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Title	AN ESSAY ON THE NORTH-SOUTH PROBLEM
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Citation	HOKUDAI ECONOMIC PAPERS, 8, 25-33
Issue Date	1978
Doc URL	http://hdl.handle.net/2115/30679
Type	bulletin (article)
File Information	8_P25-33.pdf

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AN ESSAY ON THE NORTH-SOUTH PROBLEM

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I.

"The North-South Problem" is discussed in this small essay by opposing "the efficiency principle" to "the equity principle" in the context of modern economics in the light of such a great variety of approaches that include Marxist viewpoints exemplified by "opposition between neo-colonialism and economic racialism" and "structural violence by the advanced countries".

The former principle on which advanced countries in the North insist means that in order of a globally optimal resources allocation we should establish an international division of labor based on comparative advantage, having a preference to maintaining the competitive market mechanism. In this regard, above all, the U. S. A., Japan and West Germany among the advanced countries persist in keeping this principle. Meanwhile, the latter principle on which developing countries in the South insist means that we should have a preference to making an international "system" whereby gains from international trade are equally distributed because the present international economic system is like playing loaded dice which fall one-sidely against the developing countries to their great disadvantage.

Our discussion is then pursued in following order : first, we will examine the concrete grounds on which the South argues against the defects of the present international economic system ; secondly, viewing this argument from the North side, we will dispute it about its theoretical and practical propriety.

II.

The following present the classification of various kinds of grounds for insisting on the present economic system alleged to be unfair :

〈1〉 Infelicitous Inheritance from Colonial Times.

This insistence has prevailed, looking on the present international division of labor as nothing but a succeeded one without undergoing any change ever since the colonial times when it was organized not by the developing countries but artificially by the predominants. Especially the following three points are worth mentioning. The first is as to colonial government's economic policy giving priority over development, cultivation and plantation of cash crops including tea, coffee, sugar, cotton, jute and rubber for exportation to the advanced countries, resulting in the de-emphasis of cultivation of staple food such as rice and wheat as well as of production by manufacturing industries on the part of the developing countries. The second is that the so-called "monocracy" has prevented the natives from making progress in education, skill, self-consciousness, and so on. The third is the abuse of a solid large-land ownership system due to "collusion between the colonial government and the privileged class".

〈2〉 Structural Defect in Traditional International Division of Labor.

As far as the present international division of labor is based on comparative advantage, the developing countries always gain less from international trade than the advanced countries because the former are forced all the time to produce only specific primary goods. The followings are the concrete grounds:

(a) *A long-term disadvantageous tendency in commodity terms of trade of primary goods* (Singer-Prebisch Theorem). Primary goods have inelastic demands in both price and income. The advanced countries maintain a high rate of agricultural self-support by adopting a strong protection policy of domestic agricultural production. The condition of trade has been disadvantageous to the developing countries because of the invention of large number of synthetic substitutes and a marked decrease in the input rate of raw material with rapid progress in industrialization continuing after World War II. Advanced countries' manufacturing industries have come to display a controlling power, monopolistic and oligopolistic, in the market.

(b) *Instability in Developing Countries' Export Income.* Primary goods are characterized by such instability in market price fluctuating up and down sharply in a short term that, once natural factors like a rich harvest as well as economic circumstances including depression and a new firm's entry into the market cause their prices to fall down, the developing countries exporting them sustain a loss accordingly in terms of the foreign currency paid for the same amount of such goods. Since the developing countries have to import capital goods necessary for developing their domestic economy from the advanced countries with the foreign currency as the major resource, the reduced income from the exportation brings about a confusion in their domestic investment plan, resulting in enormous difficulties in their economic growth.

(c) *Abandonment of Dynamics in Manufacturing Industries.* Specialization in production of primary goods deproves the developing countries of merits of industrialization most of development economists point out as regards various dynamic effects of manufacturing industries; namely, industrialization increases the knowledge of techniques and stimulates urbanization and then originates Marshal's "external economy", while it creates and rouses new needs by raising the standard of education and skill, modernizing value and attitude, and cultivating originality. A policy to abolish such primary goods specialization means not only to get rid of disadvantageous prices but also to help develop domestic economy more rapidly

(d) *Limitation Due to Static Theory of Comparative Advantage.* A nation's economic circumstances will change with the lapse of time. So, when a country makes a decision on a trade structure over a long term, it is unreasonable to draw only on the state of factor endowment at a given time and difference in relative production condition. This is true especially of "the infant industry protection theme". It has been already proved theoretically that resources allocation by the static theory of comparative advantage is not always reasonable when some manufacturing industries gain an increasing return on the scale.

〈3〉 "Backwash Effects"

It is argued that the late 20th century has seen such an unbalanced development between the advanced and the developing countries that has exerted malignant influences on the latter, as stated below, according to which an extreme difference has been brought about between the highly developed industrial countries and the least less developed countries in all of the aspects, such as economy, society, technology and the rest.

(a) *Demonstration Effect of Consumption.* Economic and social contacts with the advanced countries induce the developing countries enjoy a higher standard of consumption than their production capacity allows. Their attempt ends in excess of propensity to consume, a decrease in savings and investments, a deficit in international balance of payments, and finally an increase in accumulated external debts.

(b) *Policy of Welfare State.* Effects of the developing countries to establish the same high-level welfare state as the advanced countries are trying to achieve push wage cost higher than marginal production cost and at last caused a large divergence between the private and the social cost especially in the industrial sector, if introduction of various modern systems is made too early in social security, minimum wage, trade unionism, and the like, in their efforts.

(c) *Demonstration Effect of Production.* The recent world economy strongly calls on the developing countries to adopt a capital-intensive and labor-saving production method as well as mimicking and introducing highly sophisticated up-to-date techniques immediately despite their being in an early stage of economic development. One hundred years ago technical gaps between the advanced and the developing countries were not so great as in today, the general technical standard being low, whereas the speed of making technical progress was slower than now. They give a reason why the developing countries in the past could then overtake the advanced countries (Britain in the main) comparatively easily in technical advancement, which forms a striking contrast as regards extreme difficulties for the developing countries to do so nowadays.

〈4〉 Other Unfavorable Factors.

Among other factors the developing countries strongly insist on as unfavorable factor in today's international economic system are violence of multinational corporation and unfairness of the international finance arrangement.

III.

The above-mentioned grounds bear out the criticism by the developing countries that the present international economic order is essentially advantageous only to the advanced countries, causing them to cope with the circumstances by taking immediate countermeasures, which can be classified into the following two fundamental standpoints in terms of concrete behaviors:

(1) *Demand for Establishing "New International Economic Order".* Abolishing or reforming of the existing international economic system represents the developing countries' approach in their movement of demanding a large concession of the advanced countries. For instance, they have led discussions of UNCTAD and CIEC and called for the following; To have the advanced countries apply high tariff preferences to manufactured goods to be exported for the promotion of industrialization of the developing countries. To conclude various international commodity agreements for stabilization of prices of primary goods, as exemplified by "a comprehensive program of primary goods" proposed at the fourth UNCTAD conference at Nairobi in 1967. To liberalize forming of various kinds of natural resource cartels. To reinforce economic assistance from the advanced countries under better conditions. To grant a moratorium of accumulated external debts. To tighten legal regulations on behaviors of multinational corporations.

(2) *Raise of Developing Countries' Regionalism.* The developing countries are emphatic about establishing their own world by getting out of the present world economy in which "the efficiency principle" of the economic system can hardly allow them to establish a new system in favor of them. Namely, they insist on an idea of establishing an economic block of their own independent of the present world economy. This standpoint, which accounts for a minority yet, has something in common with the way of thinking of "Collective Self-reliance" advocated at "non-alliance head's conferences". Proposals for concrete policy from economists supporting the foregoing approach to regionalism follow: To establish action for the developing countries' exclusive use of main resources. To pursue policy of

preferring an agricultural reform by developing a small-scale agriculture. To cultivate small-scale manufacturing industries and abolish a western-style industrial policy. To nationalize and take over various kinds of industries by foreign firms. To encourage preferential trade agreements among developing countries. To materialize joint financing to developing projects. To organize a raw material processing regional centre. To put an end to the developing countries' competition and establish a mutually complemental relationship. To found various kinds of international monetary organs of the third world's own.

IV.

It will be reasonable at this point for me to take up the North side's objection to the foregoing points argued as to the North-South Problem as well as several concrete proposals forwarded to solve it on the grounds of "the equity principle" from the side of the South, which is critical of the present international economic system. To neither the first point of our discussion concerning the remnants of the colonial times nor the fourth point as regards disadvantageous factors attributable to multinational corporation and international finance arrangements, do I dare to refer here because most of the discussions are not worth noticing. And also, as to the third point about "backwash effects", they can not be said to constitute the essential defect of the present world economic system, since solutions can be worked out through efforts and cooperation between the advanced and the developing countries despite much difficulty due to their troublesome nature. So, I dare not to refer to any more here, either.

What is important and interesting in both theoretical and political terms is the second point about the structural defect in the traditional international division of labor, beginning with the "Singer-Prebisch Theorem", the dispute about which has not been settled yet because of a number of theoretical and practical difficulties. The data included in the introduction of the annual reports by the Japanese Ministry of International Trade and Industry showed that the commodity terms of trade of primary goods (relative price of primary goods to manufactured goods) remained almost on the same or a slightly lower level from 1954 to about 1970, and from 1971, especially from 1973 onward, it rose rapidly, and after the sudden rise in petroleum price, it rose remarkably, but since 1975 it has fallen down again. A certain evidence supporting this theorem has not been obtained from this data, either. Besides, the discussion is rather complicated in view of questions of price index number, including deciding of the reference year, marking of weights, and choosing of goods. Theoretically speaking, there is much room, for argument; namely, countries exporting primary goods are not only developing countries but also advanced countries whose exporting shares of primary goods are too large to be neglected. Income elasticity of demand in all primary goods, which is also too large to be neglected, is not low. The invention of substitute goods is being made in limited to a varying degree in all the goods. The oligopolistic controlling theory in manufacturing industries is rather conventional.

Thus, a long-term downward trend in prices of primary goods is debatable pro and con, while a short-term violent fluctuation in prices of primary goods has been rather proved statistically. In this aspect, I suggest that the advanced countries should be modest in the developing countries' insistence. To do so the advanced countries should not adopt such a price compensation formula as fixes the prices of primary goods themselves at a high level, but consider to adopt such a measure of compensation and relief as does not destroy the market mechanism.

As for the main theme of the second point, namely "benefits gained from industrialization" claimed by the developing countries, the following difficulties are pointed out by advanced countries' economists.

(a) Industrialization in the developing countries is mostly at the so-called "last touch stage" in which final goods are produced from half-processed goods that the advanced countries provide together with machinery to be assembled and technical and managerial knowledge and staff.

(b) Little expectations have been entertained of dynamic effects of industrialization in the developing countries, as their "industrialization for import substitution" soon causes a flood of inefficient, high cost, and small scale manufacturing industries along with the smallness of the domestic market.

(c) Most of industries in the developing countries, which are even oriented toward export as well as industrialization, can scarcely become grown-up ones from the stage of infancy, because the advanced countries afford tariff preferences only to a small number of goods. (Beside it, the applied period of the preferences is short, safeguard clauses protect the advanced countries and low tariffs reduced rather below by the "Kennedy Round" will be reduced further in the "Tokyo Round" again.)

(d) Far-reaching "learning-by-doing" effects of industrialization are hardly expected since domestic manufacturing industries in the developing countries are mostly managed inefficiently in urban circumstances corresponding to the low wage, limited capital and less sophisticated technique.

Finally, advanced countries' economists dispute about the static feature of the comparative cost theory as follows: We should remember that, admitting the limitation inherent to a static theory, the comparative cost theory is the only fundamental theory available in proving globally optimal allocation of resources while we lack a dynamic theory of international division of labor. Those who support "the equity principle" should present another effective principle capable of expounding international division of labor as long as they look on it as unreasonable that the present international trade pattern is based on the comparative cost theory. When they demand establishment of a "New International Economic Order" to bring about a drastic change in the market mechanism and urge the raise of developing countries' regionalism to isolate the developing countries from the present world market, they are just the same as those whom they criticize, namely the advocate of "the efficiency principle" of comparative advantage. Enforcement of a policy based on "the equity principle" will sway the market mechanism and make the rate of world resources efficiency decrease markedly, finally resulting, it appears, in failure to accomplish "the equity principle" itself. Though a sharp rise in the 1970's fall-term oil price signified an apparent victory of OPEC's "equity principle", the appropriate allocation of world resources has been swayed partially, whereby non-oil producing developing countries, which are most seriously affected countries, induced an economic loss far greater than the advanced countries. It resulted in "the unequity principle", which has made the so-called *"the South-South Problem"* much more serious.

V.

Thus, "the equity principle" promoted by the South would be more sharply opposed rather than being out of harmony with "the efficiency principle" advocated by the North. If so, I opt for the latter. According to it, in the process of extending *a pie*, namely the Gross World Product, *the pie* itself gradually extends to be disadvantageously distributed to a certain group, while, according to the former principle, *the pie* itself might absolutely diminish in size in spite of a fair distribution because of a large decrease in resources efficiency rate of the entire world.

We have not found yet, as a matter of pity, an autonomous mechanism which allows *the pie* to extend and be fairly distributed. It appears to me, however, that such a mechanism may be realized, though partially, by incorporating some of both the "principles" through certain artificial measures, for instance, as stated below:

(a) The advanced countries should give more active assistance than ever so as to develop human resources. "Missing links" to the present developing countries are not only physical ones, but also human resources like skillful workers with high-level techniques, competent managers with both an enterprising spirit and an organization ability, and efficient public officials with high morality. In this connection, the advanced countries should help the developing countries by dispatching technicians accepting students from them, granting free provision of know-how, abolishing a patent royalty, and so on.

(b) The advanced countries should give their maximum assistance to promote agricultural production in the developing countries. A clue to it may be found in "Green Revolution". Cultivating high-yielding varieties (Mexican wheat, rice in IR series, and the like), which was once praised as the means to bring about "Cornucopia", has been neglected just as being called "Pandora's Box". But from the experiences gained so far in the developing countries we have know fairly much about the reason why this revolution has not attained success in practical use. In this connection, the advanced countries are called on the offer a great deal of assistance. Certainly, carrying out this revolution might throw many peasants out of work despite successful agricultural production as shown by a sharp rise in the producing standard. Since this kind of unemployment can, however, be regarded as the so-called "disguised unemployment", released peasants may be relocated in the industrial sector as a useful factor to industrialization.

(c) The advanced countries should help more the developing countries to be industrialized in order to make up for the short-comings resulting from the static constitution of the theory of comparative advantage. The attitude the advanced countries should take is to transfer to the developing countries such industries that have a possibility to change their "comparative disadvantage" into a favorable one to them in the near future as well as a possibility to strengthen industries which have already enjoyed "comparative advantage", so that the developing countries can do their best in the conversion of the industrial structure inside of them. This would represent thoroughness of "the efficiency principle" rather than realization of "the equity principle".

(d) The advanced countries should cooperate with the developing countries to offset the loss due to a short-term fluctuation in prices of primary goods. But the cooperation policy should not be in the form of "price compensation" as is required by the developing countries but in the form of "income compensation". It has already been mentioned that "price compensation" is very likely to destroy the market mechanism and waste resources.

IV.

The purpose of the four foregoing proposals which are fundamentally based on comparative advantage having preferences to "the efficiency principle" is to achieve a partial harmony between it and "the equity principle" by making some amendments claimed by the latter. As many economists have already insisted on this sort of approach, it represents a very common way of thinking.

No specific is available, however, for the disease of "the North-South Problem". We are called on to solve the problem by taking a time-horizon as long as possible and promoting modernization of the whole society of the developing countries at a steady but very slow pace. Efforts should be devoted to bring about political stability, control a population increase, raise an educational level, and achieve a land reform. Too much adherence to immediate equity will result in a marked decrease in the rate of productivity of the entire world economy, bringing them nowhere. I agree with Prof. H. Myint to his guess saying properly that the developing countries are not so rich as to neglect "the efficiency principle" and waste scarce resources.

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