

Akyuz, Yilmaz

**Working Paper**

## Developing Countries in World Trade

Discussion Paper, No. 2004/9

**Provided in Cooperation with:**

Turkish Economic Association, Ankara

*Suggested Citation:* Akyuz, Yilmaz (2004) : Developing Countries in World Trade, Discussion Paper, No. 2004/9, Turkish Economic Association, Ankara

This Version is available at:

<https://hdl.handle.net/10419/83248>

**Standard-Nutzungsbedingungen:**

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

**Terms of use:**

*Documents in EconStor may be saved and copied for your personal and scholarly purposes.*

*You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.*

*If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.*



# **TURKISH ECONOMIC ASSOCIATION**

DISCUSSION PAPER 2004/9

<http://www.tek.org.tr>

## **DEVELOPING COUNTRIES IN WORLD TRADE**

**Yılmaz Akyüz**

**May, 2004**

11 March 2004

## DEVELOPING COUNTRIES IN WORLD TRADE

*Yilmaz Akyüz* \*

### A. Liberalization and trade performance

The basic policy challenge facing most developing countries is how to establish a broad and robust industrial base as the key to successful development, and how best to channel the elemental forces of trade and investment to this end. Shifting away from dependence on the production and export of primary commodities towards industrial products has often been viewed as a means of more effective participation in the international division of labour. Manufactures are expected to offer better prospects for export earnings not only because they allow for a more rapid productivity growth and expansion of production, but also because they hold out the promise of greater price stability even as volumes expand, thereby avoiding the declining terms-of-trade that has frustrated the development efforts of many commodity-dependent economies.

Since the early 1980s, moves to rapidly liberalize trade and foreign direct investment (FDI) have strongly influenced policy makers in many developing countries in their thinking about this challenge. Openness to international trade and investment was expected to allow these countries to alter both the pace and the pattern of their

---

\* Tun Ismail Ali Professor of Monetary and Financial Economics, University of Malaya, and former Director of the Division on Globalization and Development Strategies, UNCTAD. An earlier version of this paper was presented as a public lecture jointly organized by Ministry of International Trade and Industry and University of Malaya, on 24 February 2004, Hotel Nikko, Kuala Lumpur. The evidence cited in this paper derives from research undertaken in the Division on Globalization and Development Strategies in UNCTAD, published mainly in *Trade and Development Report* 1999, 2002 and 2003.

participation in international division of labour, thereby overcoming balance-of-payments problems and accelerating technical progress and economic growth, to catch up with industrialized countries.

At the same time as developing countries strived hard to integrate more closely into the world economy, a new trade round was transforming the global playing field. The Uruguay Round Agreements were expected to be doubly favourable to developing countries. On the one hand, a strong rules-based system would benefit smaller and poorer economies by subjecting the conduct of their major trading partners to greater transparency and discipline, and putting in place a system of reviews and sanctions which could not be subverted by powerful vested interests. On the other hand, a more open trading environment was expected to strengthen the growth prospects of developing countries by pushing their producers to the efficiency frontier and improving their access to markets in the North. The optimism was reflected in extravagant predictions made regarding the gains the developing countries would reap from the Uruguay Round.

Indeed, during the past two decades developing countries have become major players in world trade. Their exports have grown faster than the world average and now account for about one third of world merchandise trade, rising from less than one fourth in the 1970s. During this period, developing countries also became important markets for each others products: the share of trade among them reached 40 per cent of their total exports at the end of the millennium.

Much of the growth in the exports of developing countries has been in manufactures, which today account for over 70 per cent of their total exports, after hovering around 20 per cent during much of the 1970s and early 1980s. The share of developing countries in world manufactured exports now exceeds 25 per cent, compared

to some 10 per cent in the 1970s.

More important, many developing countries appear to have succeeded in moving into technology-intensive manufactured exports, which have been among the most rapidly growing products in world trade over the past two decades. For some products such as transistors and conductors, computers and office machines, and electric power machinery, developing country exports now account for between 40 and 50 per cent of total world exports. Much of this expansion has taken place as a result of their growing participation in international production networks (IPNs) whereby production chains are split up and located in different countries by transnational corporations (TNCs) seeking low-cost producers for export to world markets.

## **B. Trade and industrialization**

However, on closer examination, the picture is much more nuanced and less sanguine. The success of developing countries in expanding their manufacturing exports and attracting export-oriented FDI has not always been accompanied by faster growth in their gross domestic product (GDP). At some 4.8 per cent per annum, the average growth rate in developing countries during the 1990s was well below the average of 5.7 per cent achieved during the 1970s. If China is excluded, the decline is much more pronounced, almost close to two percentage points.

Most countries which shifted from inward-oriented to outward-oriented development through a rapid liberalization of imports and FDI, particularly in Latin America, have not shared in the expansion of manufactured exports, but have experienced surges in imports and mounting trade deficits, resulting in increased

dependence on private capital inflows for growth. On the other hand, attempts to attract private finance through capital account liberalization have made matters worse by generating boom-bust cycles in financial markets and misalignments and gyrations in exchange rates, undermining productive investment, particularly in the traded goods sectors.

Much of the expansion in manufactured exports of developing countries has concentrated in East Asia and, to a lesser extent, Central America. However, with the exception of a few East Asian first-tier newly industrializing economies (NIEs), mainly Korea and Taiwan, which have already reached income levels as high as some industrialized countries, the exports of developing countries are still concentrated on products derived essentially from the exploitation of natural resources and the use of unskilled or semi-skilled labour which have limited prospects for productivity growth and lack dynamism in world markets.

Trade statistics showing a rapid expansion of technology-intensive, high value-added exports from developing countries are misleading, because of double-counting of trade among countries linked through IPNs. Such products appear to be exported by developing countries, but in reality those countries are often involved only in the low-skill, assembly stages of production, using technology-intensive parts and components imported from more advanced countries. As trade flows are measured in gross-value rather than value-added, imported parts and components are counted among the exports of the countries assembling them. Consequently, although developing countries appear to have become major players in world markets for supply-dynamic, high-tech products, they still account only for 10 per cent of world exports of products which score high in R&D content, technological complexity and/or economies of scale.

In the past two decades the increased mobility of capital, together with continued restrictions over labour movements and various incentives provided by the recipients of FDI, has extended the reach of IPNs particularly in three sectors: clothing, the automotive industry and electronics. Trade based on specialization within such networks is estimated to account for up to 30 per cent of world exports. In the clothing sector although FDI has played some role, the major form of production relocation is subcontracting to domestic enterprises. The electronics industry is the most globalized of all industries, and trade in electronics products is underpinned by an increasing geographical dispersion of TNC-driven production networks. Relocation of production in the automobile sector is constrained by physical distance to the final market, and is greatly influenced by preferential regional trade agreements, such as NAFTA and Mercosur.

Almost three quarters of the increase in the share of developing countries in world manufacturing exports have taken place in the three sectors in which IPNs have expanded rapidly in recent years. In these networks, notably in electronics and the automotive industries, most of the technology and skills are embodied in imported parts and components, and much of the value-added accrues to producers in more advanced countries where these parts and components are produced, and to the TNCs involved. The share of developing countries in value-added is determined by the cost of the least scarce and weakest factor, namely unskilled and semi-skilled labour, whereas the rewards to scarce but internationally mobile factors such as capital, management and know-how are reaped by their foreign owners. It is in effect the labour itself, rather than the product of labour, that is exported.

Consequently, while the share of developing countries in world manufacturing exports, including high-tech products, appears to have been expanding rapidly, incomes earned from such activities by these countries do not share in this dynamism. On this

score, a comparison between the developed and developing countries over the past two decades is highly revealing. Although the share of developed countries in world manufactured exports fell from more than 80 per cent to about 70 per cent between 1980 and the end of the 1990s, they actually increased their share in world manufacturing value-added in the same period. In these countries, manufacturing value-added has consistently exceeded manufactured exports over the past two decades.

Developing countries, by contrast, have achieved a steeply rising ratio of manufactured exports to GDP, but without a significant upward trend in the ratio of manufacturing value-added to GDP. In the major exporters of manufactures in the South, export values have constantly exceeded manufacturing value-added during the past two decades, and the gap has increased further as exports have grown faster. Thus, the increase in the share of developing countries in world manufacturing exports has not been accompanied by a concomitant increase in their shares in world manufacturing value-added.

These comparisons relate to value-added generated in developed and developing countries, rather than incomes earned from manufacturing activities. The value-added left in developing countries is smaller and the income earned by industrial countries is larger if account is taken of profits earned by TNCs on their investment in developing countries.

### **C. A stylized picture of diversity in trade and industrial development**

This general picture no doubt hides diversity among developing countries in their experience regarding trade and industrialization over the past two decades. In this



respect, it is possible to distinguish among four categories:

- § *Mature industrializers:* This group includes the first-tier NIEs, notably Korea and Taiwan, which have already achieved industrial maturity through a rapid accumulation of capital, growth in industrial employment, productivity and output, as well as manufactured exports. These economies have seen a large increase in their shares in both world manufacturing income and exports over the past two decades. They still have a share of industrial output in GDP above the levels of advanced countries, but as expected, industrial growth has started to slow down.
  
- § *New generation of industrializers:* These are countries with a rising share of manufactures in total output, employment and exports, based on strong investment and upgrading from resource-based activities to labour-intensive manufactures and middle-range technology products. This group includes the second-tier NIEs (notably Malaysia and Thailand) and, to a lesser extent, China, all extensively participating in IPNs. However, in these countries industrial deepening has advanced much less than that suggested by their manufactured exports. In Malaysia, for instance, between 1980 and 2000 the share of manufactured exports in GDP increased by 42 percentage points while the increase in manufacturing value-added as a proportion of GDP was around 6 percentage points. In China manufacturing value-added as a proportion of GDP fell over the same period as a result of rationalization associated with a move away from central planning, while the share of manufacturing exports in GDP increased by some 10 percentage points.
  
- § *Enclave industrializers:* This group includes countries which have also moved away from dependence on commodity exports by linking to IPNs with a heavy

reliance on imported inputs and machinery. However, their overall performance in terms of investment, value-added and productivity growth is poor. Two countries stand out in this group, namely Mexico and the Philippines, where manufactured exports as a proportion of GDP rose rapidly during 1980-2000 while manufacturing value-added stagnated or declined.

§ *Deindustrializers*: This group includes most middle-income countries in Latin America, notably Argentina and Brazil, which have achieved a certain degree of industrialization but have been unable to sustain a dynamic process of structural change through rapid accumulation and growth. In a context of rapid liberalization, there have often been declining or stagnant shares of manufactured exports, employment and output, and a downgrading to less technology-intensive activities. In some countries in this group, notably Chile, there has been a less destructive pattern of deindustrialization as a result of a fast pace of investment, accelerating growth based on natural resources. However, this process now appears to have reached its limits.

With the notable exception of the first-tier NIEs, therefore, recent expansion in manufacturing exports of developing countries has generally been associated with their increased participation in IPNs, and generated a much more modest growth in manufacturing value-added in these countries. As a result, developing countries appear to be a lot more successful when their performance is measured in terms of manufacturing trade than in terms of manufacturing value-added and income.

Indeed the contrast between the two measures becomes even more evident when a comparison is made between the structures of trade and industrial output, using five broad categories of products: primary commodities, labour and resource-based

manufactures, and low, medium and high technology-intensive manufactures. Such a comparison shows that developing countries are becoming increasingly similar to developed countries in the structure of their manufactured exports, but not in the structure of their manufacturing value-added and incomes. But, again, there is diversity:

- § Korea and Taiwan stand out for having reached a manufacturing value-added structure that is by far the closest to that prevailing in the leading developed countries. In these countries productivity growth over the past two decades has exceeded the growth in the technological leaders in the North, notably the United States, in almost all sectors of the manufacturing industry.
- § The manufactured export structure of a large number of developing countries extensively participating in IPNs, including China, Malaysia, Mexico, the Philippines and Singapore, has also begun to resemble that of the major developed countries, but the similarity is much less so for the structure of their manufacturing value-added. In most of these countries, including Malaysia, productivity growth has been faster than in the United States in the lower end of manufacturing but not in the upper end.
- § For the majority of Latin American countries, not only the structure of manufacturing value-added but also that of exports is much less similar to those in the more advanced industrial countries. In many of these countries productivity in labour-intensive manufacturing has been falling, and the processing of natural resources continues to dominate production and export activities.

Briefly, taken together, the evidence suggests that among the major developing countries, only the major first-tier NIEs have succeeded in simultaneously upgrading

their production and export structures by raising productivity in technology-intensive sectors and closing the gap with the industrial leaders. Many developing countries relying on FDI and TNCs for expansion of industrial production and exports appear to be far behind in upgrading their production structures, but they are more successful than commodity-dependent Latin American economies in moving to manufacturing.

Clearly, participation in the labour-intensive segments of IPNs can yield considerable benefits for countries in the early stages of industrialization and with a great deal of surplus labour. It can enable them to increase employment and per capita income even when value-added generated is low. Furthermore, increased employment of low-skilled labour in activities linked to IPNs can widen the possible range of sectors where industrialization can begin, and help acquire the basic techniques and organizational skills needed for a more broad-based growth. However, that does not necessarily constitute a leap into a new pattern of rapid and sustained industrial growth.

These networks allow TNCs a good deal more flexibility in, and control over, their choice of investment locations. Moreover, their productive assets, such as know-how, design and technology, can be locked more tightly inside the firm thanks to barriers of entry that result from the high costs of managing and coordinating such complex units. The packaged nature of FDI can, in these circumstances, be the cause of a highly skewed distribution of the gains from trade and investment unless local bargaining power can bring a more balanced outcome, as it did for the first-tier NIEs.

However, replicating the success of early industrializers is all the more difficult where such investment is highly mobile: locational advantages are easily won and lost through small cost changes or the emergence of alternative sites, giving rise to the danger of enclave economies where there is a persistently high dependence on imported

intermediate and capital goods. These problems can be particularly serious for middle-income countries which have been successful in early stages of industrialization but which now need rapid upgrading and productivity growth in order to advance further along the development path.

An important motive in seeking to attract FDI in export industries is its potential contribution to balance-of-payments. Indeed, as long as the entire production is exported, participation in IPNs can make a positive contribution to the balance-of-payments in developing countries, barring such practices as transfer pricing, even if these activities are heavily dependent on imported parts and components, and the value-added left in the country is no more than the wages of unskilled labour. However, the picture can change when the goods and services produced are sold in domestic markets. More generally, the contribution of FDI to balance-of-payments varies inversely with the share of TNCs profits in value-added, the extent of their reliance on imports, and the proportion of final product sold in domestic markets. In general, since the chunk of the value-added goes to profits, the import content is high, and the goods and services produced are partly sold in domestic markets, the contribution of FDI to balance-of-payments in developing countries is often negative.

This is the case even in China, one of the most successful countries in attracting export-oriented FDI. At the end of the 1990s, total profits earned by foreign-funded enterprises (FFE) in China were in the order of \$20 billion, of which \$12 billion was reinvested in the country and the rest was taken out. In the same period, these enterprises generated a net export surplus of \$2 billion. Thus, the FFE sector as a whole was in the red by some \$6 billion even on cash-flow basis. Available evidence suggests that a similar situation existed in Malaysia in the late 1980s and early 1990s when such deficits were covered simply by relying on new FDI, in much the same way as engaging in a

process of Ponzi financing – that is, servicing debt by incurring new debt.

#### **D. Competition and the fallacy of composition**

As a result of the increased participation of several highly populated, low-income countries in world trade in recent years, as much as 70 per cent of the labour force employed in sectors participating in world trade is low-skilled. Besides, there is still a considerable amount of surplus labour in such countries, and many large countries are not yet fully integrated into the international trading system. Thus, a simultaneous export drive by developing countries in labour-intensive manufactures, or increased competition among them to attract FDI as locations for labour-intensive processes, could rekindle the fallacy of composition or the adding-up problem: on its own a small developing country can substantially expand its exports without flooding the market and seriously reducing the prices of the products concerned, but this may not be true for developing countries as a whole, or even for large individual countries such as China and India. The dangers of overproducing standardized mass products with high import dependence are typified by the electronics sector, where developing country export prices appear to be more volatile and to have fallen more steeply after 1995 than similar products traded among developed countries.

There are also more general signs that the prices of manufactured exports from developing countries have been weakening vis-à-vis manufactures exported by industrialized countries in recent years. Evidence shows that productivity gains in resource-based and labour-intensive manufactures exported by developing countries do not always go to labour as higher wages, but often benefit consumers in western markets in lower prices. These trends suggest increased commoditization of many labour-

intensive manufactures exported by developing countries.

Differences in the behaviour of prices of manufactures exported by developing and developed countries appear to arise primarily from differences in global market structures and domestic labour market conditions. Because of the existence of significant barriers to entry in high-tech product lines associated with their high R&D contents and the high costs involved in organizing production chains, markets for such products are dominated by oligopolistic producers in industrialized countries usually competing on the basis of quality, design, marketing, branding and product differentiation, rather than price. In such products, export market shares are much more concentrated than in manufactures exported by developing countries. This is also true for products that require very large and specific investments, such as machinery or transport equipment.

By contrast, there is much stiffer competition among developing countries in markets for labour-intensive manufactures. While these products provide opportunities for the new generation of industrializing economies, most middle-income developing countries also persist in these sectors because their producers find it difficult to upgrade and diversify. Industrialized economies also continue to operate in such sectors behind protection, as weak growth and high unemployment have slowed the closure of their sunset industries, thereby restricting the size of the market for developing country producers.

Competitive pressures are further compounded by the way labour markets in developing countries accommodate the additional supply of labour-intensive manufactures through flexible wages, allowing firms to compete on the basis of price without undermining profitability. Competition among firms, including TNCs, in developing countries becomes competition among labour located in different countries.

With a growing number of developing countries, including some with very large unskilled labour pools, turning to export-oriented strategies, it is the middle-income countries in Latin America and South-East Asia that appear most vulnerable to these dynamics. In particular, greater price competition in products of the electronics sector appears to have increasingly exposed traditional developing country exporters to the emergence of more competitive suppliers in countries with lower costs. In the absence of a rapid upgrading to high-skill, high value-added manufactures needed to enable them to compete with more advanced industrial countries, these exporters may face a squeeze between the top and bottom ends of the markets for manufactures.

These challenges facing developing countries in international trade have been seen in recent years through the lens of international competitiveness. However, a degree of caution is needed in applying this concept in the present context. In the first place, strictly speaking, the concept may be useful to define the position of individual enterprises vis-à-vis each other, but not for comparisons among economies as a whole or even among industries comprising many firms with different characteristics: for, it is not countries but firms that trade. From a private perspective it may matter little whether the international competitiveness of an enterprise is improved through productivity growth, wage cuts or a devaluation of the currency, but from a broader socio-economic point of view, these have totally different implications for economic growth, and social stability and welfare.

Evidence shows that wage suppression or sharp currency devaluations are not viable responses to the emergence of low-cost producers. Many countries which sought to increase the international competitiveness of their firms in this way have failed to achieve sustained improvements in their manufactured export and value-added performance. On the other hand, while productivity growth is a more secure way of



gaining a competitive edge for an individual country, a simultaneous drive by a large number of countries to improve productivity and to gain competitiveness in labour-intensive manufactures can create gluts in these products and, hence, run against the problem of fallacy of composition, in much the same way as has happened in a number of primary commodities.

### **E. Policy challenges**

The basic policy issue facing developing countries in the trading system is not, fundamentally, one of more or less trade liberalization, but how best to extract from their participation in that system the elements that will promote economic development. For some this is still a matter of switching from primary commodities, but for many others it is a question of advancing further in industrial development. There is enough evidence that there might be a risk of excessive competition among developing countries in world markets for labour-intensive manufactures and for FDI as locations for labour-intensive segments of IPNs. This could disrupt the development process by causing significant terms-of-trade losses and create serious frictions in the global trading system. To what extent such potential problems can be avoided will depend on three sets of factors:

- § First, on faster growth of markets for labour-intensive manufactures in more advanced countries – both the industrialized countries and the first-tier NIEs – which in turn depends on faster income growth as well as improved market access;
- § Second, on how quickly the middle-income countries are able to move out of labour-intensive manufactures and create space for lower-income countries;

§ Third, on the extent to which developing countries can rely on the expansion of domestic markets for industrial development.

Regarding potential markets in industrialized countries, it was estimated in the *1999 Trade and Development Report* that developing countries would be able to earn an additional \$700 billion per annum from exports of labour-intensive manufactures if protectionist barriers were dismantled. This amounts to 60 per cent of earnings from manufactured exports that the developing countries registered at the beginning of 2000. However, recent trends in trade policies in industrial countries do not suggest any easing of restrictions in such sectors. On the contrary, there has been increased abuse of anti-dumping measures. There are also concerns over the implementation of the Agreement on Textiles and Clothing (ATC). The impact of removal of quotas in developed countries can lead them to invoke the safeguards included in the ATC to prevent “serious damage” to domestic industry, and delay the removal of remaining quotas. But even if trade in textiles and clothing were to be brought fully under WTO rules, it could still be impeded by relatively high tariffs and tariff escalation in the main developed country importers.

The mounting pressure in industrialized countries to raise the level of protection against imports of labour-intensive manufactures stems from the coincidence of high unemployment levels and growing wage inequality in these countries with sharp increases in labour-intensive manufactured imports from developing countries. But renewed protectionism is not a viable option. Difficulties arising from increased competition can best be addressed in industrialized countries by making sure that the full range of macroeconomic and structural policies is employed to accelerate growth and reduce unemployment. That is how they absorbed the entry of low-cost producers such as Japan and Italy in the 1950s and 1960s.

The growth of trade among developing countries also opens new opportunities for avoiding difficulties in markets for labour-intensive products. In particular, industrial upgrading in more advanced developing countries would allow new players to take over labour-intensive activities in world trade. This has happened to a certain extent. Countries like China that have adopted more export-oriented strategies have gained much of the market share given up by the first-tier NIEs when they shifted to more technology-intensive exports. However, because of the failure to undertake timely industrial upgrading, some exporters in the middle-income countries seem to have been negatively affected. Their problems can be aggravated if large countries such as China and India rapidly expand their exports in labour-intensive manufactures. Upgrading in many of these middle-income countries should involve the replacement of imported parts and components with domestically produced ones. In this process, the shares of both imports and exports in GDP would be expected to fall as domestic value-added grew faster, reversing the trend observed in countries participating in IPNs.

Certainly, the industrial upgrading needed in the middle-income countries depends, to a large extent, on the policies they pursue in areas such as trade, industry and technology. Many of the policy measures successfully used in the past for this purpose, not only by the first-tier NIEs but also by industrialized countries, are no longer available because of multilateral commitments made by developing countries in the WTO, notably in TRIPs, TRIMs and subsidies. Moreover, effective substitutes for such measures may not always be easy to find. There is, thus, a need to reconsider, in the WTO review process, the full impact on development of limiting the policy options open to developing countries. It is also important that developing countries resist attempts to narrow their policy space further by extracting new commitments from them in areas such as FDI, competition policy and government procurement.

It is often suggested, particularly in the business community, that services provide new opportunities for middle-income countries with well-educated populations in maintaining the growth momentum in the face of increased competition in labour-intensive manufactures. While some business opportunities may indeed exist, what is at stake here may be different when one shifts from a corporate perspective to broader development objectives. Deepening the services sector is unlikely to ensure income convergence with industrial countries except for economies with massive hinterlands such as Hong Kong. The historical experience shows that the services sector takes over and a process of benign de-industrialization starts at much higher income and productivity levels than those achieved by middle-income countries; that is, at around \$9,000. Indeed a problem facing many developing countries today is that deindustrialization has been occurring and the share of services rising at levels of industrial productivity and per capita income that are much lower than in industrialized economies. More important, this has been happening in the context of erratic and slow growth. It would be a fallacy to think that middle-income countries could converge towards the income levels of highly industrialized countries by simply rapidly moving into services, before achieving industrial maturity.

Similarly, the limits of services in providing new trade opportunities would need to be recognized. A number of services, particularly those related to data processing, have been moving to middle-income developing countries with well-educated populations. However, the pros and cons of this are very much like those entailed by participation in IPNs. These countries have a competitive edge in such services because their wages are lower than those in industrialized countries; that is, because they are less-developed. But low wages have very little to do with the efficiency of labour in the services performed. A data analyst or a doctor in Kuala Lumpur is not necessarily less skilful or productive than their counterparts in Europe, but he or she earns a much lower

wage because the overall productivity of the economy is much lower. And for most countries, there is no other way of raising overall productivity than industrial development.

Finally, to avert potential difficulties in labour-intensive manufactures, larger developing economies, including China and India, will need to find ways of utilizing domestic sources of growth more fully. It is true that growth of manufacturing and industrialization in the first-tier NIEs depended heavily on expansion of exports, particularly at the early stages of their development. However, these countries were poor in natural resources, and this necessitated a rapid move into labour-intensive manufacturing to earn the foreign exchange needed for imports essential for development. Moreover, they were small in size; collectively their population is smaller than that of Guangdong Province in China. Thus, their industries needed to seek markets abroad in order to achieve the necessary economies of scale in production. Indeed, historical evidence demonstrates, in general, an inverse relationship between trade orientation and economic size; among countries with similar levels of per capita income, the ratio of trade to income tends to be lower in countries with larger populations. Therefore, countries such as China and India can rely less on foreign markets for their industrialization than did the first-tier NIEs. This would provide greater space for smaller newcomers in labour-intensive manufactures.

A strengthening of regional economic ties could also help this process along in East Asia and South America. Conventional economic thinking tends to dismiss regional arrangements as a second-best solution for meeting development goals, and as a potential stumbling-block on the road to a fully open and integrated multilateral system. However, this conclusion is based on a somewhat utopian view of the global economy. Where domestic firms still have weak technological and productive capacities, and the global

economic context is characterised by biases and asymmetries, regional arrangements may well provide the most supportive environment in which to pursue national development strategies.

Greater regional economic integration increases the risk that problems in one country may be transmitted to its neighbours. Arguably, that danger has intensified in today's globalizing world, as was seen in East Asia during 1997-1998. With volatile capital flows fuelling boom–bust cycles, a more fragile macroeconomic context has developed, vulnerable to shifting investor sentiments. Thus, a return to stable and rapid regional growth needs to be underpinned not only by policies directed at the upgrading of production and exports, but also by accompanying regional monetary arrangements and cooperation designed to ensure the stability of financial markets and achieve a stable pattern of intraregional exchange rates.