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# The Trade with Developing Countries

## Its Potentialities and Limitations

by Jörg Beyfuss, Cologne \*

**The classic view of the theory of foreign trade that unfettered international exchanges of goods enhance the economic welfare of all participating nations is gaining more and more ground in the discussions about development policy. Since past experience has shown capital aid alone to be incapable of lessening the prosperity differential between the North and the South, the "Aid by Trade" strategy is now of increasing importance. There is however no panacea which would embrace the developing countries more closely in the international goods exchanges.**

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The traditional division of labour between industrialized and developing countries was in accordance with the classic principle of natural cost advantages predominantly of a complementary nature: the industrialized countries imported agricultural products, raw materials and raw material-intensive semi-finished products from the developing countries while the trade in industrial manufactures remained by and large the preserve of the industrialized countries. As a result of structural changes in the demand in the industrialized countries — a decline of demand for "Ricardo goods" as incomes grow and technical advances cause natural raw materials to be used more sparingly or to be replaced — the complementary trade no longer answers the purpose of affording a higher share of the world trade to the developing countries. The latter's share of the world trade has on the contrary fallen in line with the mentioned structural shifts in demand. Between 1950 and 1970 it declined from 31.7% to 19.4%. By the end of 1976 it had as a matter of fact recovered to 25.7% but this was due entirely to the export successes of the OPEC states. The "other (non-oil) developing countries" did not expand their share of the world trade between 1970 and 1976.

A closer involvement of the developing countries in the process of the international division of labour — and a more dynamic development trend as a result of this — would therefore require more intensive participation by the developing countries in the trade in finished goods (substitution

trade). Theorists and politicians are largely agreed on this point but their opinions differ widely concerning the method and time-scale of this process of involvement.

According to the factor proportions theorem of Heckscher and Ohlin the existence of a wage cost differential between the North and the South should work in favour of relocating labour-intensive productions with fully matured manufacturing technologies on a selective basis but in the shortest possible time from the industrialized to the developing countries. Labour being a scarce high-cost production factor in industrialized countries where it could be redeployed for more productive alternative uses, this "phasing-out" need not even, according to this school, entail a shortfall of growth.

Another school, represented by Linder in particular, recommends that the developing countries should embark on a harmonic industrialization process with a long-term orientation making greater allowances for the existing structures of production and requirements. The industrialized countries are more inclined to back this view. They do so not because of their own acute growth and employment problems alone but because the abrupt relocation of organically grown industrial structures into developing countries would encounter cultural, religious and traditional impediments and put an excessive strain on the adaptability of these countries to cyclical fluctuations

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and changes of fashion and because the sudden phasing-out of such productions would, besides, transcend the structural adaptability of the industrialized countries.

### Futile Dispute

This dispute between rival theories is however for several reasons futile. First of all, the developing countries are – even without the OPEC states – anything but a homogeneous group: beside their climatic, sociological and ethnical differences they vary to a very important degree economically in regard to the size and development potential of their local markets, the availability of human capital, the state of the infrastructure, etc. To developing countries with a limited domestic market the Heckscher-Ohlin approach appears to offer a perfectly reasonable development concept. For developing countries with a large domestic market and development potential on the other hand Linder's approach seems to offer a better chance of success.

Another – and more decisive – consideration is the obvious one that the wage cost differential between the North and the South is by no means the dominant factor for structural shifts between industrialized and developing countries with a bearing on foreign trade policy: the extent of the comparative cost advantages of the developing countries leaves in theory – under free trade conditions – to the industrialized countries no chance whatsoever to resist the phasing-out process. That nevertheless only a minute number of developing countries have followed the Heckscher-Ohlin trail can surely not be entirely due to actually existing trade obstacles hampering the trade in (according to Heckscher-Ohlin) sensitive goods with the industrialized countries. More crucial is certainly that many developing countries are either unable or unwilling to embark on an abrupt process of export-oriented industrialization. Their interest centres for the time being on a liberalization and stabilization of the classic form of complementary trade. The empirical example of the foreign trade of the Federal Republic of Germany with the non-European developing countries bears out the fact that there is no panacea which would enable the trend of development to be dynamized through an "Aid by Trade" approach<sup>1</sup>.

In view of the grave effects of the raised oil prices on German imports it seems advisable to distinguish in an analysis of the German imports from developing countries between oil states and

"other developing countries". The oil states were able to increase their exports in the period under review (1962–1976) at an average rate of 15.2% a year, which is much more than the 11.3% annually recorded for all German imports in this period. The imports into the Federal Republic from the other developing countries rose only at an annual rate of 8.2%, with the result that their share of the total German imports fell from 14.1% (in 1962) to 9.5% (in 1976).

### Different Export Performances

This decline of the overall market share of the non-oil developing countries is a compact of highly differentiated regional trends. The largest part of it by far was borne by the less advanced countries. The share of the LLDCs in the total imports of the Federal Republic from non-oil developing countries declined from 4.5% (in 1962) to 3.7% (in 1976). The MSACs did similarly badly: their share of the German imports from the "other" developing countries slipped from 22 to 20%. The EC's Yaounde Convention associates – which have for the most part the same structural features as the MSAC states – managed to expand their imports to the Federal Republic slightly above the average but this was at least partly due to their concessionary tariff preferences.

A different picture emerges for the more advanced developing countries (those with national per capita products above \$ 550). They increased their exports to the Federal Republic at an annual average rate of 8.9% and thereby raised their share of the German imports from non-oil developing countries from 56.4 to 61.2%. Substantial regional variations are however also to be observed in this group: while the more advanced South American states – such as Argentina, Colombia and Chile, all countries which concentrate in their export trade on a few agricultural or industrial raw materials – had to reconcile themselves to an in part substantial decline of their market share, the more advanced East Asian states – and in particular the city states Hong-kong and Singapore and South Korea and Taiwan – experienced an almost explosive expansion of their exports to the Federal Republic. The German imports from these four states rose at an average rate of over 40% a year and their share of the German imports from non-oil developing countries jumped from 6.5 to about 27%. The great impact of the imports from the Far East on the total imports of the Federal Republic from non-oil developing countries becomes especially evident if the imports from these four countries are eliminated from the statistics: in this case the share of the more advanced developing countries in the Ger-

<sup>1</sup> Cf. Jörg Beyfuss, Außenhandel mit Entwicklungsländern – Entwicklung und Perspektiven (Foreign trade with developing countries – Development and prospects), in: Beiträge zur Wirtschafts- und Sozialpolitik, Institut der Deutschen Wirtschaft, Cologne 1978.

man imports from non-oil developing countries declines from 49.9% (in 1962) to 34% (in 1976) and the share of non-oil developing countries in the total of German imports from 14 to 6.9%.

### **Difficult Explanations**

It is difficult to find a convincing explanation for the different performances of the various groups of developing countries in the German market. Neither their state of development (as measured by per-capita incomes) nor the dynamism of the development process provides an adequate explanation for these differences (and the danger of auto-correlation would also have to be considered). The export achievements of the four Far Eastern states are definitely attributable to the particular range of export goods which they are capable of supplying: finished products account for between a little under 80 and almost 100% of their exports to the Federal Republic and their principal exports correspond fairly closely to the Heckscher-Ohlin criterion; they are electro-technical and precision engineering products, musical instruments, toys, leather products, and textiles and clothing. The successes of these four countries thus provide striking support for the factor proportions theorem and suggest at a first glance that the Heckscher-Ohlin approach of selective export-oriented industrialization at the level of low-technology products should be likewise applied to the other developing countries. There are however weighty, empirically verifiable arguments contradicting this theory:

A high proportion of finished products is no absolute guarantee of success in the export trade or a dynamic development process. Of the nine countries with a very high finished goods component which were examined the four threshold countries in the Far East were the only ones to achieve a vigorous expansion of their German market position. Other countries such as India, Pakistan and Lesotho the exports of which also include a high proportion of finished products did not achieve any gains in the German market. This is due to a variety of reasons. One is that their internal economic structure (agriculture accounts for a high proportion of the national product of Mauritius, Lesotho, Pakistan and India) does not tally with the composition of their exports to the Federal Republic; in other words, their production capacity did not suffice for a stronger export offensive in finished products. They also labour under other handicaps – in regard to quality and product design and as a result of their concentration on textiles and articles of clothing in which they have encountered competition from the Far Eastern threshold countries as well as the Eastern bloc states.

A high proportion of foodstuffs is in general no obstacle to success in the export trade or to advances in development. True, the 13 examined countries with an above-average proportion of foodstuffs in their trade with the Federal Republic did overall less well than the group of finished goods exporters. There are some notable exceptions also in this group however; the imports of the Federal Republic from Panama, the Ivory Coast, Cameroun, Honduras and the Philippines for instance were clearly above the average, and the national per-capita product of as many as six of these countries is above \$ 550. The exports of the mainly food producing countries are subject to much more violent fluctuations than those from countries with a larger proportion of finished goods. This also explains why the developing countries which are largely dependent upon the export trade show an uneven and, over the longer term, below-average rate of growth.

The production structure of most developing countries and the demand structure of the industrialized countries militate against a decline of the importance of the complementary trade: in the majority of developing countries agriculture and the raw materials sector account for an above-average proportion of the national product; an intensification and liberalization of the complementary trade with the industrialized countries is therefore vitally important to them. This composition of the German import trade shows besides that food and raw materials still play an important role in the goods exchanges with the developing countries. A good 35% of the German import requirements of food, raw materials and semi-finished products is covered by developing countries, and the non-oil developing countries dominate the food sector; in this area they have suffered insignificant market losses only in the period under review. As for raw materials – a sector in which the oil countries are predominant – the developing countries actually increased their market share in the examined period.

### **Limited Advantages of a Phasing-out**

These findings make it imperative to ask whether the developing countries would fare better in the export trade and thus be assured of more dynamic development processes if the industrialized countries were to open their markets to them selectively for Heckscher-Ohlin goods. It is a fact that the countries which can offer industrial manufactures of satisfactory quality at reasonable prices have scored better-than-average successes in the German market. At a first glance it would therefore make sense from the development political point of view to open the markets of the industrialized countries on an (even) more generous scale to industrial manufactures from devel-

oping countries — for instance by phasing out labour-intensive and technologically fully matured productions of finished goods and relocating them in developing countries.

The regional provenance of the imports of finished goods shows however that only a very limited number of developing countries would derive advantages from such selective import-oriented development policy on the part of the industrialized countries, namely those which are already exporting finished goods on a major scale, possess appropriate industrial structures and have therefore already made considerable headway in their economic development. Under a selective policy of phasing out and relocating labour-intensive productions these countries would probably develop a dominant world market position for themselves. Insofar as other developing countries have a chance of engaging in industrialization on Heckscher-Ohlin lines at all, they would hardly be able to compete with them, the less so as the industrialized countries would probably invest the risk capital needed for the phasing-out and relocating of productions in the countries which are seen to possess already a satisfactory infrastructure, the requisite manufacturing know-how and — thanks to the advanced state of their economic development — stable political conditions.

The developing countries which for structural, climatic, geographic and other reasons still need to concentrate on exports of raw materials and food are quite right if they regard more generous access to the agricultural markets of the industrialized countries and the stabilization of their export prices as matters of higher political priority. Over the longer term these countries could be helped by liberalization of the complementary trade and, above all, by more purposive financial aid direction to advance their development and thus to embark (as indicated by Linder) on a meaningful policy of industrialization geared to the conditions in their domestic markets.

#### A Pragmatic Argument

There is another argument against indiscriminate application of the Heckscher-Ohlin theorem which is of a more pragmatic kind. The world markets for Heckscher-Ohlin goods have only a limited absorptive capacity; a relatively small share of the global sales of "low-technology" product groups made it possible for Singapore and Hongkong for instance to achieve remarkable development successes without stepping as yet over the threshold beyond which the industrialized countries would feel a need for counteraction in the sphere of trade policy. But if populous developing countries like India or Pakistan wanted to achieve comparable development successes by resorting to the

same kind of export-oriented strategy, they would have to increase their exports to a volume surpassing the absorptive capacity of the world markets and raise them above the level which the industrialized countries would be willing to tolerate.

#### Effects on Industrialized Countries

In conclusion attention may be drawn to some potential hazards of a phasing-out of labour-intensive productions to the industrialized countries. The theoretical argument that phasing-out of labour-intensive productions would yield advantages also to the industrialized countries because they would benefit from cheaper supplies of the products in question and the redundant labour could be redeployed more productively has become problematic, and this not only because of the medium-term prospect of persistently high unemployment in the industrialized countries. For this theoretical approach attributes to the labour factor a measure of regional and sectoral mobility which it may, to judge from the experience in the labour market during recent years, in fact not possess. But even assuming that the requisite high degree of sectoral and regional mobility could be generated through state incentives, the social costs to the industrialized countries from a phasing-out policy would need to be taken into account. Retraining grants, mobility allowances, etc., are among costs of this kind which would have to be weighed against the cost advantages of the subsequent more productive use of the labour released by the phasing-out operation. Moreover, there is no guarantee that the industrialized countries would in the long run be supplied more cheaply if they imported the phased-out labour-intensive high-cost products than by producing them themselves. It is by no means impossible that a world textile cartel dominated by a few developing countries would come into being. The industrialized countries could admittedly take effective counteraction (by resuming surrendered productions) were such a development to take place but such salvage operations would be very costly.

To sum up then, it is to be noted that the Heckscher-Ohlin approach is only suitable for a relatively small group of developing countries which possess the climatic, sociological and geographic conditions for export-oriented industrialization. The vast majority of developing countries will for the time being still have to concentrate on exports of complementary trade goods for which favourable outlets demonstrably still exist in the industrialized countries. Beyond this, the industrialized countries must help to offer to these developing countries the possibility of long-term industrialization geared to the conditions in their domestic markets.