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## Relocation of Production in Developing Countries

In the context of development theory and policy the demand is voiced time and again that the industrial countries should renounce the production of specified goods and transfer it into the developing countries. According to recent studies undertaken in the Federal Republic in particular leather processing and the clothing industry would be involved. A scientist and representatives of the textile and shoe industries comment on these problems.

### A Sound Case for Relocation

by Dr Frank Wolter, Kiel \*

The past fifteen years witnessed the development of a new dimension in international trade. During the First Development Decade the developing countries, traditional suppliers of raw materials and other primary commodities to the world market, began to enjoy success in exporting manufactured goods to industrialized countries. This marked the shift from a largely vertical to a more horizontal division of labour between these two groups of countries.

The consequences for relocation of industrial activities and concomitant adjustment pressure are new phenomena as well. In the past, mutual interpenetration of markets as experienced by industrialized countries had been characterized by intra-industrial specialization, causing little adjustment hardship as branch barriers did not have to be overcome. The emergence of developing countries as competitors confronts the industrialized countries with

inter-industrial adjustment for the first time. Large segments of individual industries are threatened in their very existence.

Under these conditions relocation of production activities from North to South takes on a different character: Whereas in the past much relocation has taken place relatively noiselessly for the purpose of preserving markets in the face of import substitution policies, in the future much relocation will be necessary in response to import competition. The impetus to relocation tends to shift from "demand pull" to "cost push".

#### Increased Adjustment Pressure

Indeed, pressure for relocation has accelerated markedly since 1970. In Germany, to name but one case, imports of manufactured goods from developing countries, growing at an average annual rate of 13.2 p.c. between 1970 and 1974, by far outpaced the growth of total imports of manufactured goods

(8.7 p.c.). Throughout the 1960s suppliers from developing countries had still lagged behind those from other regions. Moreover, hidden behind the global figure for the recent past, which may even appear moderate, lie dramatic developments in individual branches. Besides the mineral oil industry, several consumer goods industries and most of the investment goods industries have been particularly hit, average annual import growth rates having attained from 30 p.c. to more than 100 p.c. (plastics products, leather products, clothing, pulp and paper products, glass and glass products, electrical engineering, office machinery, structural and light metal products, road vehicles, aircraft equipment, precision and optical goods, clocks and watches, fine ceramics, ships and boats).

Although in most of these industries the level of imports from developing countries is still fairly low, adjustment pressure on the domestic industries is almost self-evident in view

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of this import growth. In the future relief from this pressure can be hardly expected. The developing countries' firm intention of vigorously pushing forward their industrialization efforts has only recently been manifested in the Lima Declaration – whatever realism one may attribute to the controversial 25 p.c. target share of world industrial production at the end of the millennium. The industrialized countries remain called upon to desist from hindering structural change in their economies brought about by the progressing industrialization in the developing world.

### Affected Industries

Although the developing countries will surely be unable to overcome their role as marginal suppliers on a host of markets in the industrialized countries even in the long run, it is equally sure that the question of relocation will acquire increasing urgency in many other branches. At rates of effective protection presently prevailing in the developed world, particularly those branches will suffer from decreasing international competitiveness which intensively absorb these countries' relatively scarce, and hence expensive, factors of production.

□ Raw material intensive industrial activities are a case in point. As the bulk of agricultural and mineral raw material resources is located in developing countries, these benefit from their abundant supply of raw materials especially in those cases where processing leads to a significant reduction in transport costs. Apart from favourable material input costs, relatively cheap labour and relatively low pollution control standards there are additional sources of the developing countries' comparative advantage in processing activities. Consequently, the high-income coun-

tries' food, beverage, tobacco, leather, rubber, non-ferrous metal, petro-chemical, and saw-mill and wood-processing industries are obvious candidates for increasing adjustment pressure<sup>1</sup>.

□ Considerable differences in relative wages between North and South<sup>2</sup> offer developing countries a distinct comparative advantage in industrial activities whose technology is universally available and which intensively absorb low-skilled labour<sup>3</sup>. Such industries constitute the second focus of present and future adjustment pressure. Predominantly, they are consumer goods industries, e.g. manufacture of wood products, furniture, leather products, shoes, textiles, clothing, glass products, telecommunication and domestic electrical equipment, and musical instruments, toys and sporting goods. For these branches, market forces are likely to compel continuous relocation as the industrialization of developing countries proceeds.

Raw material intensity and labour intensity certainly do not exhaust the criteria determining the division of labour between developing and industrialized countries. Experience, however, has corroborated their crucial importance. Therefore, it is only reasonable to assume that the brunt of the adjustment burden will rest with the industries named above. Of course, even these contain sub-branches which are skill-intensive and hence produce goods unchallenged from developing coun-

<sup>1</sup> Indeed, already in the past import competition from developing countries was concentrated on these branches. See J. B. Donges, G. Fels, A. D. Neu et al., *Protektion und Branchenstruktur der westdeutschen Wirtschaft (Protection and Structure of Particular Trades in the West German Economy)*, in: *Kieler Studien* Nr. 123, Tübingen 1973, Chapter VII.

<sup>2</sup> See G. K. Helleiner, *Transnational Enterprises, Manufactured Exports and Employment in the Less Developed Countries*. Paper prepared for the International Labour Office, June 1975 (mimeo.), pp. 60-62.

<sup>3</sup> Of course, along with relative factor prices relative productivities have to be taken into account.

tries<sup>4</sup>; also, in some cases proximity to consumer markets may govern comparative advantage. Notwithstanding, under liberal trade policies, relocation will be the only long-run viable option for large segments of these industries<sup>5</sup>.

### Criteria for Competitive Locations

Given these forces, the question of where to locate immediately arises. Though relatively cheap labour and/or raw materials are available, the (private) profitability of any individual relocation project depends upon a host of additional factors differing widely among developing countries. Apart from transport costs, these include availability of adequately skilled and industrially disciplined manpower; sufficient transportation and communication networks, and other infrastructure; emission control and safety standards; commercial policy in general and foreign investment regulations, such as profit transferability and investment incentives, in particular; and political stability.

Indeed, under this rigorous screening process, at present only few countries seem to offer competitive locations for broad spectra of the industries enumerated above. Thus, it would be difficult to extend the list beyond

□ Hongkong, Iran, Malaysia, Singapore, South Korea, and Taiwan in Asia;

□ Brazil and Mexico in Latin America; and

□ Greece, Spain, Tunisia, Turkey, and Yugoslavia in the Mediterranean Area.

This, however, is not to say that other developing countries

<sup>4</sup> Typically these sub-branches produce unstandardized and/or high quality products.

<sup>5</sup> Due to the international mobility of capital, defensive investment, i.e. the (partly) substitution of less-skilled labour by capital, is no long-run alternative.

do not offer advantageous locations for producing and successfully exporting individual products<sup>6</sup>.

### Protectionism – An Inadequate Answer

Clearly, this structural adjustment process is of a long-run nature. Nevertheless, it will not be without pain. Experience has shown that in certain branches the developing countries' export success has been so swift that near-crisis situations have occurred. Nothing guarantees the immunity of other branches. Instead of considering relocation as an anticipatory strategy, those affected – capital as well as labour – usually advance pleas for protection. Protectionism, however, seems to be an inadequate answer to the impact of the developing world's industrialization efforts on the industrially developed part of the world. On the one hand, protectionism would severely aggravate the former countries' employment and growth problems; on the other hand, protectionism imposes high social costs on the industrialized countries. That in these countries it prevents

<sup>6</sup> See M. Böhnet et al., *Industriestandort Afrika: Keine Utopie – Möglichkeiten für die Errichtung von Exportindustrien in den assoziierten afrikanischen Staaten* (Industrial Location Africa: No Utopia – Chances for the Establishment of Export Industries in the Associated African States), in: IFO-Schnelldienst, 21, München, July 1975.

factors from moving into their most productive employment, is conveniently ignored in arguments for protection.

"Unfair competition" is one such frequently heard argument. The more sophisticated versions point to some developing countries' export subsidies as a distorting influence lending artificial advantages to suppliers located there. However, such commercial practices – apart from offering infant industry support – often constitute only partial compensation for overvalued currencies. The less sophisticated version focuses upon low wages in developing countries as the source of unfair competition. Differences in factor-price relations, however, form the very basis of a mutually beneficial division of labour.

"Protection to preserve employment" is a particularly expensive policy. Should macro-economic instruments not suffice to maintain employment during adjustment to changing international supply conditions, adjustment assistance measures are the efficient strategy for tackling regional and sectoral employment problems.

"Protection for independence (or even autarky)" can be argued only politically. It seems to find its most engaged proponents either among would-be

beneficiaries or among those unaware of the costs.

"Protection for protecting developing countries from attracting industrialized countries' 'structural-problem-branches'" is a plea which ignores the structural problems' causes. In developing countries most of these very branches would find not only favourable supply conditions but also would face a much more income-elastic demand.

Still more complex arguments for protection, such as balance of payments and optimum tariff arguments, have been advanced. In their core, they restrict themselves to static effects and attack symptoms rather than causes of real problems.

### Concluding Note

Relocation of industrial activities from North to South is not an end in itself. Rather, it should be looked upon as an efficient vehicle for smoothing adjustment and reducing its costs in a developing world economy. For developing countries it is a means especially of reducing unemployment. For industrialized countries it frees production factors to move into activities in which long-term growth prospects are brightest. Hence, there is a sound case for relocation, at least from a cosmopolitan point of view.

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