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# Deficiencies of Orthodox Foreign Trade Theory with Regard to Employment

by Detlef Lorenz, Berlin\*

**The orthodox theory of foreign trade, which is simply a theory of re-allocation, can scarcely do justice to the issues that arise in the context of North-South relations. Its isolation from the problems of world and regional economic development, different trade flows and the transfer of production factors reduces its relevance to employment.**

Along with other specialised economic theories, the orthodox theory of foreign trade is an "isolated" theory in that it generally disregards other over-riding circumstances, in particular historical factors or the overall context of development. It is commonly perceived to be no more than a micro-economic or price theory applied to international transactions. As it is a theory of relative prices and comparative advantages, it relates to the re-allocation of the means of production as a result of foreign trade.<sup>1</sup> Accordingly, it does not consider the actual situation with regard to the deployment of labour but assumes full employment.

Orthodox foreign trade theory was therefore always handicapped when applied to international trade between developing and industrialised countries, a context for which it had not been created.<sup>2</sup> The economic backwardness and demographic pressures in many developing countries manifest themselves in widespread unemployment or underemployment, which make the full employment assumption seem inappropriate and also mean that foreign trade is regarded not only in terms of imports of development goods to support a strategy of industrial development but also from the viewpoint of the export of labour-intensive products as a contribution towards reducing unemployment.

On the other side of the coin, full employment has been slipping further and further from the grasp of the industrialised countries for some time, and the change does not appear to be temporary. The persistent serious unemployment in these countries undoubtedly has various endogenous causes, which cannot be examined here.<sup>3</sup> Apart from the "re-emergence" of cyclical fluctuations and economic stagnation, only two need concern us:

□ the first, which has no connection with foreign trade, is the important part played by technical progress, with its marked tendency to displace labour (microelectronics, the introduction of robots, etc.), and the influence of the welfare state on the demands of large sections of the population to be highly paid and immobile;<sup>4</sup>

□ the second, which is related to foreign trade, is the crowding out of labour by increasing competition from imports, particularly by developing and newly industrialising countries.

It should also be noted that both technical progress and foreign trade not only displace jobs but at the same time – or over a period of time – also create jobs, so that here is a case of creative destruction in the sense used by Schumpeter.

<sup>1</sup> Cf. K. Rose: *Theorie der Außenwirtschaft*, 8th edition, Munich 1981, pp. XV and 255; and, for the opposite view, the portrayal of the subject in A. Predöhl: *Außenwirtschaft*, 2nd edition, Göttingen 1971. For the fundamental problems of allocation theory versus development theory with respect to foreign trade, see J. Wiemann: *Selective Protectionism and Structural Adjustment. European Response to the Growing Competition from Developing Countries*, Berlin 1983, chapter 1.

<sup>2</sup> Even the English Classical School did not conceive the foreign trade theory for Britain's colonial trade! Cf. K. Knorr: *British Colonial Theories 1570-1850*, Toronto 1944; and D. Lorenz: *Dynamische Theorie der internationalen Arbeitsteilung. Ein Beitrag zur Theorie der weltwirtschaftlichen Entwicklung*, Berlin 1967, p. 80.

<sup>3</sup> Cf. OECD: *The Employment Outlook: Where are the Jobs in Today's Labour Market?*, in: *OECD Observer*, No. 130, 1984, pp. 5-10; D. H. Aldcroft: *Full Employment: The Elusive Goal*, Brighton (Sussex) 1984; M. Beenstock: *The World Economy in Transition*, London 1983.

<sup>4</sup> With regard to the link between the welfare state and neo-protectionism or neo-mercantilism, see inter alia A. Lindbeck: *Emerging Arteriosclerosis of the Western Economies. Consequences for the Less Developed Countries*, Institute for International Economic Studies, University of Stockholm, Reprint Series, No. 191, Stockholm 1982, pp. 37-52; D. Lorenz: *Ursachen und Konsequenzen des Neomerkantilismus*, in: A. Woll (ed.): *Internationale Anpassungsprozesse*, Berlin 1981, p. 21; K. W. Rothschild: *Außenhandelsstheorie, Außenhandelspolitik und Anpassungsdruck*, in: *Kyklos*, Vol. 32, 1979, pp. 48-54.

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There is serious disagreement among economists as to the net result of these tendencies. Ex ante estimates are obviously subject to a wide margin of uncertainty, both in absolute terms and in terms of attributing effects to the two factors at the root of the employment problems. The employment effects of technological progress are certainly far greater than those of foreign trade and are in any case a familiar companion of structural change. On the other hand, it cannot be overlooked that in an ever more interdependent and competitive world technical advance is being used increasingly to promote foreign trade; it does not simply "fall from heaven like manna", but is a response to crowding-out competition on a world scale.

This applies not only between the industrialised countries but on a fatally magnified scale in North-South relations. For example, market-related adjustment strategies based on labour-saving technical advances in sensitive labour-intensive industries have given the industrialised countries new comparative advantages that cut across the strategy of exploiting labour-intensive advantages and exports that the developing countries have been recommended to pursue. This is a serious problem from the point of view of employment. Successful "positive" adjustment à la OECD in industrialised countries can clearly exacerbate the employment situation in developing countries and discredit their outward looking policy.<sup>5</sup>

#### **Employment Implications of the Re-allocation Model**

Since the days of the Classical School, but especially since the time of the Neoclassical theory of equilibrium, foreign trade theory has been dominated by the simple re-allocation model of comparative cost advantages, which serves to demonstrate the advantages of a substitutional international division of labour.<sup>6</sup>

Let us assume that all countries have the technical ability to produce the same functionally homogeneous goods. In other words, the ubiquitous availability of identical (physical) products is postulated, which differ from one country to another only in terms of their respective advantages in terms of cost or productivity. The division of labour as a result of exports and imports accentuates competition and leads to a fall in prices. The supply of goods to the economies is not diversified, but "merely" becomes cheaper as a result of substitutional trade flows. The displacement of production capacity unable to compete with imports on price and its re-allocation to more productive export sectors should result in a switch to the most efficient global production pattern.

Because of the assumption of full employment, the additional production factors needed to expand export industries must be drawn from the resources released by competition from imports. That automatically means that lost jobs are offset by new ones with no more than frictional disruption. Hence, in the re-allocation model full employment is maintained in principle during the change-over, although the increase in productivity initially causes a net displacement of labour in that a smaller overall volume of production factors is now needed to generate the same national product. It is assumed that the surplus will either lead to increased consumption of existing goods via price reductions or be used to produce new goods (investment); hence, to all intents and purposes economies are assumed to be expanding.<sup>7</sup> Nevertheless, the re-allocation analysis itself reveals employment risks or a growth requirement equal to the productivity effect.

Equally, the employment aspect virtually disappears if we work on the basis of balanced trade accounts, which is also postulated in the orthodox foreign trade model. If imports are exactly offset by exports through changes in the level of prices, wages and exchange rates, net employment effects can occur only if the factor contents of imports and exports are different. Hence in North-South trade it is quite possible for imports of labour-intensive industrial goods from the developing countries to be offset in balance-of-payments terms by exports of capital-intensive goods from industrialised countries and yet to result in a negative net employment effect for the industrialised countries.<sup>8</sup>

Let us go a stage further and broaden the static basic model of re-allocation by permitting a number of variations.

<sup>5</sup> Cf. J. Wiemann, op. cit.; R. Kaplinsky: The International Context for Industrialisation in the Coming Decade, in: Journal of Development Studies, Special Issue on Industrialisation, 1984; G. Junne: Automation in the North: Consequences for Newly Industrializing Countries, unpublished manuscript, University of Amsterdam, May 1984.

<sup>6</sup> With regard to the opposite case of *complementary* specialisation, see the comparison of the two models in D. Lorenz: Dynamische Theorie etc., op. cit., chapter 7; D. Lorenz: Explanatory Hypotheses on Trade Flows Between Industrial and Developing Countries, in: H. Giersch (ed.): The International Division of Labour. Problems and Perspectives, International Symposium, Tübingen 1974, pp. 90-98.

<sup>7</sup> Wiemann also emphasizes that high productivity effects entail employment risks, even in expanding economies; cf. J. Wiemann, op. cit.

<sup>8</sup> For example, in Germany the overall employment effects of trade in industrial goods with developing countries in 1977 were as follows: 85,000 persons employed for every US\$ 1 billion of exports and 94,000 persons made redundant for every US\$ 1 billion of imports. Measured in terms of the actual trade surplus of about DM 17 billion, 957,000 jobs were dependent on exports and 358,000 were lost as a result of imports. With regard to this and the situation in other EC countries, see D. Schumacher: Trade with Developing Countries and Employment in the European Community, EC Commission, Study No. 82/22.

(1) Let us first go back to the case of technology alluded to above, where technical progress leads to different factor intensities for identical groups of traded goods, in other words widens the scope for substitution within the production functions. In this case there is the danger that foreign trade will be restricted if the developing countries cannot or will not adequately counterbalance the industrialised countries' new development advantages by reducing prices – reducing wages or devaluing the currency, in other words accepting a deterioration in the terms of trade – or by relying more heavily on land-intensive primary products or services such as tourism.

For the industrialised countries, the employment effect depends partly on the extent to which the developing countries' labour-intensive exports decline in quantitative terms rather than just in value or can be replaced by complementary trade flows, and partly on whether the industrialised countries' own exports also fall owing to a reduction in the developing countries' receipts of foreign exchange.

(2) Leaving aside this topical technology question, which nevertheless clearly demonstrates the developing countries' handicap in the form of a lower transformation capacity corresponding to their lower level of development,<sup>9</sup> there are three further variants of the re-allocation model that appear to have particular relevance to employment:

□ If the international immobility of capital is removed to broaden the analysis to include the acknowledged transfer of old industries from the industrialised to the developing countries owing to wage cost advantages (the establishment of export platforms by means of direct investment), the displacement of labour to the detriment of the industrialised countries is accentuated to some extent. The exporting of jobs leads to a reduction in labour-intensive exports by the

<sup>9</sup> Cf. D. Lorenz: *Dynamische Theorie etc.*, op. cit., chapter 10.

industrialised countries' old industries, only to be replaced by labour-intensive imports. The employment effect does not occur only via the trade balance; there can also be a double employment effect within the group of industrialised countries if the job-exporting country (Germany, for example) is different from the country importing the developing countries' labour-intensive goods (the United Kingdom, for example). Admittedly, negative employment effects may be attenuated in this instance if the direct investments generate follow-up exports for the industrialised countries or if these countries become more competitive by devaluing their currencies, for example. A completely different and often ignored effect occurs if complete cycles of international debt or of the innovation/imitation processes with pronounced lags are taken into account.

□ If the re-allocation model is coupled with borrowing, opposing employment effects are drawn apart, as it were, which can lead to adjustment shocks. If the industrialised countries export capital, the initial effect on their trade balance and on employment is positive. If the debt is handled commercially, the return transfer in the form of goods follows much later and the problems it may pose can be all the more serious, the more the creditor countries have in the meanwhile become "rentier states" (mature creditor countries) and now have to cope with a trade deficit and negative employment effects. Borrowing inevitably leads to the fundamental "transfer problem", namely the acceptance of merchandise.

□ A parallel effect occurs in the familiar product cycle model. The industrialised countries initially enjoy an export monopoly in the new products, which therefore create employment. Through imitation, the developing countries establish production facilities that first reduce the industrialised countries' exports and may then transform them into "re-imports" owing to the developing countries' cost advantages. As positive and

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negative employment effects are separated by more or less pronounced or permanent lags, as in the debt model, the employment neutrality of foreign trade postulated in the allocation model does not apply. However, in neither case need the effects occur all at once; they are more likely to be modified or masked by overlapping between branches or by new capital transfers or debt moratoria.

### Competing for Jobs in North-South Trade

The change from employment neutrality to competition for jobs can be further pursued from a completely different angle, namely the motives and objectives of foreign trade.

For industrialised countries at the same stage of development, the re-allocation model justifies engagement in foreign trade on the grounds of the cost reductions or welfare effects to be derived from imports. Exports are only the consequence, undertaken to reabsorb displaced factors of production and to balance the trade account, whereas imports set the re-allocation process of the international division of labour in motion by undercutting domestically produced goods. The fact that cheap imports also boost exports, as they are intermediate inputs for manufacturing industry at the microeconomic level and help keep down prices and wages and generally enhance competitiveness at the macroeconomic level, is again no more than a side-effect. There is no room in the re-allocation model for export-led foreign trade. Export-led as opposed to import-led growth is therefore a mercantilistic hangover! Admittedly, in economic policy as it is actually practised the emphasis seems to lie more on the export function of foreign trade, not least on the grounds of employment considerations and because foreign trade is an integral part of the competition for growth.<sup>10</sup>

The developing countries also seem to be primarily interested in the import component of foreign trade, though not for the reasons stated in the re-allocation model but mainly to gain access to "development goods". They are not used to re-allocate existing factors of production to more profitable uses but are essential to the first-time allocation of resources as part of these countries' industrialisation strategy.<sup>11</sup> Obviously, from the point of view of an "outward-looking policy" the imported goods should not be used for nationalistic

import substitution but should help make exports competitive; however, during the long early stages of development the developing countries see foreign trade not as an instrument of an international re-allocation of labour but as the means to develop national productive capacity. In the case of the developing countries, the re-allocation function common to exports and imports in the orthodox substitution model can therefore be split more aptly into a development-related import function and a corresponding trade-balancing export function (compare the "deficit trade" below). If the foreign trade model is further complemented by the superposed development model, which entails a strategy of modernisation and emulation for most developing countries, the following situation will arise.

In the context of an outward-looking strategy of industrialisation as quickly as possible, the developing countries' complementary import needs – besides their internal absorption capacity – are limited externally by their financial capacity to import. If international capital transfers and the primary sector are left out of account for the time being, then the secondary sector conforms to the standard factor model, with exports of capital-intensive industrial goods from industrialised countries and labour-intensive industrial goods from developing countries. Thus, the developing countries' import capacity depends ultimately on the success of their income-generating exports to the industrial goods sector of the industrialised countries. These markets become the scene of competition for jobs between industrialised and developing countries. The developing countries command the one factor that is not copied from the industrialised countries and which the latter would themselves find it difficult to imitate, namely the development-related, "monopolistic" supply of surplus labour or the low level of wages, with which the developing countries move on from passive to active imitation, in other words to exports.<sup>12</sup>

But is this competition for jobs within North-South trade different from the orthodox re-allocation model, in which home-produced goods are also displaced by imports in both countries?

In the static *re-allocation model*, foreign trade flows seem to be set in motion simply by price signals. In fact, however, they are also stimulated by a further function that gives competition from imports a character of its own. Imports are purchased not only if they are cheaper

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<sup>10</sup> Cf. D. Lorenz: Ursachen und Konsequenzen des Neomerkantilismus, op. cit., p. 12; J. Wiemann, op. cit.

<sup>11</sup> With regard to development strategies in general and those relating to foreign trade, see for example V. Timmermann: Entwicklungstheorie und Entwicklungspolitik, Göttingen 1982, chapter 4.

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<sup>12</sup> Even if it is a question here of an absolute macro-economic supply advantage, a distinction should obviously be made according to the micro-economic productivity of the labour-intensive products. Cf. D. Lorenz: Dynamische Theorie etc., op. cit., pp. 97 ff.; D. Lorenz: Notes on Unequal Exchange between Developing and Industrialized Countries, in: INTERECONOMICS, 1982, No. 1.

abroad but also because they are needed to supplement the displaced domestic supply. In a context of full employment or shortage of resources, production factors must be diverted from the sectors competing with imports to expand the production of exports. Price and cost motives are therefore augmented by an import pull effect.

In the *North-South model* this is replaced by fundamental asymmetry, since the supplementary effect is weaker or absent, for three reasons:

□ in North-South trade, the industrialised countries' import markets are typically stagnating "sunset" markets, which react to substitutional price effects but derive little from the income growth resulting from the parallel increase in the industrialised countries' exports to developing countries (weak derived product pull);

□ given the underemployment experienced for some time in industrialised countries as well as the substantial labour-saving technological advances, the labour released in these sensitive import markets is hardly needed for increased export production (weak derived factor pull);

□ finally, an important disparity between the growth rates in industrialised countries and those in developing countries can be put forward as a further argument; export growth in the industrialised countries is not matched by equivalent import growth (due to the above-mentioned structural conditions), whereas the developing countries must keep exports expanding in line with imports owing to the need to balance their trade account.

The growth in exports of industrial goods by the industrialised countries as a result of export-led growth accords with the growth in imports of capital goods by the developing countries as a result of their need for intensive industrialisation, in that both seek the highest possible rate of growth. Quite the opposite applies to the flow in the opposite direction – exports by developing countries and imports by industrialised countries – owing to the above-mentioned structural disparities, unless capital imports or other complementary exports of primary goods "delink" the rate of growth in the developing countries' exports to industrialised countries temporarily or permanently from that in their imports of industrial goods.

Apart from this fundamental asymmetry that marks the competition for jobs between North and South, the closeness of relations or the degree of competition can also be varied and more precisely determined by the following factors.

On the face of it, we are dealing with a terms of trade problem, namely the effect of each group's pressure on the export and import prices of the industrialised countries' trade in industrial goods (or the reverse situation in the case of the developing countries). However, this conceals the following "bargaining positions":

If the industrialised countries (a) do not have to rely particularly on the developing countries buying their exports (sellers' markets) because the markets of other industrial countries are highly absorptive and (b) are not particularly interested in imports from developing countries because they take a conservative view of their welfare function<sup>13</sup> or prefer a lower level of re-allocation mobility<sup>14</sup> (neoprotectionism!), then the developing countries are in a bad position, particularly if they have a high import propensity that leads to comparable pressure to export. They are then faced with a kind of "Prebisch situation". They have to calculate how long they can tolerate a fall in the terms of trade or an "unequal exchange" because of industrialisation and employment preferences, and whether they have any alternative.<sup>15</sup>

On the other hand, the industrialised countries' position could also deteriorate. They may become more dependent on sales to developing countries or they may in turn have to modify the terms of the game by devaluing their currencies or reducing wages to ward off competition from imports, in other words, they may have to make a sacrifice to improve their competitiveness and their employment situation.

### Significance of Complementary Trade Flows

In reality, world trade, and particularly trade between industrialised and developing countries, does not consist even today solely of *substitutional* foreign trade flows, as in the re-allocation model of orthodox foreign trade theory. These have increased considerably during the development of a new horizontal international division of labour, but North-South relations as a whole are still dominated by *complementary* trade flows.

In the context that concerns us here, the most important characteristic of these trade flows, and one which distinguishes them utterly from substitutional flows, is their positive employment effect. Whereas substitutional trade flows are a form of international

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<sup>13</sup> Cf. W. M. C o r d e n : Trade Policy and Economic Welfare, Oxford 1974, p. 107.

<sup>14</sup> Cf. K. W. R o t h s c h i l d , op. cit.

<sup>15</sup> Cf. D. L o r e n z : Explanatory Hypotheses etc., op. cit., p. 102; D. L o r e n z : Notes on Unequal Exchange etc., op. cit.

competition in which the more expensive goods are displaced, the complete opposite is the case with complementary flows. As a rule, they do not make labour or plant redundant; instead they are an expression of the complementarity of countries in that they supply a larger volume and wider range of goods that the importing countries cannot (or cannot yet) obtain without foreign trade.<sup>16</sup>

From the nineteenth century to the present day, these trade flows have been important vehicles of mutual export-led growth, and not only for developing countries.<sup>17</sup> More important in today's context is perhaps the often neglected fact that they imply not only positive but also reciprocal employment effects. Owing to their complementary nature, exports create jobs in the exporting country without making workers redundant in the importing country. In the substitution model of re-allocation, on the other hand, positive

employment effects can occur in only *one* country group in the event of a trade imbalance.

However, this does not exhaust the advantages of including this type of trade flow, which only emerge fully if they are examined in conjunction with substitutional trade. Hence, in reality, the world economy is a mixed system of both types of trade flow, to some extent a combination of the international division of labour in the conventional sense on the basis of substitution and international specialisation of a complementary nature.

This may cause positive employment effects to occur even if the trade account is in balance, precisely because the two types of trade flow are combined. Quite apart from the question of equilibrium in the overall trade account, the combination is highly relevant in practical terms, in that the industrialised countries have recorded large permanent surpluses in trade in industrial goods in this mixed system. The resultant large positive employment effects for the industrialised countries are often referred to in connection with the danger of neo-protectionism. Obviously, they are due in no small measure to the fact that these surpluses in trade in industrial goods are also needed as a counterpart to substantial imports of primary products and capital exports by the industrialised countries.

<sup>16</sup> With regard to the availability model of more recent foreign trade theory, see inter alia D. Lorenz: *Dynamische Theorie etc.*, op. cit., chapter 8; E. Minx: *Von der Liberalisierung- zur Wettbewerbspolitik*, Berlin 1980, pp. 71-137; K. Rose, op. cit., pp. 157-161; D. Bender: *Außenhandel*, in: K. Bender et al. (eds.): *Vahlens Kompendium der Wirtschaftstheorie und Wirtschaftspolitik*, Vol. 1, 2nd edition, Munich 1984, pp. 405-411.

<sup>17</sup> See J. Riedel: *Trade as the Engine of Growth in Developing Countries. A Reappraisal*, World Bank Staff Working Papers, No. 555, Washington 1983.

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The old mixed system, which has worked to the advantage of employment in the industrialised countries up to now has been changing for some while owing to the developing countries' employment-oriented export strategies, which have been recommended to them by all and sundry. With important developing countries (NICs) switching from the old complementary form of specialisation to the new substitutional division of labour, the structure of trade and hence the international employment effect is changing asymmetrically. The industrialised countries' exports to developing countries continue to be largely complementary, and only the developing countries' exports of new industrial goods to the industrialised countries are making production factors redundant. The outcome of this development is an absolute, or at the very least relative, reduction in the industrialised countries' trade surplus and net positive employment effect in the substitutional complex of industrial goods. This is fully in accordance with the logic of the re-allocation model of the new international division of labour, and it is also necessary to the commercial settlement of debt.

The industrialised countries, however, are reluctant to accept this division of labour and they occasionally doubt the "wisdom of their free trade doctrine".<sup>18</sup> The new wave of protectionism towards developing countries should also be judged in the light of this fundamental change from complementary specialisation to the substitutional division of labour. Both the employment conflict in general and the danger of increasing protectionism undoubtedly depend largely on the speed, intensity and breadth of this structural change in international trade relations.<sup>19</sup> Whether the policy of the NICs in Asia, for example, is the model for the general strategy of the developing countries (Cline) and the extent to which the "adding-up effect" (Lorenz) is attenuated by the stages model (Balassa) are matters of debate<sup>20</sup> that cannot be described more fully here.

Let us instead examine another aspect, namely variations in the size of the "deficit trade". This term was coined in an attempt to classify the substitutional component of North-South trade by reference to complementary trade.<sup>21</sup> "Deficit trade" means the trade resulting from the developing countries' surplus of complementary imports (industrial goods, development

goods) over their complementary exports (primary products, raw materials) and which must be paid for through substitutional exports of industrial goods if it is not financed by borrowing. The way in which the size and intensity of this substitutional net component can be influenced can be illustrated quite well in terms of the OPEC-complex, in which at least two components come together: (1) an expansion in the complementary component and (2) the introduction of a financing component.

(1) The substantial tribute that OPEC was able to exact from the rest of the world for more than a decade created an enormous international purchasing power potential which, surprisingly enough, can be classified as belonging to the old complementary world trade structure, akin to the situation in the nineteenth century. This "revaluation" of the developing countries' complementary exports actually turned their negative complementary balance into a surplus for a time,<sup>22</sup> thereby to some extent temporarily removing the rationale for "deficit trade". However, as the revaluation of these complementary exports of primary products benefitted only the small group of OPEC countries, it had two effects on trade in industrial goods.

Some industrialised countries were able to offset a large part of the deterioration in their terms of trade by directly increasing their exports of industrial goods to OPEC countries. The terms-of-trade loss was therefore converted in practice into an employment gain, in the form of an increase in the surplus on industrial goods. The general effect would have been the same if the OPEC tribute had flowed into a "common fund" for all developing countries.

(2) Furthermore, a substantial part of the OPEC tribute was channelled into the Euro-credit market via recycling, or lent via this route to non-OPEC developing countries (debt component) to finance their higher oil costs and further industrialisation. The initial benefit again accrued to the industrialised countries as suppliers of complementary industrial goods (development goods), so that the old complementary trade structure was further bolstered indirectly via capital transfers.

At the same time, substitutional exports of industrial goods, especially those of the NICs, had to be greatly increased in pursuance of the now even more urgent export strategy. The necessity for "deficit trade"

<sup>18</sup> Cf. J. W i e m a n n, op. cit.

<sup>19</sup> Cf. H. P. G r a y : Free Trade or Protection: A Pragmatic Analysis, Macmillan, London 1985, chapters 4-6.

<sup>20</sup> Cf. D. L o r e n z : Industrial Imports from the Asian NICs, Principal Adjustment Problems and European Strategies of Protectionism, in: S.-H. J o, C. M o r r i s o n (eds.): Conference on Patterns of Growth and Structural Change in Asia's Newly Industrializing Countries (NICs) and Near-NICs in the Context of Economic Interdependence, 3rd-8th April 1983, The East-West Center, Honolulu, Hawaii, forthcoming 1985.

<sup>21</sup> Cf. D. L o r e n z : Explanatory Hypotheses etc., op. cit., pp. 100 ff.

<sup>22</sup> Cf. D. L o r e n z : Ursachen und Konsequenzen des Neomerkantilismus, op. cit., p. 27.



became even greater for non-OPEC developing countries. Over the longer term, however, indebtedness and especially its exacerbation by largely exogenous interest rate developments poses a new threat to employment in the industrialised countries. The falling purchasing power of OPEC and the debt boomerang are undermining the net employment benefits enjoyed by the industrialised countries in the past.

### Implications for the World Economy

An international division of labour along orthodox, substitutional lines does not create jobs but increases the productivity of existing resources by distributing factors of production more efficiently (re-allocation). The resources released (labour) constitute real factor supply for generating new potential growth in world GNP, but only to the extent that incentives or market opportunities are sufficiently exploited. International competition for jobs does not solve the problem; if crowding out competition leads to further productivity gains, the need for growth becomes all the greater; if it only leads to a redistribution of unemployment, the productivity gain is not matched by a growth in purchasing power stemming from an increase in income; at most, it can be expected to bring benefits in the form of price reductions.

If new growth is stimulated by technology goods (innovations) from the industrialised countries, the question arises in the North-South context whether these new international goods can be adequately and meaningfully absorbed by the South via a few NICs. If the industrialised countries are seen by developing countries as the key to the creation of jobs, they must squarely face up to this absorption problem, which is virtually of their own making, and they must do so basically in the same way as they themselves help set the terms for crowding-out competition through low wages.<sup>23</sup>

Mention should also be made of a fundamental tenet of foreign trade theory, namely that international free trade in goods makes up for the immobility of the factors of production. In the model of orthodox foreign trade theory, factor price equalisation can only be achieved through foreign trade. The problems that foreign trade theory avoids by adopting the central assumption that factors of production are immobile at the international

<sup>23</sup> For example, if development requirements place a heavy demand on the country's import capacity, a decision must be taken on the basis of opportunity costs how low the wage level will be held or how far the exchange rate may be allowed to fall so that the import bill can be met out of export receipts. Whether imports are bought at the cost of *excessively* low wages is ultimately not a question of "exploitation" (unequal exchange) but of the developing countries' development priorities. Cf. D. Lorenz: Notes on Unequal Exchange etc., op. cit., p. 19.

level become clear if one considers how many workers would migrate if there were no natural or political obstacles to international mobility. Movement impeded at the direct factor level finds an indirect outlet through foreign trade (exports).

Viewed in these terms, protectionism is also a consequence of international barriers to the entry of labour, and national labour markets become so-called "non-competing groups" as a result of the international protection of foreign trade. If the parallels revealed here are considered in economic terms, it becomes more obvious that in the North-South context the "economics of interdependence", in the phrase of R. N. Cooper, must be subject to limits that are difficult to quantify.

If competition for jobs in North-South trade is to have a positive net outcome, action at several levels would seem to be necessary to regain control over world economic events, which are already moving willy-nilly in this direction.

- At the level of exchange conditions, the problem of the terms of trade for complementary trade flows should continue to be monitored to ensure that OPEC-like surpluses and recycling do not get out of hand.
- At the level of trade volumes, the differences in the mix of welfare functions in the North and South are leading to a re-appraisal of the scale of worldwide interdependence.
- The mix between complementary and substitutional trade flows, including the balancing component, deserves greater attention from the employment angle.
- In both cases, inter-regional and intra-regional fields of action should be examined, as the international division of labour and specialisation contain not only a solidarity component that should not be underestimated<sup>24</sup> but also a very important regional component.<sup>25</sup>

A foreign trade theory in the form of a simple re-allocation theory can scarcely do justice to such a panoply of issues. Its "isolation" from the problems of world and regional economic development, from different trade flows and factor transfers considerably reduces its significance for the field of employment.

<sup>24</sup> Cf. D. Lorenz: International Division of Labour versus Closer Co-operation? With special regard to ASEAN-EC economic relations, paper presented at the "Third Conference on ASEAN-EEC Economic Relations", 26-28 October 1983, Bangkok (forthcoming 1985, ed. by Institute of Southeast Asian Studies, Singapore)

<sup>25</sup> With regard to the mix of trade flows and the intra-regional aspects, see the interesting remarks on the Pacific example (the relations between Japan and the NICs in East and South-East Asia) in: The Developing Economies, Vol. XXI, No. 4, Tokyo 1983, and especially the papers by Yamazawa et al. and Watanabe and Kajiwara, pp. 281-339.