MANUFACTURE EXPORTS OF THE
DEVELOPING COUNTRIES AND THEIR TERMS
OF TRADE VIS-À-VIS THE DEVELOPED
COUNTRIES:

IS INDUSTRIALIZATION OF DEVELOPING COUNTRIES AN
"ESCAPE ROUTE" FROM PREBISCH-SINGER HYPOTHESIS?

SHOUVIK CHAKRABORTY¹

ABSTRACT: In the recent past, the developing countries, in particular the Newly Industrialising Countries (NICs), ASEAN, China and India, have become a major player in the global market of manufactured goods. Some economists and academicians have argued that this changing composition in the export baskets of these developing countries in favour of the manufactured goods had helped the developing countries to escape from the problems of 'deteriorating' terms of trade. It doubts the validity of the Prebisch-Singer hypothesis, in its original form, in the present world economic order. This study makes an attempt to address this issue and analyses the manufacture-manufacture terms of trade of the developing countries vis-à-vis the developed countries. This paper tries to empirically find the trends, if it exists, in the movement of the manufacture-manufacture terms of trade of the developing countries vis-à-vis the developed countries spanning over a period of almost 30 years i.e. 1975 to 2005. It also identifies the probable factors responsible for the long-term movements in this terms of trade index. This paper essentially tries to find an answer to the question whether this diversification of exports towards more of manufactured goods helped the developing countries to escape from the problem of 'deterioration hypothesis'.

¹ The author is grateful to Prabhat Patnaik for his valuable comments and suggestions on the draft of this article without implicating him in anyway. The author is Assistant Professor at the Indian School of Business and Finance, New Delhi and can be reached at shouvik.chakraborty@gmail.com.
1. Introduction

The impetus of the industrialisation strategy in the post World War-II phase of the developing countries got its theoretical support from Prebisch (1950, 1959 and 1964) and Singer (1950, 1975 and 1982).\(^2\) The general policy conclusion from the “Prebisch-Singer hypothesis” was that the developing countries must diversify their exports into manufactures as intensively and rapidly as possible. This the authors believed to be an ‘escape route’ from the secular decline in the terms of trade of primary commodities vis-à-vis manufactured goods, which would eventually lead to an improvement in the gains from trade of the developing countries.\(^3\)

By their following an industrialization policy since the 1950s, the product composition of the export basket of the developing countries has undergone a major change in the direction of dominance by manufactures. Figure-1(a) shows the share of manufactured goods (SITC 5 to 8 less 68) in the total export basket (SITC 0 to 9) of the developing countries from 1955 to 2002. The share of manufactured goods in the developing country’s total export basket increased sharply from 8.31 percent in 1955 to 65.37 percent in 2002. Figure-1(b) shows the share of the developing countries in the total world trade of manufactured goods. The ratio of the developing country’s export of manufactured goods in the total world export of manufactured goods increased from 5 percent in 1955 to 28.1 percent in 2002. From the figures, it is evident that the developing countries have become a major player in the world trade of manufactured goods, especially since the mid-

\(^2\) As noted by Bagchi (2008, pp.23), “...the imperially imposed division of labour under which the underdeveloped countries were to specialize in agricultural commodities with low income elasticities of demand had to be overtuned and a vigorous programme of industrialization had to be taken in hand if the poverty of these newly independent nations was to be seriously dented. The Prebisch-Singer thesis that the terms of trade of primary commodities vis-à-vis the industrialized nations had been on a downward trend for most of the twentieth century added vigour to the industrializer’s argument.”

\(^3\) However, the industrial strategy of the Prebisch-Singer hypothesis did not suggest clearly whether industrialization would be through export-promotion or import-substitution. But, in some of his later writings, Singer (1998) clarified that there was a natural preference for import substitution in the 1950s for the developing countries.
1970s. These statistical figures shifted the focus of the debate from primary commodity-manufacture terms of trade to manufacture-manufacture terms of trade between the developing countries and the developed countries in the trade and development literature.

Figure-1 (a)

Share of Manufactured Goods in the Total Export Basket of Developing Countries (1955 to 2002)


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4 However, this expansion of manufactured goods exports by the developing countries has been mainly confined to a few nations like the Newly Industrialising countries of East Asia, ASEAN-4, India and China.
Nevertheless, this does not imply that the traditional concern with the secular decline in the terms of trade of primary commodities vis-à-vis manufactured goods can now be ignored. This is primarily because though the exports of manufactured goods from the developing countries have increased steadily, the expansion has been confined to a few countries only. Amongst the developing countries, the four Newly-Industrializing Countries (NICs) of East Asia (Hong Kong, South Korea, Singapore and Taiwan) together with the ASEAN-4 (Indonesia, Philippines, Malaysia and Thailand) and China accounted for almost 80 percent of the increase in the value of exports by all developing countries (including China) from 1980 to 1990.\(^5\) If India, Brazil, Pakistan, Turkey and the former Yugoslavia are considered then the proportion rises to almost 90 percent. Even considering the latest period from 2002 to 2006, the average ratio of the former is almost 77 percent and of the latter 85 percent.\(^6\) This signifies that the majority of the developing countries are still dependent on the revenue from their primary

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commodity exports for the bulk of their foreign exchange earnings. Thus, from the majority of the developing country’s development perspective, the issue of the terms of trade between primary commodities and manufactured goods still remains a crucial one.

Nonetheless, with a shift in the trading pattern in favour of the manufactured goods in some of the developing country’s export basket, the terms of trade issue between manufactured goods of the developing countries vis-à-vis those of the developed countries emerges as an important area of research in the trade and development literature. The focus of the debate shifts from the commodity-manufacture terms of trade to the manufacture-manufacture terms of trade. Though, there is a significant literature on the issue of commodity terms of trade, previous research has failed to give due importance to the issue of the manufactured goods terms of trade between the centre and the periphery; which, in totality, would have also reflected the issue of the “country-terms of trade”. Charles Kindleberger (1956 and 1958) was the first to emphasize this shift from “commodity-terms of trade” to “country-terms of trade”. Kindleberger did not find any conclusive evidence in favour of a secular decline in the terms of trade of primary commodities vis-à-vis manufactured goods; however, he found strong evidence of a decline in the terms of trade of underdeveloped countries vis-à-vis industrialized countries. He concluded that over the period 1913 to 1952, the terms of trade of Western Europe improved by 50 percent vis-à-vis the “underdeveloped world outside of Europe” (1955, pp.290). Prebisch and especially Singer et al. (1958, pp.87-88) and Singer (1982, pp.283-293) readily accepted this shift of emphasis.7 Hence, they realized the immediate necessity to shift the focus from the commodity-manufacture terms of trade to manufacture-manufacture terms of trade between the developing and the developed countries. Later, Singer (1998, pp.14) emphasizing this need to shift the focus of the debate pointed out, “A

7 When Prebisch and Singer wrote their original articles in 1950, both the authors were concerned about the gains from trade of the periphery with the centre as their trading partner. Their central thesis made an implicit assumption that the developing countries are the major exporters of primary commodities whereas the developed countries are mainly the exporters of the manufactured goods.
first and simple extension of the PST [Prebisch-Singer Thesis] was to move from a proposition related to different kind of commodities to a proposition related to different kind of countries. As the share of manufactures in the exports of developing countries increased, it became increasingly necessary to break with the identification of the terms of trade between primary commodities and manufactures with the terms of trade of developing countries with more industrialized and richer countries and to undertake separate studies of the manufacture-manufacture terms of trade.”

2. Manufacture-Manufacture Terms of Trade of Developing Countries vis-à-vis Developed Countries: A Review of the Literature

The research on the terms of trade of manufactured goods between the developing countries and the developed countries was initiated in the late 1970s and early 1980s – the period which also coincided with some of the developing countries gaining strength in the world manufacture trade. Keesing (1979) initiated the debate by comparing the unit value indices for the manufactured exports of developing countries and developed countries for a period from 1960 to 1976. He observed a large drop in the developing country’s price index in 1975 and attributed this large drop to the inclusion of non-ferrous metal, whose prices showed a great variation from the movement of the manufactured good prices in general. However, the second part of his study focusing on the disaggregated wholesale price indices of manufactured goods in the United States shows a declining trend for textiles, clothing, electronics and other labour-intensive goods of the developing countries relative to the prices of other manufactured goods.

In an influential study, Singer and Sarkar (1991) initiated the empirical based debate on the terms of trade of manufactured goods between developing and developed countries. They defined the net barter terms of trade as the ratio of the unit value of the manufactured goods from the developing countries to those of the developed countries. After fitting an exponential trend equation on the net barter terms of trade over the period
1970 to 1987, the authors (1991, pp.335) observed that “in both US dollars and SDRs, the unit values of manufactured exports of the periphery declined by about 1 percent per annum in relation to those of the centre. Over the period of 18 years, 1970 to 1987, there was a cumulative decline of 20%.” However, given the high growth in the volume of exports of manufactured goods from the developing countries, the income terms of trade increased by 10% per annum in favour of the developing countries. Observing that the average rate of growth of labour productivity of the manufacturing sector in developing countries declined much more steeply from 2.3% in 1960-70 to 0.4% in 1970-80 (in comparison to the developed countries labour productivity which declined from 4.1% to 2.3%)\(^8\), the authors concluded that the double factorial terms of trade deteriorated even more than the net barter terms of trade. The second part of their study analyzed the annual trend growth rates of the manufacture-manufacture terms of trade of the individual developing countries vis-à-vis the rest of the world and the ‘centre of the centre’ i.e. the USA. The authors observed that the result in their sample of 28 developing countries and 1 region over the period 1965 to 1985 was neutral in the context of the rest of the world. The results were not statistically significant for about half the countries, while for the remaining half some had a positive trend and the others negative. But, for the terms of trade vis-à-vis the United States i.e. the ‘centre of the centre’, very few developing countries showed a significant improvement in their dealing with the United States. Even some countries which showed an improvement in their terms of trade with the rest of the world, demonstrated a negative trend in their terms of trade relations with the United States.

This paper was profoundly criticised by Athukorala (1993). There were mainly six points of criticism in response to the Singer-Sarkar (1991) paper. Firstly, a common criticism in a time series analysis is the choice of endpoints. Athukorala pointed out that the endpoint of the study period chosen by the authors coincided with the debt crisis and real devaluation of the currencies of developing countries. Bleaney (1993) also supported this

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\(^8\) These statistics have been cited from Singer and Sarkar (1991, pp.335).
criticism. Secondly, Athukorala questioned the choice of unit value indices to calculate the terms of trade of the manufactured goods between developing and developed countries. He pointed out the limitations of this unit value index.\(^9\) Thirdly, Athukorala argued that the aggregate United Nations export unit value indices of manufactures for both the developing and the developed countries relate to the total exports rather than inter-group exports of these two country groups. The industrialised countries manufactured exports have a high proportion of intra-regional trade (almost 80 percent), whereas the developing countries intra-regional trade in manufactured goods exports are merely 25 percent.\(^10\) According to him, even the commodity composition of the traded manufactured goods appears to be starkly different between the intra-regional trade and developed-developing country trade. Hence, the United Nations export unit value indices fail to capture the true picture of inter-country trade between the developed and developing nations. Fourthly and most importantly, the author argued that the inclusion of non-ferrous metals (SITC-68) as a part of the definition of manufactured goods exports (SITC-5 to 8) of the developing countries affected the price index of developing countries. This might have created a bias in the “declining-trend hypothesis” of the manufacture-manufacture terms of trade since the net barter terms of trade of non-ferrous metals vis-à-vis the industrialised countries showed a statistically significant negative trend.\(^11\) Hence, the author concluded that the inclusion of non-ferrous

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\(^9\) Athukorala (1993, pp.1608) pointed out that, “Unit values are values per unit of quantity at selected level of a given commodity classification, usually at the four-digit level of the Standard International Trade Classification (SITC). Unlike primary commodities, manufactured goods tend to be highly heterogeneous even at a very fine level of commodity disaggregation. Changes in a unit value index compiled by combining various unit values derived at a selected level of a given commodity classification are, therefore, influenced not only by “genuine” price changes but also by changes in the commodity mix. In other words, changes in the commodity mix can generate spurious price movements....Unit values are defective not only because of this ambiguity of computation but also because quantities used to compute unit values are usually available only for a limited number of categories at the four-digit SITC level of aggregation.”

\(^10\) Athukorala (1993, pp.1608).

\(^11\) Athukorala (1993, pp.1608) argued, “ As far as exports from DCs [Developing countries] are concerned, this commodity category is composed predominantly of mineral products (mostly unprocessed) such as copper, tin, zinc, lead and aluminium, whose price movements tend to be significantly different from those of standard manufactured goods. Moreover, as compared with ICs
metals was responsible for this deterioration of the net barter terms of trade of manufactured goods between developing and developed countries. Fifthly, in the country-wise analysis of the terms of trade index, the author highlighted the problem of aggregation bias. Sixthly, in calculating the double factorial terms of trade index, the use of labour productivity index of the manufactured goods sector instead of the export-oriented manufactured goods sector also invited criticism from the author.

In their response to these criticisms put forward by Athukorala (1993), Sarkar and Singer (1993) also tried to provide some counter-arguments in defence of their thesis. Responding to the first criticism of the choice of endpoints, Sarkar and Singer (1993) used dummy variables to test whether the declining hypothesis holds for an extended study period from 1970 to 1989. Their analysis showed that the results did not differ due to the choice of endpoints as the average rate of decline was 1 percent per annum even for the extended study period. Hence, the argument that the choice of endpoints biased the results in favour of the declining hypothesis did not hold true. Regarding the choice of unit value index as an indicator of the price movements, Sarkar and Singer (1993, pp.1617) pointed out that the choice of this variable does not create a systematic bias in favour of any direction, which Athukorala himself also admitted. On the third argument of high proportion of intra-regional manufactured goods trade among the industrialised nations and a low proportion for the developing countries, Sarkar and Singer argued that this had the potential of creating a bias against the deterioration hypothesis. Although Athukorala emphasized that this will create a bias in favour of the declining trend, Sarkar and Singer argued just the opposite - due to the increasing technological gap between the ‘centre’ and the ‘periphery’ and the demonstration effect of the ‘first world manufactured’ goods, the monopoly power of the manufactured

[Industrialised countries], this commodity group accounts for a greater share of total SITC 5-8 exports from DCs. Because of these reasons, the standard practice of GATT, World Bank and International Monetary Fund (IMF) as well as most independent researchers is to define manufactured goods as "SITC 5 through 8 less 68"."
exporters of developed countries increased over time. The definition of the net barter terms of trade is the ratio of the unit value index of manufactured goods of developing countries to those of developed countries. Following this definition, the denominator of the terms of trade series is likely to underestimate the relative upward movements of the unit values of manufactured exports from the industrialized countries to the developing countries (arising due to this monopoly power). Thus, a bias may be formed against the result of the declining trend. To test the validity of the fourth criticism, namely the inclusion of non-ferrous metals causing a bias in favour of the negative trends, Sarkar and Singer (1993, pp.1618) fitted a simple regression equation between the non-ferrous metal share in the total manufactured exports of the developing countries and the annual trend growth rate of the terms of trade of individual developing countries. From the regression results, the authors concluded that the cross-country variations in the rate of change in the terms of trade in manufactures of the individual developing countries cannot be explained by the cross-country variations in the share of non-ferrous metals in the total manufactured exports. Rowthorn (1997) too supported Sarkar-Singer; his study found that in the post-1975 phase, the inclusion of non-ferrous metals made very little difference to the Sarkar-Singer analysis of declining manufacture-manufacture terms of trade. In response to the fifth criticism of aggregation bias, Sarkar and Singer cited the study by Lucke (1993). Lucke (1993) analysed the behaviour of the net barter terms of trade of ‘resource-free’ manufactures of 37 developed and developing countries from 1967 to 1987. To capture the impact of the economic development of individual countries on the behaviour of the terms of trade, the author regressed the terms of trade figures on the real per-capita GDP of these individual countries. Lucke (1993) concluded that there was a relative decline in the prices of the manufactured goods exported

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12 According to Sarkar and Singer (1993, pp.1618), “Rapid technological progress in the IC [Industrialized Countries] leading to an increasing technological gap between IC and DC [Developing Countries] coupled with the fact that the consumption pattern of the DC is coming closer to that of the IC due to the international demonstration effect leads to a rising monopoly power of the IC-manufactures in the DC market. The product cycle pattern of division of labour between the IC and DC and technology transfer from IC to DC which follows a time path of obsolescence in the IC, bilateral trade aid etc. - all these factors add to this monopoly power.”
predominantly by the developing countries, which he explained as “market entry by developing country implies an expansion of supply as well as intensified competition” (1993, pp.589). Finally, on the issue of labour productivity of the manufacturing sector as a proxy of the labour productivity of manufactured exports, Sarkar and Singer (1993, pp.1619) argued that this cannot create any bias on the declining hypothesis since, “differences in the rate of growth of the labour productivity in the total manufacturing sectors of the developing countries and industrialised countries also indicate the actual difference between the rates of growth of labour productivity in the export-oriented manufacturing sectors of the two regions”.

In a later study by Minford, Riley and Nowell (1997), the authors compared the price index of the manufacturing exports of the developing countries with a price index for the combined exports of the services and the hi-tech manufactured goods of the developed countries. The authors do not include non-ferrous metals in the construction of their price index. Over the period 1960 to 1995, the authors found a large although irregular deterioration in their terms of trade index of developing countries vis-à-vis developed ones. There was a large and significant drop in the 1960s, which again is repeated in the 1985 to 1990 phase. The authors blamed the former on the increased volume of exports from the developing countries, and the latter on China’s sustained entry into the world trade of manufactured goods. In another study by Maizels, Palaskas and Crowe (1998), the authors provided further support for the declining terms of trade of manufactured goods between the developing countries and the developed areas of European Union. Over the time period 1979 to 1994, the authors analysed the unit values of manufactured goods imported by the European Union from the developing countries and of the European Union’s exports of manufactures to the developing countries and the results pointed to a deterioration in the terms of trade of manufactures of the developing countries vis-à-vis the European Union.
Like the study of the terms of trade of the developing countries vis-à-vis the European Union, Maizel's (2000) analysis was based upon a new price series data published by the United State's Bureau of Labour Statistics, whose uniqueness is that it only reflects price changes and is not affected by the quality changes. Maizel's analysis ranges from 1981 to 1996. From their study, the results derived are - i) the net barter terms of trade of developing countries vis-à-vis the United States declined significantly in the first half of the 1980s and thereafter, have been trendless; ii) the net barter terms of trade of the developed countries vis-à-vis the United States have been trendless in the first half of the 1980s and thereafter experienced a significant improvement. By combining both the results, the overall inference from this analysis was that of a significant deterioration in the terms of trade of manufactured goods of the developing countries vis-à-vis the developed countries.

Differing with the views of the declining terms of trade between manufactured goods of developing and developed countries, Athukorala (1998) analysed the terms of trade of the manufactured exports for India (1971 to 1986), the Republic of Korea (1970 to 1990) and the Taiwan Province of China (1976 to 1990). His analysis suggested that the terms of trade of the manufactured goods from these three individual countries and their various subcategories vis-à-vis the developed countries are basically trendless. In another study, on the development of the Sri Lanka’s terms of trade of the manufactured goods, and two sub-categories i.e. textile and clothing over the period 1978 to 1998, Athukorala (2000) found strong evidence of an improvement in the terms of trade in favour of Sri Lanka’s manufactured goods. The inclusion of textile and clothing industry is important since these two sectors experienced a huge increase in their share of the total exports from 10 percent to 50 percent over the study period. Analysing the unit value indices and the volume indices, the author concluded that the Sri Lanka’s net barter terms of trade of exported manufactured goods have improved over this period as well as the income terms of trade. Even for the two sub-categories, namely textile and clothing,
the results were similar. However, over the same period, Sri Lanka’s primary commodity exports experienced a decline in their net barter terms of trade. The author concluded from these results that the Sri Lankan economy had benefited by diversifying their export basket from primary commodities to manufactured goods.\(^\text{13}\)

### 3. An Analysis of the Manufacture-Manufacture Terms of Trade of the Developing Countries vis-à-vis the Developed Countries

From the review of the literature on the manufacture-manufacture terms of trade, it is apparent that there exists a debate on whether the terms of trade of manufactured goods of the developing countries vis-à-vis the developed countries have actually deteriorated over the years or not. In this section, to address this question an attempt is made to find the trend of the manufacture-manufacture terms of trade over the years and to analyse whether there has been any deterioration in these terms of trade. In this analysis, another attempt is made to resolve the original debate between Singer-Sarkar (1991) and Athukorala (1993) by re-analysing their study over an extended period from 1975 to 2005; and thereby, to derive from this analysis whether after excluding non-ferrous metals from the terms of trade index there has been any declining trend of manufacture-manufacture terms of trade or not. The data source of this analysis is the United Nations’ Monthly Bulletin of Statistics, which provides unit value indices of manufactured exports for both regions of market economies i.e. the industrial centre and the developing periphery. The data series has been spliced to the same base year i.e. 1980=100.

#### 3.1 Methodology:  
In this study, the methodology applied to calculate the annual trend growth rates of the manufacture-manufacture terms of trade of developing countries vis-à-vis developed countries is twofold. First, we fit a

\(^{13}\) However, the author cautions about generalizing the results from a single country case. Sri Lanka’s clothing and textile exports accounted for only 1 percent of the total world’s export over the study period.
lowess curve to provide a visual understanding about the manufacture-manufacture terms of trade of the developing countries vis-à-vis the developed ones. Then, based on this visual understanding, a simple regression equation is fitted to find the annual trend growth rate of the terms of trade. Both these areas need greater attention and have to be studied in greater details.

3.1.1. The Concept of Lowess Curve: Firstly, a smoothing procedure is used called lowess, which stands for *locally weighted regression scatter plot smoothing*, to have a visual design of the movements in the time-plot of the terms of trade index of primary commodities vis-à-vis manufactured goods. Lowess, as defined by Cleveland and Devlin (1988, pp.596), is “a procedure for fitting a regression surface to data through multivariate smoothing: The dependent variable is smoothed as a function of the independent variables in a moving fashion analogous to how a moving average is computed for a time series.” Smoothing by local fitting is an old idea, and dates back to the work of Macaulay (1931). This methodology is deeply buried in the time series models, where data measured at equally spaced points in time were smoothed by the local fitting of polynomials. This idea was further developed by Watson (1964), Stone (1977), Cleveland (1979), Cleveland and Devlin (1988) and Fan et al. (1996).

Lowess specifically denotes a method usually descriptively known as locally weighted polynomial regression. At each point in the dataset a low-degree polynomial is fitted to a subset of the data, with explanatory variable values near the point whose response is being estimated. The polynomial is fitted using weighted least square procedure, giving more weight to points near the point whose response is being estimated and less weight to points further away. The value of the regression function for the point is then obtained by evaluating the local polynomial using the explanatory variable values for that data point. The lowess fit is complete after regression function values have been computed for all the data points. Many of the details of this method, such as the degree of the polynomial model and the
weights, are flexible. A user-specified input to the procedure called the "bandwidth" or "smoothing parameter" determines how much of the data is used to fit each local polynomial. It is called the smoothing parameter because it controls the flexibility of the lowess regression function. However, greater the value of the “bandwidth”, greater the smoothing effect but less may be the details of the curve. In practice, the choice of the bandwidth mainly ranges from 0.4 to 0.8.

Mathematically:
Let \((x_i, y_i)\) be an observation in a scatter plot of \(y\) against \(x\). In the lowess procedure, the user chooses \(f\), a fraction of the points to be used in the computation of each fitted value. Suppose, a variable \(g\) be defined as \(f.n\) rounded to the nearest integer, where \(n\) is the number of all data points i.e. the size of the data. Let \(d_i\) be the distance from \(x_i\) to its \(g\)-th nearest possible neighbour along the x axis (\(x_i\) is counted as a neighbour of itself). Then, the weight given to any point in the rectangular co-ordinate system, namely \((x_k, y_k)\) when computing a smoothed value at the \(x_i\) is defined as

\[
w_k = T(x_i - x_k / d_i),
\]

where,

\[
T(u) = \begin{cases} 
1 - |u|^3, & \text{for } |u|<1 \\
0, & \text{otherwise}
\end{cases}
\]

is the tri-cube weighted function and \(u = ((x_i - x_k)/d_i)\).

If \(d_i = 0\) i.e. the \(g\)-th nearest neighbours of \(x_i\) all have abscissas equal to \(x_i\), then points whose abscissas are equal to \(x_i\) are given weights 1 and all other points are given weight 0. In such a case, a constant is fit instead of a line. Thus, to compute the fitted value at \(x_i\), a line (or a constant if \(d_i=0\)) is fitted to the points of the scatter plot using weighted least squares with

\[\text{Suppose, } x_i \text{ and } y_i \text{ for } i=1 \text{ to } n \text{ are measurements or observations of } x \text{ and } y. \text{ Then a plot of } y_i \text{ against } x_i \text{ will be referred to as a scatter plot of } y_i \text{ against } x_i.\]

\[\text{The computation of weights is a three-step process: (a) determining the distance from each point to the point of estimation, (b) scaling the distances by the maximum distance over all points in the local dataset, and (c) computing the weights by evaluating the tri-cube weight function using the scaled distances.}\]
weight \( w_k \) at the point \((x_k, y_k)\). Hence, the estimated values of \( a \) and \( b \) are found by minimizing the equation,
\[
\sum_k w_k(x_k(y_k - a - bx_k))^2
\]  
(3)

If \( a_{\text{estimate}} \) and \( b_{\text{estimate}} \) are the values that achieve the minimum, then we have
\[
b_{\text{estimate}} = \frac{\sum_k w^2_k (x_k - x_{\text{mean}})(y_k - y_{\text{mean}})}{\sum_k w^2_k (x_k - x_{\text{mean}})^2}
\]  
(4)

and,
\[
a_{\text{estimate}} = y_{\text{mean}} - (b_{\text{estimate}})(x_{\text{mean}})
\]  
(5)

where, \( y_{\text{mean}} \) and \( x_{\text{mean}} \) are the weighted means of \( y \) and \( x \), respectively.

Then, the fitted value at \( x_i \) is defined to be
\[
(y_i)_{\text{estimate}} = a_{\text{estimate}} + b_{\text{estimate}}(x_i)
\]  
(6)

Thus, this fitted lowess curve provides a better picture of the movements of the terms of trade index of primary commodities vis-à-vis manufactured goods by smoothening the haphazard movements and fluctuations.

3.1.2. The Econometric Modeling: After forming a visual idea of the price movements, the next task is to find the trend growth rate of the relative prices over a given time period. A time series is a set of data connected over a span of time in a definite ordering given by the sequence in which the observations occurred. Conceptually, for the purpose of modeling, a time series data is considered to compose of three components – a trend (smooth line or curve), a cycle (or combination of cycles) and fluctuations (irregular components). The trend is basically a broad direction of change over time. It is an abstraction in the form of a smooth line or curve.

As already discussed in the literature, there is more than one structural break in the data series.\(^{16}\) The whole idea behind looking at the structural breaks is to mark the periods where the shifts in the terms of trade might have been due to some factors which are quite exogenous to the system. One of the most useful devices to model a data series with structural breaks is the use of binary, or dummy, variables. A dummy variable takes a pre-assigned value (or in some cases the value one) for some observations to

\(^{16}\) Later, we will have more evidence of structural breaks from the lowess curve.
indicate the presence of an effect or membership in a group and zero for the remaining observations. These variables are a convenient means of building the discrete shifts of the function (or the dataset) into a regression model. With the help of these dummy variables, we want to find the trend or the growth rate of a random variable over an individual sub-period in a given time-span. This form of regression is commonly known as the *piecewise semi-log linear regression* for trend fitting.$^{17}$

Suppose $Y_t$ is a time series dataset, where the variable $Y$ denotes the random variable and $t$ denotes the time variable. We assume that the dataset has a break at time period $k (0<k<t)$. If there are good reasons to believe why the break had occurred at the point $(k)$, then we can refer to it as a structural break. Let us define a dummy variable such that

$$D_t = 0, \quad \text{if } t\leq k$$
$$= (t-k), \quad \text{if } t>k.$$  (7)

Now, the linear regression model is of the form:

$$\ln Y_t = a + b.t + c.D_t$$  (8)

Therefore,

$$\ln Y_t = a + b.t \quad \text{if } t\leq k$$
$$= (a-c.k) + (b+c).t \quad \text{if } t>k$$  (9)

Thus, one can argue from here that $b$ is the growth rate in the first period (i.e. $t\leq k$) and $(b+c)$ is the growth rate for the second period (i.e. $t>k$). The dummy variable $D_t$ defined this way ensures that the two trend lines, corresponding to the two periods, meet at the breakpoint $k$.\(^{18}\)

### 3.2. Estimation Results:

We now turn to the results. Figure-2 shows the lowess curve (bandwidth 0.4) of the manufacture-manufacture terms of trade of developing countries vis-à-vis developed countries.$^{19}$ From the figure, it can be seen that the logarithmic value of the terms of trade index

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17 For a detailed study on this issue, see Boyce (1986).
18 One must note here that this specification is useful only when there is no jump at the breakpoint.
19 A monotonic transformation is done by converting the terms of trade index (ToT) to $\ln$ (ToT), where $\ln$ denotes the logarithmic value to the base $e$. The lowess curve is fitted to the $\ln$ (ToT).
falls over the period 1975 to 2005. The relative prices exhibit wide fluctuations with abrupt peaks and troughs, and a sharp decline in 1984-85.\textsuperscript{20} The fitted lowess curve helps to smoothen the fluctuations and form an idea about the trend of this relative price index. From Figure-2, it can be observed that there is a structural break in the year 1984, when the terms of trade index abruptly drops. This indicates a definite break or shift in the time path of the relative price index.

\textbf{Figure-2}

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{lowess_toT.png}
\caption{Lowess: ToT of Developing countries and Developed Countries Manufactured Goods(SITC 5-8), US$ index(1975 to 2005)}
\end{figure}

Source: Author's calculations.

To find the trend growth rate over the period 1975 to 2005, we apply the piecewise semi-log linear regression model with dummy variables. To

\textsuperscript{20} This sharp decline in the manufacture-manufacture terms of trade between the developing countries and the developed countries might arise because of two possible factors. Firstly, acceleration in the export of manufactured goods from the developing countries since the mid-1980s can be partially explained by the debt crisis, when the developing countries expanded their manufactured goods exports in an effort to service their burgeoning debt obligations. Secondly, during that period, the entry of China and East Asia in the world manufacturing market increased the supplies of manufactured goods in the world market, which led to a sharp reduction in the prices of the manufactured goods of the developing countries in that intermediate phase. However, the prices of the manufactured goods of the developed countries remained more or less stagnant for reasons discussed in the next section.
capture the break in the time path of the terms of trade series in the year 1984, a dummy variable is introduced. In this regression analysis, the variable $Z_t$ denotes the manufacture-manufacture terms of trade index between the developing countries and the developed countries and the variable $t$ denotes time. The regression analysis is done with $Z_t$ as the regressand and $t$ as the regressor.

For this regression analysis, the dummy variable is defined as
\[ D_t = 0, \text{ for } t=1975 \text{ to } 1984 \]
\[ = 1, \text{ for } t>1984. \]

Now, the linear regression equation can be defined as
\[
\log(Z_t) = (a+b.D_t)+(c+e.D_t).t, \tag{10}
\]
where, $Z_t$ denotes the terms of trade index, $t$ denotes the time variable and $D_t$ denotes the dummy variable as defined above.

Then, from the period 1975 to 1984, equation (10) assumes the form
\[
\log(Z_t) = a + c.t \tag{10(a)}
\]
and from the period 1985 to 2005, equation (10) can be written as
\[
\log(Z_t) = (a+b) + (c+e).t \tag{10(b)}
\]

Thus from equation 10(a) and 10(b), one can argue that the annual rate of growth of the terms of trade index in the first period i.e. from 1975 to 1984 is $c$, whereas $(c+e)$ denotes the annual rate of growth of this index in the second period i.e. from 1985 to 2005. Thus, the dummy variable defined in this way ensures that the two trend lines corresponding to the two different sub-periods meet at the breakpoint. The results derived from the regression equation are summarised in Table-1. Figure-3 denotes a comparison of the loess curve and the fitted values of the price index. From the figure, it appears that the fitted line has been approximately able to predict the path of loess curve of the terms of trade index.\textsuperscript{21}

\textsuperscript{21} An Augmented Dickey Fuller (ADF) and Phillips-Perron Unit Root test is performed on the residuals of regression equation to test whether the residuals have any time taken. The value of the test
Table-1
Regression results of the Manufacture-Manufacture Terms of Trade Index (1975 to 2005)

<table>
<thead>
<tr>
<th>Period</th>
<th>Annual Growth Rates</th>
<th>t-statistics</th>
<th>Adj. R²</th>
<th>F-value</th>
<th>Root-Mean Square Error</th>
</tr>
</thead>
<tbody>
<tr>
<td>1975-1984</td>
<td>0.45%</td>
<td>(-2.56)</td>
<td>0.8069</td>
<td>42.79</td>
<td>0.04779</td>
</tr>
<tr>
<td>1985-2005</td>
<td>(-)0.96%**</td>
<td>(0.86)</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Author’s calculations.

Note: ** indicates that the results are significant at 95% level of significance.

Figure-3
A Comparison of the Lowess Curve and the Fitted Values of the Terms of Trade Index

Source: Author’s calculations.

The manufacture-manufacture terms of trade of developing countries vis-à-vis developed countries declined at an annual rate of (-)0.96 percent per annum over the period 1985 to 2005. However, during the period 1975 to statistics is -3.691 and -3.640, respectively. The MacKinnon approximate p-value for the test statistics is 0.0042 and 0.0091, respectively. Thus, the residuals are independent of any time trend. Hence, the terms of trade index can be well explained by the time variable.
1984, there is an annual growth rate of 0.45 percent. But, this result over the period 1975 to 1984 is statistically insignificant. Thus, this finding is in conformity with the Singer-Sarkar (1991) analysis of an annual decline of (-) 1 percent per annum, which is quite close to -0.96 percent over the period 1985-2005. Therefore, from Table-1, one can argue that the decline in the manufacture-manufacture terms of trade of the developing countries vis-à-vis the developed countries continues even in this present era. Hence, the developing countries export diversification to manufactured goods did not help them in escaping from the ‘deteriorating hypothesis’.

In the above analysis, the definition of the manufactured goods is SITC 5-8. However, this definition will invite the same criticism as that made by Athukorala (1993) against the Singer-Sarkar (1991) results; namely, that the inclusion of non-ferrous metals (SITC-68) in the definition of manufactured goods gives a misleading picture. But, in this debate regarding the inclusion of non-ferrous metals in the definition of manufactured goods, Sarkar-Singer (1993) following Teitel’s (1989) argument seem to be quite reluctant to accept this criticism. Teitel (1989, pp.316, 337-338) argued, “It seems quite arbitrary that when metalworking processes are applied to iron and steel inputs the results should be considered manufactured products, but when similar processes are effected on non-ferrous metal inputs they should not…..The non-ferrous metals case is, in principle, similar to iron and steel and its products; that is to say, various metalworking operations are involved to produce sheet and other flat products, bars and other shapes, tubes and pipes, wires and so on. Obviously, these metal products constitute manufactured products, equivalent, from the point of view of the industrial operations involved, to similar iron and steel products.” Thus, whether non-ferrous metals should be included in the definition of the manufactured goods or not is a debatable issue. However, in our analysis, we accept this point of Athukorala (1993) and try to find out the trend growth rate of the terms of trade index of manufactured goods (excluding non-ferrous metals) of developing countries vis-à-vis developed countries. This is done mainly to find out whether, even after accepting this criticism,
the result of declining terms of trade of manufactured goods holds true or not.

In the next part of our analysis, we calculate the trend growth rate of the manufacture-manufacture (excluding non-ferrous metals) terms of trade of the developing countries vis-à-vis the developed countries. Therefore, a new terms of trade index is constructed, following the methodology adopted by Athukorala (1993), to form a relative price index of manufactured goods excluding non-ferrous metals. However, in Athukorala’s calculations, the net barter terms of trade is defined as the ratio of the unit price index of manufactured goods (SITC 5-8 less 68) of developing countries to the unit price index of manufactured goods (SITC 5-8) of developed countries. Since in the unit price index of the developed countries, the non-ferrous metals are not excluded from the price index of the manufactured goods, it creates an upward bias to the terms of trade index formulated by Athukorala. Hence, to remove this bias from the terms of trade index, we make an adjustment in the data of the unit price index for both the developing countries and also the developed countries. The data adjustment is simply to purge non-ferrous metal prices (unit values) from the reported export unit value index of the developing countries as well as the developed countries.

Suppose, we define

\[ X_{\text{PADJ}} = \text{adjusted export price (unit value) index} \]
\[ \text{OR}_{X\text{P}} = \text{original (reported) export price (unit value) index} \]
\[ \text{NFM}_{X\text{XP}} = \text{non-ferrous metals export price (unit value) index} \]
\[ \text{NFM}_{X\text{XS}} = \text{the share of non-ferrous metals (SITC 68) in the total manufacturing export (SITC 5-8)} \]

Then, the adjusted export price (unit value) index \( (X_{\text{PADJ}}) \) can be defined as

\[
X_{\text{PADJ}} = \frac{[\text{OR}_{X\text{P}} - \text{NFM}_{X\text{XP}} \cdot \text{NFM}_{X\text{XS}}]}{1 - \text{NFM}_{X\text{XS}}} \tag{11}
\]

Now, if \( (X_{\text{PADJ}})_{i} \) and \( (X_{\text{PADJ}})_{dc} \) denotes the adjusted export price unit value index for the industrialised countries and the developing countries, respectively, then the terms of trade of the manufactured goods (excluding
non-ferrous metals) of the developing countries vis-à-vis the developed countries can be denoted as
\[ (\text{ToT\_NF})_t = \{(\text{XPADJ})_{dc}/(\text{XPADJ})_{i}\}_t, \quad (12) \]
where, \( t \) denotes the time period over the years 1975 to 2000.\(^{22}\)

Figure-4 denotes the logarithmic values of the terms of trade index of the manufactured goods (excluding the non-ferrous metals) over the period 1975 to 2000. It also shows the lowess curve (bandwidth 0.4) of the manufacture-manufacture (less non-ferrous metals) terms of trade of the developing countries vis-à-vis the developed countries. From the figure, it can be seen that this terms of trade index also falls over the study period. Though, there are wide fluctuations with abrupt peaks and troughs similar to those in Figure-2, the fitted lowess curve helps to smoothen the fluctuations and form a view about the trend of this terms of trade index. There is a structural break in the year 1984, when the terms of trade index abruptly drops, which shows a definite break or shift in the time path of the relative price index.

\(^{22}\) In a personal email correspondence with the United Nations Statistical Division, the author asked for the data entitled "Export price Indices of Primary commodities and non-ferrous base metals" (Serial Number-37) in an annual basis. However, the United Nations Statistical division replied that the "series has been discontinued from the MBS and is no longer available." So, in our present analysis, the data ranges from 1975 to 2000.
Thus, we apply the piece-wise semi-log linear regression technique to calculate the annual growth rate of this terms of trade index. Applying the same regression equation-1, we obtain the results summarised in Table-7.2. Chart-5 shows a comparison of the fitted values of the terms of trade with the original lowess curve. From the figure, it appears that the fitted curve is able to capture the movements in the terms of trade index.\(^{23}\) Thus, the slope of this fitted curve gives the approximate values of the annual rate of growth of the terms of trade index.

\(^{23}\) An Augmented Dickey Fuller (ADF) and Phillips-Perron Unit Root test is performed on the residuals of regression equation. The value of the test statistics is -4.53 and -4.489, respectively. The MacKinnon approximate p-value for the test statistics is 0.0002 and 0.0002, respectively. Thus, the residuals are independent of any time trend.
Table-2
Regression Results of the Manufacture-Manufacture Terms of Trade Index (SITC 5 to 8 less 68), US$ index (1975 to 2000)

<table>
<thead>
<tr>
<th>Period</th>
<th>Annual Growth Rates</th>
<th>t-statistics</th>
<th>Adj. R²</th>
<th>F-value</th>
<th>Root-Mean Square Error</th>
</tr>
</thead>
<tbody>
<tr>
<td>1975-1984</td>
<td>0.36%</td>
<td>(0.76)</td>
<td>0.799</td>
<td>34.21</td>
<td>0.04334</td>
</tr>
<tr>
<td>1985-2000</td>
<td>(-) 0.91%**</td>
<td>(-2.40)</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Author’s calculations.

Note: ** indicates that the results are significant at 95% level of significance.

Figure-5
A Comparison of the Lowess Curve with the Fitted Values (ToT) (SITC 5 to 8 less 68) (1975 to 2000)

Even after excluding the non-ferrous metals (SITC-68) from the manufactured goods (SITC- 5 to 8) terms of trade index, the annual trend growth rate declines by (-)0.91% per annum over the period 1985 to 2000. The annual trend growth rate over the period 1975 to 1984 is 0.36% per annum, but this result is statistically insignificant. These results contradict the findings of Athukorala (1993), whose study showed that the exclusion of non-ferrous metals led to a secular improvement in the manufacture-
manufacture terms of trade of the developing countries vis-à-vis the developed countries. Our study does not find any evidence in favour of Athukorala’s results. Though there is some fall in the absolute value of the rate of decline of the terms of trade index of manufactured goods after the exclusion of non-ferrous metals, but that does not disprove the “deterioration hypothesis”. Hence, one can conclude from these results that there has been a secular decline in the manufacture-manufacture terms of trade of developing countries vis-à-vis developed countries, whether the non-ferrous metals are included or excluded in the definition of manufactured goods. Thus, with the evidence generally pointing towards a secular decline in the manufacture-manufacture terms of trade of the developing countries vis-à-vis the developed countries, the conclusion is that the thesis of a ‘deterioration hypothesis’ is verified and supported. For this it does not really matter whether the data are interpreted as a persistent declining trend or a decline with intermittent downward breaks; nor does it matter whether non-ferrous metals should be included in the definition of manufactured goods. The general conclusion would be that of a decline in the terms of trade of manufactured goods of the developing countries in their trade relations with the developed countries.

4. Factors Responsible for the Secular Decline in Manufacture-Manufacture Terms of Trade of the Developing Countries vis-à-vis the Developed Countries

Given that the manufacture-manufacture terms of trade of the developing countries vis-à-vis the developed countries has deteriorated over the years, it becomes important to identify the factors responsible for this secular decline in the terms of trade. In this section, we will try to identify the probable factors responsible for a secular deterioration in the manufacture-manufacture terms of trade.
The manufactured goods produced in the world economy can be classified into two broad categories of products – a) the ‘simple’ manufactured goods produced by the developing countries as well as the developed countries, and b) the ‘sophisticated’ manufactured goods produced mainly by the developed countries, which are beyond the purview of the developing countries due to lack of advanced technologies. The developed countries produce hi-tech, sophisticated manufactured goods, which are technologically much more advanced than those produced by the developing countries. These advanced technologies are primarily located in the developed countries, which give them the ability to produce these ‘sophisticated’ manufactured goods. This is primarily on account of a dominant technology based upon Research and Development (R&D) monopoly of the advanced capitalist countries. The high level of R&D expenditures in developed countries helps in innovation of new technologies and products and thereby, the production of new “sophisticated” manufactured goods. On the other hand, the manufactured goods produced by the developing countries are simple goods, which are mostly mere value additions to the primary commodities without involving much sophisticated technological processes. The developing countries continue to remain trapped in the traditional international division of labour, modified by the fact that it is not primary products alone which are the province of third world, but the lower-level manufacturing activities which involve a degree of value addition to primary products.

As far as these ‘simple’ manufactured goods are concerned, the developing countries have an advantage over the developed countries because of the low wage rate (in terms of food) paid to the workers in these countries. This is primarily because there is a huge ‘reserve army of labour’ located in the developing countries, which keeps the wages (in terms of food) in the developing countries tethered to the subsistence level. The developing countries can increase their global market share in these ‘simple’ manufactured goods and outperform the developed countries since the wages in the developed countries are higher than those prevalent in the
developing countries. On the other hand, in the production and marketing of the ‘sophisticated’ manufactured goods, the developed countries have a clear advantage over the developing countries. Since the advanced technologies required for the production of these goods are primarily located in the developed countries, these countries have the potential to produce these products, which the developing countries lack. The developed countries also enjoy a ‘monopoly’ power in the marketing of these ‘sophisticated’ manufactured goods since they do not face competition from the developing countries in these products.\(^{24}\) Hence, the developed countries are in an advantageous position to set the prices of these manufactured goods. Therefore, given this production and marketing conditions in the developed countries, one can assume that there is a ‘downward rigidity’ on the prices of the manufactured goods produced in the developed countries.

If the ‘simple’ manufactured goods produced by the developing countries enter as raw materials in the production of the ‘sophisticated’ manufactured goods of the developed countries\(^{25}\), then all the factors responsible for the secular deterioration in the terms of trade of primary commodities vis-à-vis manufactured goods once again become appropriate in explaining the secular deterioration of the manufacture-manufacture terms of trade of the developing countries vis-à-vis the industrialised countries.\(^{26}\) Theoretically, an increase in the post-tax wage share or an increase in the share of post-

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\(^{24}\) In the advanced countries, the marketing of the ‘sophisticated’ manufactured goods is mainly done by the multinational corporations and the big business houses. These multi-national corporations and big business houses are mainly concentrated in the advanced countries. There is a centralised decision making power of the multi-national corporations in setting the prices of manufactured goods in the world market. According to Singer (1975, pp.376), “The investing countries are the seats of the multi-national corporations, the homes of a modern autonomous appropriate technology, and are economically integrated societies in which the marginal groups are definable minorities (and even they tend to participate in the gains from progress, at least through social welfare). Being all this, the investing country will tend to be the chief gainer from any kind of relationship, whether the trade or investment or transfer of technology involves primary commodities or manufactured goods.”

\(^{25}\) Developing countries’ share of global intermediate goods exports dramatically increased from 3.9 percent to 31.7 percent from 1988 to 2006 (Source: Sturgeon and Gereffi (2009)). For example, the intermediate manufactured goods export had a share of 71 percent in the total exports of Chinese Taipei during 2008 (Source: World Trade Developments, WTO, 2009).

\(^{26}\) The factors responsible for a secular decline in the terms of trade of primary commodities vis-à-vis manufactured goods are discussed in greater details in Patnaik (1997, 2002, 2008).
tax profits or an increase in the share of taxes in the gross value of manufacturing output produced by the advanced capitalist countries can lead to a secular decline in the manufacture-manufacture terms of trade of the developing countries vis-à-vis the developed countries. Furthermore, in a world of freely moving finance capital, the secular tendency for the exchange rate of the developing countries to depreciate can also give rise to a secular decline in the manufacture-manufacture terms of trade of the developing world vis-à-vis the developed, assuming that there is a ‘downward rigidity’ on the prices of manufactured goods of the developed world. Even if the manufactured goods produced in the developing world do not enter as a raw material in the production of the manufactured goods of the developed world, then also a secular depreciation of the currencies in the third world countries can lead to a secular decline in the manufacture-manufacture terms of trade of the developing countries vis-à-vis the developed countries since the relative wages of the former vis-à-vis the latter will keep declining over time for given levels of money wages in their respective currencies.

A similar argument can be made for the differential impacts of technological progress in the manufactured goods sector on the prices of these products in the developing countries and the developed countries. In the long run, with technological progress in the manufacturing sector of the developed countries as well as the developing countries, the labour productivity increases in this sector of both these countries. In the developing countries, with technological progress over a period of time, the prices of the manufactured goods (in terms of food) decline. This is due to the fact that the wages of the workers (in terms of food) in the developing countries do not rise with an increase in the labour productivity because their wages remain tied to the subsistence level. However, in the developed countries, an increase in the labour productivity with technological progress, does not get reflected in a fall in the prices of the ‘sophisticated’ manufactured goods (in terms of food) since we have argued that there is a ‘downward’ rigidity in the prices of these manufactured goods. In the long run, an increase in the labour productivity in the developed countries gets absorbed in the form of
higher factor incomes of the manufactured goods sector i.e. the wages (in terms of food) of the workers in the developed countries might rise or the profit-margin of the capitalists might increase over time. Hence, with technological progress in the manufacturing sector, the prices of the manufactured goods decline (in terms of food) in the developing countries, whereas in the developed countries the prices of these products remain more or less rigid or rise but do not fall (in terms of food). This leads to a secular decline in the manufacture-manufacture terms of trade of the developing countries vis-à-vis the developed ones.

5. Is Diversification to Exports of Manufactured Goods an ‘Escape Route’ from the ‘Deterioration Hypothesis’?

The developing countries attempt to industrialize and their effort to diversify the export baskets with an increase in the share of manufactured goods proved successful for some developing countries, especially the East Asian Tigers and some countries like China. However, this model of development of East Asian economies cannot be easily replicated by other developing countries, even though these countries may have an advantage in terms of the lower wages (in terms of food) paid to their workers compared to those of the developed countries. There are mainly two problems associated with the replication of such a model. Firstly, one of the main factors contributing to the remarkable success of such a development model is that it was mainly confined to a few nations. But, if all the developing countries would have attempted to raise their share of manufactured goods in the world market, then it would have led to the fallacy of aggregation. Since the technological capacity of the developing countries, even countries like China and India, are limited, they cannot compete with the advanced countries in a whole range of activities. In the remainder they compete against one another, which means that all cannot be as successful exporters as some have been

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till now. The collective success of all developing countries emulating East Asia would be far less significant than what has been achieved by a few in East Asia. Secondly, the historical context of the export drive of the East Asian economies is far different from the present world scenario. The East Asian expansion drive was taken at a point when world trade was expanding at an extremely rapid rate and world capitalism was in the midst of a pronounced boom. But, the present state of affairs in the world economy is completely different from the past. In the present scenario, the world economy is going through a recession and the growth rate of the advanced capitalist countries has plummeted. The developed countries are far more cautious about protecting their economies from the threats of cheap manufactured imports from China and other East Asian economies. Hence, in such a scenario, it is extremely difficult for the developing countries to expand their manufactured goods share in the world trade, even if they intend to do so by reducing the price level.28

Rather, to escape from the problem of ‘deterioration hypothesis’ and to further increase their share in the world market of manufactured goods, the developing countries will have to concentrate on building up indigenous scientific and technological capacities and increase their R&D expenditures in the development of new techniques and products to compete with the developed world as innovators in the manufactured goods market. But, for this innovation, a minimum scale of capital is a precondition, which applies not only to the innovation of new technology but also for their imitation.29 However, there are a few limitations of the imitation process - the drawback of imitation is that even if the developing countries are successful in imitating, it happens with a time lag. Within this time lag, though the developing countries have successfully imitated the technology of the already produced manufactured goods of the advanced countries, the latter have shifted to a totally new and different production technology and introduced even newer ‘sophisticated’ manufactured goods into the scene.

28 This discussion has benefited immensely from Patnaik (1997, pp.239)
29 For a detailed discussion on this, see Patnaik (1997, pp.226)
Thus, the developed countries are always in an advantageous position as innovators of new products and can set the price level in the world market of manufactured goods. The developing countries can be in a better position in the global market of manufactured goods if they can become successful innovators. But the precondition for them to be successful innovators is “where the minimum scale of production is not prohibitively large, where the scale of the home market in which a footing must first be obtained is also correspondingly large, where the technology in question is relatively simple and does not require the use of sophisticated technology in a number of complementary spheres...”.

If there is an increase in the innovation promoting expenditure by the State in the developing countries, then it can lead to development of newer and newer sets of blue-prints of techniques and also encourage the innovation of newer ‘sophisticated’ manufactured goods. Nonetheless, it is important to note here that, given the high level of unemployment prevalent in the underdeveloped countries, the kind of technological progress involved in the innovation of manufactured goods in the developing countries should be of such a nature that it is able to absorb the huge “reserve army of labour” which persists in these countries. If this “reserve army of labour” gets absorbed in the production process, then the benefits of such technological progress will accrue to the working population in these countries. So, technological progress leading to innovation of new products and newer

\[\text{30 Quoted from (Patnaik (1997), pp.227).} \]

\[\text{31 This argument will also hold true if the underdeveloped countries are mere imitators of manufactured goods originally produced by the advanced countries. It is desirable from the perspective of the working class in the developing countries that the technology involved in the innovation or even in the imitation of the first world countries' manufactured goods be labour absorbing. This is due to the fact that every technological progress involves an increase in the labour productivity. If a huge level of unemployment prevails in the developing countries, then any such improvements in the labour productivity through technological progress will be lost in the form of lower prices of the manufactured goods (if they are imitators of the first world countries goods or producers of 'simple' manufactured goods) or an increase in the profit margin of the capitalists (if they become innovators of new 'sophisticated' manufactured goods). But, if the labour reserves get absorbed with the introduction of new technologies (assuming that the technologies are labour absorbing), then such increases in the labour productivity might get absorbed in the form of higher wages (in terms of food) in the developing countries.} \]
production techniques in the developing countries should be such that the “reserve army of labour” gets used up in these countries; otherwise, all the benefits of such innovation promoting expenditure by the State leading to manufacture of newer products, development of newer techniques and an increase in the market share of manufactured goods, will accrue to the capitalists of the developing countries in the form of a higher profit margin and the wages of the workers will remain tied to the subsistence level. Therefore, even the innovation of manufactured goods should come through such technological means that it eventually reduces the high level of unemployment, which prevails in the developing countries and improves the living standard of the working population in these countries.

However, this innovation promoting expenditure is only one element. Discussing on the limitations of increasing only innovation promoting expenditures, Patnaik (1997, pp.142) argued, “An identical relative level of flow expenditure on the promotion of innovations in two different countries would have quite different results if the already existing facilities of research and development, the levels of domestic skill development, the levels of literacy and education in society, the levels of development of the financial infrastructure, and the levels of transport and communications development vary widely between them. A minimum infrastructure for product innovation destined for the world market must exist if flow expenditure on innovation promotion is to make a difference to the country’s status as an innovator on the world economy.” Hence, there should be more emphasis on the development of infrastructural facilities in the developing countries along with building up of technological capacity, entrepreneurial skills and improving ‘human capital’ in general. It is the responsibility of the State to increase investments for the development of communications, transport, financial and marketing infrastructures. For this, the State has to increase its development expenditures on these infrastructural facilities so that it facilitates the developing countries to become innovators in the world market. This would need an active participation of the State in the
development of their respective infrastructural facilities in the domestic
economies and also increase their research and development expenditures.

In the literature, it has been argued that the industrialisation strategy of the
developing countries might help these countries to escape from the problem
of ‘deterioration hypothesis’ by diversifying their exports into more of
manufactures. However, the experience of the developing countries over the
last three and a half decades had shown that such export-oriented
industrialisation strategy did not help them to escape from the ‘deterioration
hypothesis’. If the developing countries can become innovators of
manufactured goods through active state support, especially in R&D and
infrastructural facilities, then it might help these countries to escape from
the problem of secularly declining terms of trade. But a precondition for this
is that such innovations should generate large scale of employment and
reduce the reserve army of labour. Only then can it improve the living
standards of the working people in these developing countries.

6. Conclusion

This paper tries to sketch a scenario of the export market of manufactured
goods for developing countries mainly from the 1970s. The study finds that
especially since the 1970s, the developing countries were able to increase
their share of manufacturing exports in the global market. However, these
exports were concentrated mainly in the hands of the South East Asian
Tigers along with a few other countries like China and India. But, the
alarming point is that the developing countries attempt to diversify their
exports to manufactured goods did not provide a way out from the
‘deterioration hypothesis’. From 1975 to 2005, the net barter terms of trade
of manufactured goods of developing countries vis-à-vis developed countries
experienced a secular decline at an annual rate of -0.96 percent. In the
literature, some doubts were raised over the statistical index used and it
was claimed that the inclusion of non-ferrous metals within manufacturing
produced these results. Even after excluding non-ferrous metals from the
definition of manufactured goods, the study still finds a tendency of secular decline at a rate of -0.91 percent per annum in the newly defined net barter terms of trade of manufactured goods of the developing countries vis-à-vis the developed ones.

To identify the factors responsible for this secular decline in the manufacture-manufacture terms of trade of the developing countries vis-à-vis the developed countries, this study segmented the manufactured goods produced in the world economy into two broad categories: a) the ‘hi-tech’, technologically advanced sophisticated goods produced mainly by the developed countries, and b) the ‘simple’ manufactured goods produced in the developing countries as well as the developed countries. In case of the ‘simple’ manufactured goods, the developing countries have an advantage over the developed countries in the sense that the wage rate (in terms of food) paid to the workers in the former are lower than those prevalent in the latter. The wages of the workers in the developing countries are tied to the ‘subsistence’ level because of the existence of a huge ‘reserve army of labour’ in these countries. Hence, the developing countries can charge a lower price for their products and increase their market share in these ‘simple’ manufactured goods in the world economy. But, there is a range of ‘sophisticated’ manufactured goods which the developing countries cannot produce due to the lack of advanced technologies since these technologies are primarily located in the developed countries. The developed countries have a ‘monopoly’ over the production and marketing of these ‘hi-tech’, ‘sophisticated’ manufactured goods and therefore, we assume that the prices of these products (in terms of food) have a ‘downward rigidity’ i.e. the prices of these goods can never fall.

If these ‘simple’ manufactured goods produced by the developing countries enter as raw materials into the production of ‘sophisticated’ manufactured goods of the developed countries, then the factors that are responsible for the secular decline in the terms of trade of primary commodities vis-à-vis manufactured goods will also become pertinent in explaining the secular
decline in the manufacture-manufacture terms of trade of the developing countries vis-à-vis the developed countries. Even if manufactured goods of the developing countries do not enter as raw materials in the production of the manufactured goods of the industrialised nations, then also a secular tendency of the third world countries’ currencies to depreciate will lead to a secular decline in the manufacture – manufacture terms of trade of the developing countries vis-à-vis the developed world. Moreover, with technological progress in the manufactured goods sector, the prices of the manufactured goods produced by the developing countries tend to fall (in terms of food) over time, whereas the prices of the ‘sophisticated’ products produced by the developed countries remain more or less the same or rise (in terms of food). In totality, all these factors contribute for a secular decline in the manufacture-manufacture net barter terms of trade of the developing countries vis-à-vis the developed countries over the years.

In this paper, we find that a blind pursuit of the East Asian country’s strategy of development by the other developing countries may not be beneficial for the developing countries as a whole. To improve their position in the global market for manufactured goods, the developing countries have to occupy the seat of innovators in the production of manufactured goods. For this to happen, the state of the developing countries will have to increase not only their research and development (R&D) expenditure in improving technological capacities, entrepreneurial skills and ‘human capital’; but, at the same time increase development expenditures in the building of infrastructural facilities and improving them. And even then their labour reserves are unlikely to get absorbed until and unless the technology used in the production of these newly innovated goods is ‘labour absorbing’ in nature.
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