

THE NIC CHALLENGE AND THE CHANGING STRUCTURE OF WORLD TRADE: SOME IMPLICATIONS FOR CANADIAN REGIONAL DEVELOPMENT POLICY*

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Introduction

This paper eclectically surveys the changing structure of world trade, especially in view of the NIC (newly industrialising countries) challenge, in order to review the policy implications for regional development in Atlantic Canada. It is argued that neoclassical economic policy-making would be an insufficient prescription for regional development, because the appropriate concept of equilibrium in such a model is neither Canada-wide, nor North American, but a *global equilibrium*. Neither is a dependency model of regional underdevelopment relevant, because labour costs in Atlantic Canada are too high in relation to peripheral countries of the Third World. However, it is recognised that past regional development subsidy programs have tended to generate quasi-rents; therefore a major economic restructuring and a serious effort at promoting *endogenous development* are considered essential ingredients in a new strategy for Atlantic Canada. In particular, a regional refugee/immigration policy financed along the lines of the standard Keynesian fiscalism is recommended.

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The Changing Structure of World Trade

The structure of the international economy is changing. Manufacturing, especially labour-intensive assembly operations, are moving from North to South. After the Japanese Miracle, there is a new NIC challenge, posed by newly industrializing countries that are acquiring new comparative advantage in an increasing range of manufactures. Textiles, clothing, shoes and leather industries are now regarded as declining industries in the North, but this is only a short list and the beginning of a secular, long term Southward trend.

Some recent examples of new trends are illuminating. According to UNCTAD [18] figures, in 1970 developed market economies accounted for 70 percent of the total volume of world exports, compared with the 17 percent share of the developing countries. By 1982, the share of developing countries had risen to just over 25 percent compared to a 63 percent share for the developed market economies. This structural shift is more fundamental than the rise of OPEC. Developing countries are structurally changing from being exporters of primary products to exporters of an increasing range of manufactures. In 1965, only 16 percent of the merchandise exports of middle income countries and 20 percent of that of upper middle income countries consisted of manufactures; by 1983, these shares had risen to 46 percent and 55 percent, respectively [21:198-9]. To cite a few specific examples, developing countries as a whole accounted for only 6 percent of telecommunications equipment exports in the world in 1970; by 1982, their share had jumped to just over 20 percent. Their export share of ships and boats in the same time period rose from virtually zero to 20 percent. In road motor vehicles and agricultural machinery, the developing countries accounted for over 2 percent of world exports in 1982 compared with negligible shares in 1970.

A dozen years ago Raymond Vernon [3:ch. 3] coined the phrase "sovereignty at bay" to document the rising power of multinational corporations (MNCs). This notion is now valid in a new sense: Keynesianism and Monetarism are beoming obsolete because they are theories based on the notion of an all-powerful nation-state capable of managing a national economy for full employment without inflation. This is becoming an increasingly obsolete assumption in the light of external supply shocks, imported inflation, global stock market speculation, and, even more fundamentally, because of the dynamics of shifting comparative advantage. More and more less developed countries (LDCs) are graduating as NICs [13]. What we may be seeing is not so much the deindustrialization of the North, as the growth of a more integrated and interdependent world in which macro-economic policies have to be internationalized.

The newly emerging world economy has far-reaching implications at the regional level as well. As we move closer to the Global Village, our markets become global supermarkets. As competition for investment intensifies, and MNCs close plants in one community in the North and relocate to the South, no region or community can be isolated from the dislocating dynamics of a new system of competitive world trade. Accordingly, no regional development policy should be formulated without a good understanding of the evolving structural trends and shifting comparative advantages in the international economy, both North and South.

The NIC Challenge

The successful industrial development of the East Asian "Dragons"—South Korea, Taiwan, Hong Kong and Singapore—in the postwar period is often cited as a shining example of the inherent validity of neoclassical growth theory, if and when governments are willing to "get prices right" and adopt free trade strategies [2]. Deepak Lal [9] and an influential group of economists associated closely with the World Bank have generalized that, "if you get prices right, then growth with equity will follow—as happened in the case of the Four Dragons." The success of the East Asian NICs has enhanced confidence in *imitative development*, based on the view that other developing countries can replicate the NIC experience by adopting export-oriented industrialization and relying on privatization to encourage foreign investment and technology transfers.

In fact, however, the success story of the Four Dragons is open to challenge on a number of theoretical and empirical grounds. Dependency theorists have argued that these NICs are merely "client states" dependent upon the United States for preferential treatment and access to the American market. They are controlled by oppressive military or authoritarian regimes who suppress wages to attract monopoly capital. Others have argued that these are "special cases" [14], dominated by Buddhist values, whose experience can hardly be replicated in other cultural environments. Bienefeld [3], among others, has challenged the myth that the East Asian NICs are examples of free enterprise proving the validity of neoclassical orthodoxy. Behind Hong Kong stands China with unlimited supplies of labour. South Korea, Taiwan and Singapore all have highly authoritarian, interventionist governments, and rely upon economic plans and public subsidies (for example, subsidies for public housing, manpower training; technology consortia for R&D). They have carefully crafted regulations to promote foreign investment in accordance with predetermined social policy goals [6]. These countries, and Japan, which is the proto-model for them, actually reflect a powerful government-business partnership in

industrialization whereby monopolies and oligopolies act jointly in a new, 20th-century mercantilist pursuit of profits and trade surpluses. Successful transplantation of this partnership into LDCs is far from easy, as can be seen from the Malaysian experience briefly detailed below.

Malaysian Imitative Growth: The Problem of Quasi Rents

Malaysia provides an interesting case study of imitative growth modelled on the East Asian NICs. In particular, Malaysia adopted a deliberate "Look East" policy of imitating Japanese and South Korean work ethics and the government-business partnership symbolized by the idea of "Malaysia Inc." Foreign investment and technology imports were vigorously promoted through generous tax credits and investment incentives, and extensive subsidy programs were implemented, including the creation of numerous industrial estates and free trade zones, and featuring low wages, anti-strike legislation and cheap serviced land [12].

But Malaysia's imitative "Look East" policy has not been successful. The Malaysian economy is still a primary producing economy seriously vulnerable to fluctuating commodity prices. The major explanation for the failure of government subsidies to make a success of the imitative "Look East" policy must, however, be found in the rent-seeking behaviour of the ruling elites and special interests who manipulated the policy for personal enrichment. Foreign and local investors were obliged to pay large transaction costs, fees, and margins to political and bureaucratic elites acting as middlemen arranging licences and securing contracts. Nationalistic equity ownership rules introduced under the New Economic Policy (NEP) also had a discouraging effect. Quasi-rents, which enriched the special interests, were largely squandered for conspicuous consumption or in speculative stock and real estate deals at home and abroad [12].

The Malaysian experience has important implications for Atlantic Canada because quasi-rents also exist in the Atlantic region. Subsidies always provide the ideal environment for rent-seeking behaviour. We shall return to this theme shortly, after reviewing a new source of competition in the international economy.

International Production Sharing

One of the latest techniques of the search by MNCs for maximum global profits is international production sharing, variously known as international subcontracting or intrafirm production sharing [8]. It is a system that is replacing international trade in *products*, supposedly under free and competitive conditions, with trade in parts and com-

ponents controlled by vertically and horizontally integrated oligopolistic MNCs.

This new system of production sharing is creating a new international division of labour based on the notion of a *global assembly line* or *global factory*. Thus, American MNCs may centralize new product design in R&D centres in the U.S., certain parts and components may be subcontracted to affiliates in Taiwan, Malaysia or Singapore, then shipped, via the U.S. on a duty-exempt basis, to Mexico or some other labour-surplus economy for final assembly before re-export back to the United States. International product sharing enhances the power of the MNCs, since all stages of the global factory are controlled and manipulated by these oligopolies to take advantage of tariffs, taxes and labour cost conditions in different countries.

To give one example of the new global assembly line, we can cite the *Maquila industries* which have mushroomed just inside the Mexican side of the U.S.-Mexico border. These are labour-intensive assembly operations created as a direct result of the American MNCs' demand for cheap labour in order to compete in the U.S. market against imports from Japan and the Four Dragons. Thus, many U.S. firms are closing plants at home, much to the resentment of American labour, and relocating to the Mexican *Maquila industries*, where hourly wages are as little as US\$0.75 as compared with up to US\$12 for unskilled union workers at home. They are shipping parts and components from East and Southeast Asia, via the U.S., to these *Maquila industries* for final assembly, and then re-shipping the assembled products back into the U.S. market. Under U.S. tariff regulations these reshipments qualify for tariff-exempt re-entry; only minimal duty on Mexican value added (that is, labour) is levied. It is estimated that some quarter million Mexican jobs in these low-wage *Maquila industries* have been created, earning Mexico some US\$1.5 billion annually with which to repay its huge foreign debt.

There is a highly significant implication of this international product sharing for regional development strategies. Not only is competition for attracting foreign investment and technology becoming more intense; for certain manufacturing industries, it is becoming impossible to compete. Not only is the choice for MNC investment and location expanding globally at a rapid pace, but slow-growth regions in industrialized countries (such as the Atlantic region) face an impossible task of competing with sweat-shop or *Maquila* wage-rates. Any industrial strategy based on downward wages flexibility for such regions would be unrealistic.

Development Strategy in Atlantic Canada

The Atlantic region of Canada is sometimes seen as Canada's Third World. Dependency theorists like Matthews [10] and Veltmeyer [19], relying on Frank, Galtung, Dos Santos and others, describe it as a Canadian hinterland, underdeveloped for the greater economic benefit of the industrial centre in Ontario and Quebec. Regional disparities in incomes, high and persistent poverty, and unemployment in relation to the rest of Canada are "not natural, but created" by policy [10].

The Atlantic regional economy may indeed contain structural characteristics which parallel those of Third World countries; for example, artisanal fishery with excess productive capacity. Historians like Harold Innis and, more recently, T.W. Acheson [1] and S.A. Saunders [15], have presented evidence in support of the view that the structure of the regional economy has been damaged by Confederation. Prior to Confederation this regional economy was a *maritime* economy of wood, wind and water, and its "magnificent achievement" of the Golden Age lasted as long as it was ocean-oriented. The maritime economy's equilibrium was upset as it became landward oriented, once Confederation was established and industrial activity shifted to the Ontario-Quebec centre. The Atlantic region gradually entered a secular decline, adopting the character of a dependent hinterland. Thus, as James Frost [7] has documented, the Bank of Nova Scotia transformed itself from a regional bank financing regional industrial expansion, to gradually emerge as a *national* bank exporting capital out of the region to central Canada and beyond.

Despite its elegance and inner logic, the argument that the Atlantic region is a dependent region comparable to Third World periphery is an obvious overstatement. Analytically, this region is not a labour reserve with substandard wages and working conditions. Despite excess labour, wage rates and labour costs (and living standards) are too high to fit Third World standards. Why are wage rates and labour costs so relatively high? The answer lies primarily in past regional development policies.

Past Regional Development Policy: The Subsidy Mentality

It is not necessary to repeat past development policy here. What is important is to highlight the fact that this policy has been based on what can be termed the *subsidy mentality*: the idea that regional disparities can be eliminated by massive subsidies and transfers channelled by the federal government. Presumably, the federal government's subsidy mentality was a response to the post-Confederation disequilibrium argument. Capital in the region has been subsidized to encourage investment in new industries or to keep the old ones running, while

labour has been subsidized through unemployment insurance benefits, make-work projects, and so on.

The subsidy approach in Atlantic Canada has had three major negative effects: (1) it reduced mobility and out-migration of excess labour; (2) it distorted the structure of industry in the region; and (3) it promoted a top-heavy administrative superstructure and encouraged rent-seeking behaviour. The failure of the subsidy approach has been recognized by the Macdonald Commission and others [4:212-4]. Despite its failure on efficiency grounds, however, it should be noted that the subsidy approach to regional development in the Atlantic region has raised living standards toward the Canadian national norm and, in this sense, contributed to national unity.

Future Alternatives and Prospects

In the current thinking about Atlantic regional development, there are two major alternative development strategies to the subsidy mentality: neoclassical orthodoxy; and endogenous development.

Neo-classical Orthodoxy

Economists like Courchene and Melvin [5] argue in terms of partial equilibrium analysis for industrial restructuring based on private initiative, market efficiency, and abolition of subsidies. In the transition period, they favour adjustment programs until the regional economy achieves a new equilibrium in the Canadian economic union, or in a U.S.-Canada free trade area if that were to occur. The labour market equilibrium would be achieved through out-mobility of excess labour from the region generated by lower wage-rates once UIC benefits are terminated and wage flexibility relied upon.

This market efficiency approach, which is in line with the Mulroney government's philosophy of deficit reduction through privatization, would indeed have the effect of reducing distortions and disequilibria in interregional flow of goods and services in Canada, or within North America, if/when a free trade deal with the U.S. is completed. It would, however, be subject to two important shortcomings. In the first place, it is unclear from the neoclassical orthodoxy where excess labour from the Atlantic region is to be relocated. Where are the labour shortages and productive job opportunities to absorb excess labour, assuming that unemployed and displaced workers from the slow growth Atlantic region were willing to move to regions of faster growth? Even if such willingness to move existed on the part of workers, could the resulting depopulation of the region be politically acceptable? Large-scale out-migration policies have been tried in the past, but have achieved only limited success. Secondly, neoclassical

orthodoxy seems to be flawed, inasmuch as it is based on a Canada-wide equilibrium. In reality, the appropriate target equilibrium has to be the global equilibrium that, as discussed above, is currently emerging in the world economy. A more rational industrial structure in the Atlantic region or any region in Canada has to be exposed to increasing competition from NICs, existing and future ones. It is unclear whether orthodox economists who advocate free trade and elimination of subsidies would abandon this position in the face of the NIC challenge. In the new international economy now emerging the Atlantic region is at a double relative disadvantage: (1) its labour costs, even after elimination of subsidies, would still be too high in comparison with those of NICs to have any realistic chance of attracting significant volume of foreign investment; and (2) its manufactured products would be uncompetitive relative to low-cost imports from NICs. Given international market forces, the region may only achieve a labour market equilibrium at wage rates similar to those now found in the sweat-shops of Southeast Asia or in the Mexican *Maquilas*—a most unlikely prospect! Similarly, the Atlantic region has little chance of matching the extensive capital subsidies and incentives available in developing countries. In short, industrial restructuring in a global competitive environment can offer little hope for the region.

Endogenous Development

A more appropriate strategy would be *endogenous development* based on small business and local institution-building for a more self-reliant economy. In one sense, this is the old community development approach, which brings to mind the Antigonish Movement. In the more important sense, however, it is a new approach that utilizes experience from developing countries such as Bangladesh as well as the next-door New England states (see below). It is based on the notion of “small is beautiful”, that even hi-tech, knowledge industry can be harnessed towards the creation of viable small businesses and industries, maximizing local value-added. Endogenous development is a people-focused approach, with emphasis on human capital formation at the community level to develop entrepreneurial talent for employment locally; thus it requires considerable delegation and decentralization of budgetary and bureaucratic decision-making powers from the national to community levels of government. It represents a new, experimental approach to subsidizing growth in slow growth regions. Donald Savoie [16] and James McNiven [11], to cite two representatives of this new approach, recommend a more self-reliant, community-oriented strategy, with emphasis on local entrepreneurial development through education, and more decentralization of funding to local authorities as recommended by the Macdonald Commission [4]. This strategy is

based on the yet-untested assumption that small business is an untapped source of growth potential that can be mobilized more effectively at the regional and local decision-making levels than at the national, federal level. It is an assumption with considerable merit and relevance, judging by the fact that there seems to be a small-business boom now under way in many centres in the Atlantic region, especially in computer- and knowledge-based services. This small-business boom, while unlikely to turn the region into another Silicon Valley, underscores the potential that was so remarkably realized in neighbouring New England states since 1980, based on a successful collaboration between universities, industry and hi-tech pioneers like Mitch Kapor (the creator of Lotus) and An Wang (the creator of Wang Computer). Out of this partnership emerged the New England post-1982 boom centred on a new knowledge/talent industry.

Endogenous development is a relatively new and untested concept. Currently, the Economic Council of Canada is undertaking an experimental study focused on identifying community resources and potential for community economic development. This is a qualitative approach utilizing interview-observation methods and drawing upon experience with community development efforts in Canada (such as the Coady Movement in the 1930s and 1940s and, more recently, the Company of Young Canadians) as well as in Bangladesh (such as the Comilla project and the Grameen Bank) and other Third World countries.

There are many successful cases of institution-building to mobilize and empower local communities for development in Canada and abroad. Father Coady's Antigonish Movement is a classic case in point. Other examples include the Mondragon project in Spain; the Comilla integrated rural development project in what was then East Pakistan; the water users association in the Philippines; credit unions and farmer cooperatives in Cyprus; and, most recently, the Grameen Bank in Bangladesh to provide unsecured loans to assetless peasants. These are just a few notable success stories of bottom-up development efforts.

At the same time, it must be noted that grass-roots movements rise and fall with charismatic leadership. This is the lesson, from the Antigonish Movement to the Sri Lankan Sarvodaya Movement led by Ariyaratne. How to organize and mobilize communities for successful take-off, and how to ensure sustained growth and expansion after the original leaders are gone, are difficult questions with as yet no clear answers to guide policy.

Conclusion

Despite these inherent problems, endogenous development merits sympathetic attention in the Atlantic region if only because alternative strategies of regional development are so dismal. Small business and self-reliant development may indeed work as the engine of future growth in the Atlantic region.

Any quick fixes in this direction, however, are constrained by two major limitations. First, and according to Statistics Canada [17:Table 32], there appears to be a significant under-investment in community-college-level education. The share of graduates from these colleges in Atlantic Canada is about half the Canada-wide level. On the other hand, university graduation shares appear to be consistent with population shares. Under-investment in community-college-level education is particularly severe in business, computer-related, and engineering and applied science fields. Bearing in mind the experience of Japan and the Far Eastern NICs, it is evident that under-investment in technical/vocational education is a serious limiting factor for endogenous development in the region.

Secondly, as even a casual analysis of Canadian immigration figures would show, the Atlantic region receives a negligible share of new immigrants into Canada. It would be naïve to think that every immigrant is a pioneer like Mitch Kapor or Dr. An Wang, but there can be little doubt that immigration often represents an inflow of talent, skill and human capital. Such inflows are important causal factors behind the current boom in Toronto and Vancouver, and they can be especially beneficial in slow-growth regions. Endogenous development can succeed if and when the supply of local entrepreneurship is adequate to the task of seizing opportunities in the marketplace; if and when local talent is inadequate or unwilling to undertake the risks of being innovative, then a brain inflow, perhaps in the form of a regional refugee and immigration policy with appropriate economic incentives, may be the necessary trigger. Such a policy, now feasible under the Meech Lake Accord, could stimulate the regional economy in accordance with the standard Keynesian multiplier process.

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