusetts northwards where they utilize the skills of workers in declining industries. It has been reported, for example, that "because they had done stitching in the old shoe factory... Littleton (New Hampshire) workers were adept at learning the wiring, assembling and other hand work required for an electronic subcontractor". Also, in Berlin, New Hampshire, "A Converse sneaker factory closed in 1979, primarily because of the area's strength in computers and electronics."

The case of the shoe workers conflicts with the claim that it is a practical impossibility to move workers from one industry to another. In this connection I may recall a statement made at a World Bank Seminar on Industrialization and Trade Policies in the 1970s by Nat Goldfinger, the then senior advisor to the AFL-CIO* on trade matters, to the effect that the period of adjustment in the shoe industry was 50 years!

The transferability of skills is also indicated by a World Bank study of 120 occupational categories in 58 industries that covers all the major developed countries. And, when skills are not directly transferable, retraining programs may be employed and the normal attrition of the labor force reinforced by early retirement provisions.

Push-pull

Early retirement provisions, together with normal attrition and retraining, will determine the speed at which decreases in the production of a particular industry may be acceptable to the developed countries. At the same time, it should be emphasized that, apart from the push emanating from productivity improvements and imports, there is a pull from other industries, as shown by the example of the sneaker factory. "Pull" and "push" factors also operate within individual industries as imports partly take the place of the abandoned home production of low-value-added products of low domestic profitability and partly prompt the upgrading of home production for domestic use as well as for exports.

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* American Federation of Labor - Congress of Industrial Organizations
Desirable policies by developed countries

My conclusion is that the liberalization of trade in manufactured goods would bring benefits to the developed countries through the upgrading of their labor force and the exchange of physical and human capital for unskilled labor, while adjustment costs could be minimized by avoiding sudden spurts of imports. These findings have policy implications for those countries.

According to the estimates referred to earlier, textile and clothing imports from the developing countries will rise 6-7% a year during the 1980s, permitting increases of over 2% a year in the production of both textiles and clothing in the developed countries. These projections reflect the assumption that the present provisions of the Multifiber Arrangement will be retained in renewing the Arrangement. Although there are pressures within the European Common Market to make the MFA more restrictive, the well-conceived interests of the developed countries suggest the opposite conclusion. Thus, on the projections made, imports from the developing countries will account for only 7% of the increment in the consumption of textiles in the developed countries during the 1980s, while the corresponding ratio will be 28% for clothing. These percentages can be doubled, with commensurate increases in the growth of imports from the developing countries, without cutting the projected growth of the production of textiles and clothing in the developed countries by more than one-third.

Such a change, spread over a 10-year period, could be accomplished by not replacing the normal attrition of labor, since the annual job loss would hardly exceed 1% of the present employment in the textile and clothing industries of the developed countries. At the same time, the developed countries would benefit, as new entrants into the labor force would move into higher-productivity and better-paying jobs.

Transforming the Multifiber Arrangement

The introduction of these considerations would allow the Multifiber Arrangement to be transformed from an instrument of protection to one of adjustment. Apart from allowing for a satisfactory overall growth of imports from traditional sources, it would be necessary to ensure markets for newly-emerging exporters in countries at lower levels of development. Furthermore, it would be desirable to reduce the discretion of developed countries in undertaking unila-
teral action under the MFA and to increase the flexibility of the developing countries to shift among product categories. Rather than ex ante quantitative limitations as under the Multifiber Arrangement, ex post safeguards could be utilized in the event that a sudden surge of imports causes serious injury to any other industries of the developed countries. This, in turn, would require rectifying the failure of the Tokyo Round of Multilateral Trade Negotiations to reach agreement on an international safeguard code. A newly established code should provide for the surveillance of national practices as well as for the resolution of conflicts in cases when safeguard measures have been employed.

Safeguard code

A two-stage procedure could be envisaged. In the first stage, national authorities could impose safeguard measures unilaterally, subject to certain conditions. These conditions would include several provisions:

- that the share of imports from the developing countries in the domestic consumption of the developed countries not be reduced;
- that the safeguards not be invoked against the least developing countries;
- that the application of the safeguard measures remain temporary.

The temporary nature of the safeguard measures would be expressed by their limited duration, the progressive liberalization of import restrictions during the period of their application, and the requirement that the re-imposition of safeguards be countenanced by an international forum.

The application of these provisions would allow for speedy action on the part of the developed countries, without the need for agreement at the international level. Developed countries could also take selective action, and would avoid the payment of compensation that is postulated by Article XIX of the General Agreement on Tariffs and Trade (GATT), which further permits retaliation on the part of adversely affected exporters. Article XIX has rarely been applied, however, and countries have in practice invoked safeguard measures on a bilateral basis.

Under the second stage of the proposed safeguard code, developing countries could bring complaints to an international forum — to be set up within the GATT framework — if the code’s provisions were not respected. This forum would countenance extending the period of application of safeguards only if appropriate adjustment measures were taken.
The provisions of the code would also apply to safeguard measures presently employed, which would be subject to review under the code.

Desirable policies by developing countries

The proposed safeguard code would represent a compromise between the position taken by the European Common Market, which is not favorable to international surveillance, and that of the developing countries, which object to selectivity. But selectivity is a fact of life, and the developing countries would benefit if it were limited in scope and time and brought under international surveillance in the GATT framework.

More generally, it is the interest of the developing countries to participate in the work of GATT, where they can constitute a pressure group for trade liberalization by the developed countries. The lack of such action prevented the developing countries from exploiting fully the opportunities for multilateral tariff reduction in products of interest to them in the framework of the Tokyo Round. It is also in the interest of the developing countries to subscribe to the codes on non-tariff barriers, the benefits of which — such as the special and differential treatment for the developing countries — are generally limited to signatories.

At the same time, more highly industrialized developing countries would increase their bargaining power in trade negotiations if they liberalized their imports. It should be recognized here that the political decision-making process in the developed countries is not favorable to the maintenance of unilateral concessions for countries that have established a strong position in world trade. Furthermore, developing countries have more to gain from multilateral tariff reductions than from preferences granted under the General System of Preferences, which are temporary in character and are limited quantitatively.

Import liberalization in the framework of an outward-oriented strategy would also bring direct benefits to developing countries at higher levels of industrialization, as recent experience shows. Developing countries applying such a strategy have achieved more rapid rates of growth of exports and gross national product (GNP) and have been better able to surmount the adverse effects of external shocks in the form of petroleum price rises and the world recession.
Less developed countries, too, have an interest in seeing the more industrialized developing countries adopt an increasingly open trade stance that would contribute to a shift in their exports towards more skill-intensive products, thereby providing opportunities for expanding the exportation of simpler, unskilled-labor-intensive products by less developed countries. These exports could be oriented to developed country markets as well as to markets of the more industrialized developing countries. At the same time, less developed countries would have to follow appropriate policies that would not discriminate against exports.

Concluding remarks

Trade liberalization by developed and developing countries would thus bring benefits to both groups through the expansion of trade in manufactured goods. In addition, the upgrading of exports by the more industrialized developing countries would impose less of an adjustment cost on the developed countries, since skill-intensive industries, such as machinery and equipment, provide considerable possibilities for shifts in product composition.

To the extent that these countries take the place of Japan in exporting skill-intensive products, as they have done in the case of textiles and clothing, the problem of adjustment does not arise. The same conclusion applies to the eventual replacement of the more industrialized developing countries by less developed countries in exporting simple, unskilled-labor-intensive products to the developed nations.

The adoption of an outward-oriented strategy by developing countries would also provide greater incentives for the exportation of primary commodities. There are considerable market possibilities for several of these products in other developing countries and, in particular, the Middle East. Primary exports by the developing countries would further be promoted through reducing agricultural protection in the developed nations and, in particular, through the liberalization of the Common Agricultural Policy of the European Economic Community (EEC). The food-importing EEC countries plus the United States, Canada, Australia, and New Zealand also have a considerable interest in the liberalization of trade in agricultural products.

It would be desirable, then, to put the liberalization of agricultural trade on the agenda for future negotiations. The same conclusion applies to trade in services, which have
assumed increasing importance in the world economy. The principal purpose of negotiations on trade in services should be to develop multilateral rules and procedures for liberalizing such trade and for resolving international disputes to which it may give rise.

The implementation of these proposals would permit shifts in world trade to take place in accordance with the changing pattern of comparative advantage without involving excessive adjustment costs. At the same time, the lowering of trade barriers would ensure greater competition domestically, and it, in turn, would provide inducements for productivity improvements and technological progress. With foreign direct investment further contributing to the process of change, market forces could be harnessed to promote harmonious growth and development in the world economy.

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