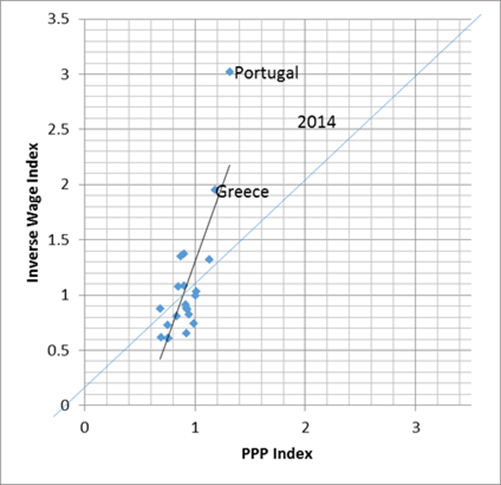
Excerpt from

A Micro-regional Strategy for Developing Countries

Industrialization has been happening in stages since the start of the machine age in the late 17th century. Robbing countries of their intellectual property isn’t something new to the world, but has been going on since the start of the industrial period so we should not be surprised by Chinese industrial espionage. When most of the advanced countries developed they were operating using a mercantile model, thus England had colonies for supply of raw materials and markets for finished manufactures. The price of raw materials, wages of workers, and the finished price of the manufactured products were all in some alignment. But what about today—what if the price that we pay for finished products including iron and steel and plastics is in line with the wages of workers in the advanced countries. The price of raw materials then must reflect that higher prices. Making a car in China with imported iron ore then may cost more than the prevailing wages of most workers. When Ford made the Model T he priced it in a way that it could be afforded with some financing by the average worker in his factories. Economists have spent many hours comparing the real cost of living in China compared to the United States – it is about 1/3rd as expensive for a similar standard of living for a Chinese than for an average American. Thus the PPP index for China is 3 and the US 1. But have Chinese wages kept up with Chinese internal prices. Based on the graph below the Chinese wage compared to the US wage is 1/7th the US wage and the PPP is 1/3rd US living standards. One reason for this is that the cost of raw materials to make the products is set not by Chinese internal prices but by international prices. The cost of steel is set in Detroit, not Shanghai.

Chart 8a: Comparison between Local Wages and Local Prices (Purchasing Power Parity Ratios for Labor Costs and Prices – Emerging Countries Group

Chart 8b: Comparison between Local Wages and Local Prices (Purchase Power Parity Ratios for Labor Costs and Prices) – Advanced Countries



In this chart we compare the purchasing power parity index or each country to the hourly wage differential using the same scale. Because the index is based on the differential in purchasing power, we use the inverse for the wage rate relative to the US hourly wages (1.0). Chart 8b shows this relationship for the advanced countries while Chart 8a for a group emerging countries. If relative wages and relative internal prices are in line then the countries should fall along the diagonal line. What we see if that the real wages, measured as an inverse to the actual wages fall below the purchasing power parity index. When wages and costs of finished products are misaligned, as is the case for developing and emerging markets, then the natural pattern of industrial development and entrepreneurship fails to maintain growth.

As we have illustrated, for the developing countries the benefits that had come from globalization for much of the period from the 1980’s to 2020 failed to raise incomes sufficiently. Most of the benefits of this outsourcing of jobs and technologies were concentrated in a few of the better geographically situated and educated countries in Asia. The success of the emerging markets, mainly in Asia, has doomed the developing countries to a second class status even as the emerging markets are slowly closing the gap with the advanced countries.

Regional trading groups, even membership such as Romania and Bulgaria can claim, may not be sufficient to force up living standards. Bulgaria and Romania, after years being within the richest trading bloc in the world, the European Common Market, have a standard of living that is 1/5th the European average, 1/7th of Germany. Just being within a rich community does not provide the answer. Wages in Bulgaria and Romania are less than $ 2.00 an hour compared to a $ 30 average real wage in Europe as a whole. The issue is the lack of manufacturing capacity and the low level of capital investment. Much of the economic literature of the past three centuries dealt with the question of infant industries and their importance to growth and development. We live in a world with substantial over capacity and the ability to organize flexible capital rapidly. Thus there may be no way for manufacturing something in Bolivia as inexpensively as in China even after taking into account transportation costs to neighboring countries in the region. And yet without being able to make more things in Bolivia an entire generation of young people may be locked into a cycle of poverty. A micro-regional strategy is not efficient, but it will create manufacturing jobs and finished products. Failing to go through this stage of development makes it harder to reach a higher level of personal income.

One approach to speeding growth in these developing countries is to unify markets for a selective group of essential products. A few developing countries with contiguous or near contiguous borders analyze existing trading patterns with advanced and emerging markets and choose products that one or several countries are exporting to other emerging or advanced countries and that are being imported by neighbors and make these preferential products within the micro-trading group. Direct investments by governments and private sector in protected product categories can encourage development of localized production and distribution within the market. Export taxes on raw materials can lower domestic prices sufficiently to make local production of near substitutes possible. By keeping the list of products to what is already imported and what is potentially exported, i.e. mining existing trade data, these subsector groups, may begin to do what the Coal and Steel Community did in the 1950’s in Europe, shift the dynamics in ways that will make small, poor, countries possibly able to gradually narrow the gap for more people. These smaller, localized, economies may not be fully up to Western standards, but once local raw materials prices and local wages are in balance, then localized manufacturing can replace foreign products. Efforts to turn developing countries into smaller versions of advanced or emerging economies may waste resources better used for raising everyone’s standard of life.

Table F offers a rough analysis of what share of the regional group’s exports to the world can cover imports of the group from the world. Within the micro-trading region, discounts would be offered for trade within the region, trading group conferences might be established to reorganize market access, companies would be encouraged much like the early work of the Coal and Steel Community that launched the European Common market to partner with competitors and share markets with expansion coming from rising standards of living the result of faster growth in urbanized employment and higher wages. A sub-currency, secure letters of credit insuring payment in these crypto-currency units that may be exchanged for domestic currency at fixed rates, can facilitate trade. A single external tariff for the selected products sufficient to limit close foreign substitutes, and forbearance from WTO rules for these “preferential” product categories to limit retaliation, are also required Outside investors would be encouraged and groups like the IMF and the World Bank could provide financial capital for these subcritical financial arrangements and for low cost loans to companies investing in manufacturing capacity.

I have included in the two examples the largest and most important country in the trading group in two developing regions as an example. For the Western Latin Group, Chile represents the central core economy and within the Subcontinent group, India. For comparison I’ve eliminated India from the Subcontinent group and we see that even smaller groups can have meaningful shares that at least some may be rerouted. Every dollar of imports substituted by exports of a partner country or to a partner country yields an improvement in the standard of living. We can see how critical to the success of a micro-regional trade group when there is at least one major country in a geographical region included.

A second measure for the Indian Subcontinental Group shows the share of domestic demand that existing exports could satisfy. This may be important especially when we consider the likelihood of less openness on the part of advanced countries. Table F shows how India, with its large population size and growing potential for manufacturing sophisticated products, stands at the heart of a potentially vibrant trading region with a concentration of population. India’s existing exports dwarf the demand of all three of its weaker neighbor’s consumption.

Global Benefits from Speeding Developing Market Growth

Why should we worry about the poorest countries and not about the poverty at home? This is the question that electorates ask politicians in the advanced countries often enough. The issue comes down not to equity and closing the income gap, but rather to the larger issues that we are all facing, as the global pandemic illustrate no country is an island in a sea of grief. At the same time the future holds challenges that will test our ability to adapt to a changing climate and fragile environment. We will likely see many places in the world that are no longer habitable or viable.

The world has a short window to solve the problems that uncontrolled development has caused. Closing the gap for many of these poor countries is critical not just to their futures but to ours. We get useful raw materials from African and South American mines, and the human diaspora has made it difficult to ignore so much of the world because it is inconvenient or better to see their problems as out of sight and out of mind. Walls will not stop this migration, and unless the emerging and advanced countries are willing to forgo all connections, all trade, all communications with these declining and food insecure parts of the world, then people will force borders and anarchy or autocratic governments will be the rule, not the exception in the advanced and even emerging nations of the world.

The global pandemic illustrates two points – the first we are all connected in some way with the world at large and that disease knows no walls or borders; and the second, that we can find when we want to solutions quickly. Advanced countries can redirect water resources or adapt, poor countries are forced to just suffer. Poor countries, falling further behind, will not be able to do this and the result will be anarchy. As an economist and sometimes novelist, I can imagine a future, not too distant from today, when the world will split into two worlds – in one the problems of climate change and shortages of food or raw materials – can be met by science and engineering; in the other, people will die, not in the thousands or millions, but in the billions. The image of that suffering will become too much, but the answer might well be to ignore the suffering, to ban reporting from these places, to cut off communications, to build walls, not bridges. I hope, pray, that this vision will not come true, but human beings often enough ignore poverty at home, they likely will be happy to ignore the suffering and death in those parts of the world that are no longer viable.

A Final Thought

This paper describes one future – the path that I believe the world economy will take once the pandemic ends this year and vaccines are widely available. In doing so, it highlights too the widening gap between the advanced countries, emerging markets, and the larger group of developing economies that have failed to fully benefit from the near forty years of rapid trade growth and wealth creation. It is this gap that needs to be closed because by not closing this gap we open the door for insurrection, mass migrations, even wars. We can estimate that about 30% of the population of the 72 countries included in the QuERI sample, about 2/3rd of the total population of the world, but closer to 95% of the global wealth, lives urban lives that are largely above the poverty level or in countries where their children have the potential to have an adequate standard of living. No walls can stop a mass migrations if they happen because people have no hope except to reach the barriers and take what they need. No walls can stop viruses from spreading. We have created a fully interconnected web of reliance and so lifting the lives of the poorest people in far off places may be part of the mandate for the next half century if the human race is to survive the challenges before us.