

Unequal Exchange¹

By Claudio Jedlicki*

Periodically, TJSKA publishes Briefs of relevance for The Living Wages North and South Initiative (TLWNSI). In this Brief Claudio Jedlicki assesses economist Arghiri Emmanuel's theory of Unequal Exchange, to delve, from an economic analysis angle, into TLWNSI's central argument: that we endure a North-South system of exploitation, which, among other features, has a direct and premeditated impact on the misery wages paid in all countries in the South. This unequal exchange constitutes a trade imperialism that historically has generated vast earnings for the North, greater than the interests recovered by banks and the profits obtained by transnationals. Nonetheless, the author alerts us, these are only the traceable evidence left by the system of exploitation, for the earnings, in themselves, cannot be seen, since they are hidden in the prices the North manages for all the goods and services in its transactions with the South, as well as for the miniscule value of Southern exports, which is mainly the result of its low labour endowments. Indeed, in this commercial imperialism labour endowments stand out, which, in a fashion exogenous to the so-called logic of market economies, are established by way of institutional policies. In this way, the author's assertion that the

North-South unequal exchange constitutes a very meaningful endowment for the high average living standard of Northern Societies becomes an indisputable argument. To be sure, the South's misery subsidises "the North's good living". This is why Jedlicki argues that any serious assessment in pursuit of a solution to the North-South's unequal exchange cannot escape this reality. Thus, any re-assessment of the South's exports, with the sustainability of people and planet in mind, forcefully entails rebalancing living standards on both sides, increasing in the South and diminishing in the North.

□ The Price Formation

For classical economists, the price of goods gravitates around the price or cost of production. That is, it gravitates around an objective value representing the producers' offer. This offer represents the price at which producers are willing to sell a specific quantity of a good. In contrast, for the Marginal School, prices depend fundamentally on demand, and, thus, on the subjective value that goods have for consumers; it is the utilitarian value that each consumer gives to a good that determines the price at which consumers are willing to buy it. Alfred Marshall, British economist at the end of the Nineteen Century and beginning of the Twentieth Century, reconciles both visions by solving the problem once and for all, by asserting that prices are ultimately the result of simultaneously contrasting supply and demand at every moment. In the mid and long term the supply and demand functions, for various reasons, may shift and draw a new balanced price. Demand may shift due to changes in consumers' tastes and preferences, changes in income, changes in the number of buyers, or, lastly, due to changes in the price of other goods,

¹ The author wishes to request the consideration of the reader, given that condensing into a few pages Emmanuel's work: Unequal Exchange, with 400 pages in its French edition, naturally demands the exclusion of several issues. The same can be said relative to other commentaries about theories that rebut the thesis here presented, and that are discussed succinctly. Moreover, an effort has been made to use layman's terms in order to make this paper accessible to all. All that remains is to enthusiastically encourage the reading of the original work of the author of "Unequal Exchange", which today has been translated into nearly twenty languages.

particularly of similar or alternative goods. Supply may also shift due to alterations in one or more of the following elements: technology –the mix of labour and capital to produce the good, which engenders in turn a shift in productivity, the price of the factors of production, particularly labour, and, finally, the number of producers or a change in the competing arena, such as a merger of various producers or the constitution of a cartel-like agreement.

□ The thesis of Unequal Exchange

The thesis of Unequal Exchange of Arghiri Emmanuel², can be summarised in this way: the normal price of a good in international markets is that which allows all factors participating in its production, in every part of the world, to be compensated at the same level. This would take place if there were world markets for every factor in which supply and demand would be contrasted for each factor. Nonetheless, wages as well as income or indirect taxes, constitute the remuneration of the factors that are established in an independent or institutional manner; to be sure in a way exogenous or outside of the economic realm. If more than one may contest the inexistence of a labour market at the national level, in the way Emmanuel proposes it, this appears to be far less arguable at the international level. At the national level simply because, for Emmanuel, wages are more a reflection of the state of the trade unions' leveraging power vis-à-vis the employers' leveraging power, to which State regulations on this area are added – minimum wage, length of the working day, social security contributions– than to the contrasting of the supply and demand for labour. At the international level because it is not possible to pretend that emigration here or there, given its size, is determinant as to having a decisive weight on labour supply. Relative to the factors generating rent, such as soil or subsoil, the preclusion of an international market is readily admissible given the impossibility of their physical movement. Instead, capital, in contrast to the preceding factors, can move internationally, and, thus, its remuneration, the rate of return, tends to equalise itself amongst the different nations. Under these conditions, the unequal exchange comes from the differences between the remunerations of the factors, whose price is determined institutionally, outside the market, in the

different countries of the world. In the terms of trade among the countries that undervalue the latter factors and those that endowed them at their fair price, there is a transfer of value in detriment of the former and in favour of the latter countries. Generally, it is proposed that the countries of the industrialised world exploit Third World countries through trade, for the wage gap between the two zones is greatly superior to the foreseeable differences in productivity.

□ Objections and defence of the Unequal Exchange thesis

It seems to us that it is necessary to insist on the issue of differentials in productivity, for it constitutes the main objection that is usually opposing the existence of the transfer of value under these circumstances, from the Periphery to the Centre. It is evident that if differentials in productivity are in line with the corresponding wages, the latter appear fully justified, and, under such circumstances, there is no exploitation nor are there goods undervalued or overvalued. Yet these differences are less frequent and particularly less wide than what is usually believed. Estimates on the matter are generally the result of comparing the corresponding productivities assessed parting from the value added per worker; coincidentally forgetting, if all possible, that the latter, when assessed in this way, has already incorporated the wage differentials, which are the very differences that are intended to be justified. In other words, a demonstration is carried out by using as proof what constitutes, precisely, the object of demonstration. To be sure, the only possible comparison of productivities that can be performed is between productions of identical goods, and measured in physical and not monetary terms. There is another problem to be added. Productivities are only apparent measures³, and what is intended to be demonstrated is only the eventual difference in productivity of the labour force. The eventual differences of the capital factor are considered to be already incorporated in the value that is transferred to the good that it contributes to produce, and are consequently already included in the cost of production. In this way, for example, if a specialised machine produces a good in less time, using fewer workers and/or with less waste of raw materials, its acquisition value will necessary be higher that that of

² EMMANUEL A. (1969) : *L'échange inégal*. François Maspero. Paris.

³ Apparent refers to the fact that when assessing productivity, all greater production is attributed exclusively to the factor that the calculations performed are referring to, labour or capital, when in fact both concurrently participate in this increase, being impossible to determine the exact contribution of each.

another yielding an inferior output. Thus, if the investment is greater, the rate of return expected from the investment is more important; yet there is no reason whatsoever for the labour endowments to be greater, unless this implies the use of a labour force with superior skills, which would need to be confirmed on a case by case basis. Otherwise, the same thing would be taken into account twice.

Another important objection that can be added against our arguments so far is that the limited international mobility of the labour factor, as well as the complete immobility of the land factor, make impossible in both instances the convergence towards a World price for each of these factors. The famous Factor-Proportions Model, better known as the Heckscher-Ohlin⁴ Model, pretends the opposite. Indeed, this model demonstrates that each of the factors of production leans towards a price that will be the same in all nations. This takes place, according to these authors, for the simple reason that the price of the goods, and, thus, their variance, leans towards a single international price if trade is free. Given that each country that joins international trade tends to specialise in the goods that use the factor of production that is plentiful (labour or capital), this factor will be exported indirectly already built-in the good. Its relative price will tend to increase. Exactly the opposite situation will take place with the goods that use the scarce factor. At the same time, in other nations with an inverse allotment of the factors, the opposite will take place in both instances. Changes in relative prices of goods move in parallel with the price of the factors participating in their manufacturing. In this way, the convergence of prices of each good triggers a convergence in the price of the factors.

Without going too far into the critique of the theory just introduced, scarce credibility could be awarded to such an insight when, for example, the famous study directed by Raul Prebisch at ECLAC, regarding the evolution in the terms of trade among commodity and manufactured goods between 1876 and 1938 assessed a 40% decline in the value of commodities. Better yet, the reader does not need someone's quote to consider a fact of the public domain: that North – South wages, rather than converging, have not ceased to distance from each other in line with the development of international trade, especially during the second half of the Twentieth Century.

We can make this assertion despite the periods where the terms of trade have moved inversely; that is, in favour of developing countries. This is true today and since the end of the Asian crisis, at the end of the 1990s. This does not change, nonetheless, the general trend discussed, in the long term. Should this empirical confirmation not be sufficient, that the price of a good indeed determines the endowments of the factors that participated in its manufacturing, how then does it explain what follows? That, for instance, the price of cacao is low enough as to remunerate the small African farmer at a misery level, and after its transformation into chocolate is high enough to pay the highest wages in the planet in a country like Switzerland, a major producer of this staple. The neo-classical answer typically argues that the demand conditions have been altered, particularly a decrease of cacao demand. However, given that cacao is the essential raw material of chocolate, how can it be that the demand of the former does not move in conjunction with the demand of the latter? In this case, as with almost all export commodities, they undergo a transformation in developed countries. Under these conditions the demand of reference must be that of the good transformed, for this is the determinant element along with the price of the final good; the demand for raw materials is fundamentally conditioned by the final product that they in turn generate. Consequently, their structures are similar. That is, their respective elasticity are quite close. In other words, variations in quantities and prices of both, cacao and chocolate occur in the same proportion respectively. To be sure, what occurs in Europe as well as a couple thousand kilometres to the South is that wages, high here, miserable there, render one price for cacao and another for chocolate, almost with no relationship that could be established between cacao and chocolate prices with their demands, albeit certainly with a relationship with their respective production costs.

Let us evoke a last critique. This frequently comes from the progressive sectors of developed countries, which feel uneasy appearing to benefit as consumers of the low prices of Third World imports. These sectors observe, supported with statistics, that the rate of return frequently is higher in the Third World.

⁴ Eli Heckscher and Bertil Ohlin, Swedish economists of the Neo-classical current are among those who have been the most influential in the liberal vision of the international division of labour and, particularly, among free-trade apologists. I deem feasible to recall that Ohlin received the Nobel prize in Economics in 1977. Krugman P. and Obstfeld M.,(2003), *International Economics: Theory and Policy*, Sixth edition Pearson Education Inc.

As for the remuneration of the capital factor, we obviously do not deny the possibility of eventual differences that can be attested here or there amongst the levels in the rates of return. There are two occurrences in this case: the attraction generated by higher rates will tend to nullify the difference due to the downward pressure exerted by the abundance of incoming capital, where it is better remunerated, while the rate of return will tend to increase in places where it becomes relatively scarce due to the outflows of capital. It is for this reason that it is more convenient to talk in this case about a tendency to the equalisation of the rates of return. More generally and more in the long term, the differences among countries in rates of returns as well as in interest rates are explained due to the somewhat high country-risk rating borne by the recipient country. In this last case, it is not, therefore, the rate of return or interest in itself what explains the difference, but the risk rate borne. The latter is demanded by investors and lenders to execute an operation.⁵ Undoubtedly, whether we like it or not, the countries in the Periphery appear to investors and "rating" services, with very rare exceptions, as riskier than countries in the Centre. The consequence is a scarcity of capital, equivalent to the risk premium that is added to the cost.

□ *The inelasticity of demand, a necessary condition for equality in exchanges*

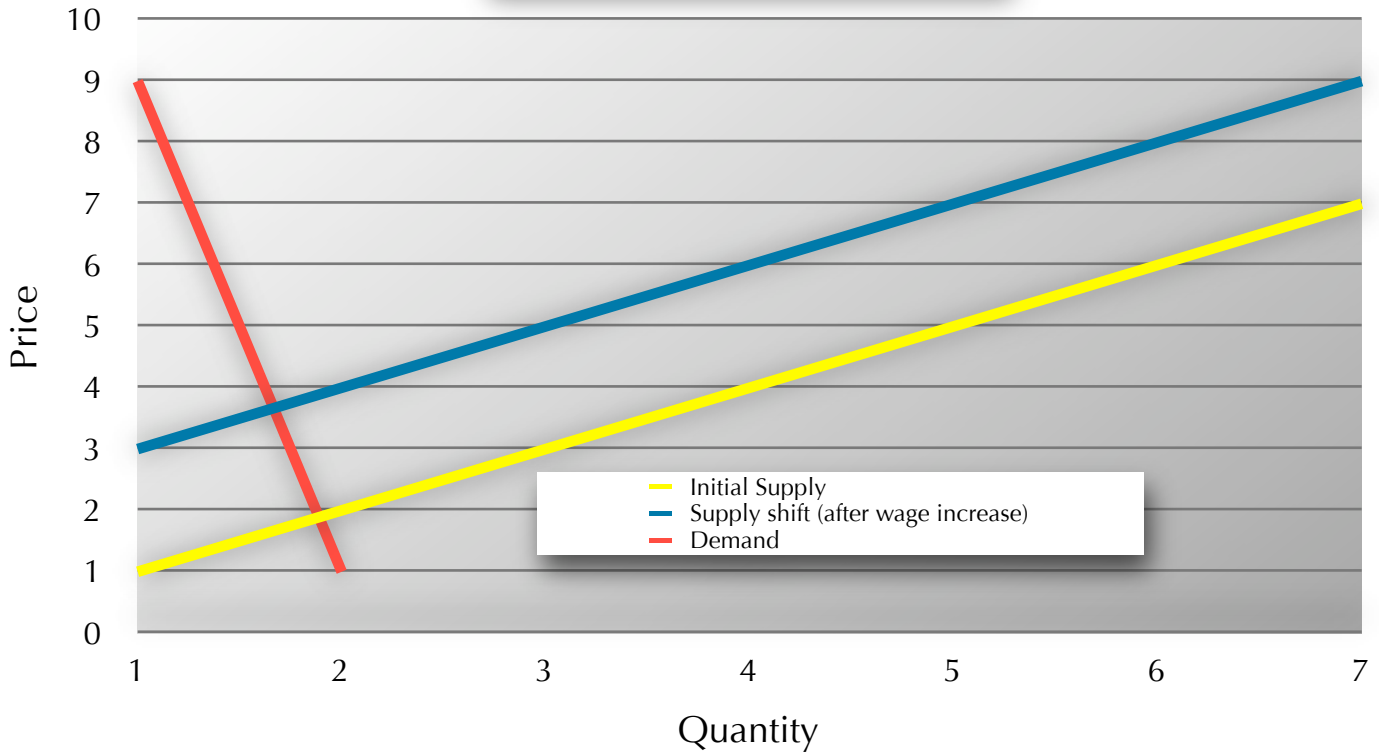
The issue of demand elasticity is a crucial point in the complexities of the unequal exchange. Neo-classicals

consider that raw materials generally have high elasticity, greater than a unit. This means that when price changes, quantity changes in a greater proportion. This carries a perverse effect: when price increases, for example 5%, demand decreases 10, 20% or more. This translates into a decrease of total revenue. If this were to be, the pursuit of a price increase would be a futile exercise. In contrast, if demand is inelastic; that is, less than a unit, when price increases, the quantity purchased is certainly less, but the revenue from exports increases, given that the latter drops proportionally less than the price.

This last point is determinant for if the goods exported by the Third World experience an inelastic demand, this may potentially materialise into an increase in the value of exports and, thus, in the general welfare of the exporting country; consequently, disrupting the unequal exchange, putting an end to it. In other words, achieving equality in the exchanges is possible through the demand side. Certainly, we still have to address the supply side; something that should not be a problem in principle. In this way, for example, if all Third World exporting countries were to increase wages, automatically the supply side would move leftwards in a chart where we measure prices in the ordinate axis and quantity in the abscissa axis. The supply function coordinates in this chart show, for instance, that for the same quantity offered the price would be greater, or for the same price the quantity would be less, as a consequence of the increase in costs.

⁵ The value of the goods of production in which technical progress is incorporated includes the high wages of the skilled labour used to manufacture them. The most important value of these goods of production normally will be transferred to the value of the goods that they are designed to produce, as we have already noted. There is, therefore, no reason to transfer time and time again these high wages in the use of this machinery in the manufacturing of consumer goods that not always need high skilled labour. To proceed in this way would duplicate the same element.

SUPPLY AND DEMAND



This is approximately what occurred with oil in 1973, albeit it was not wages triggering an increase in this case, but another institutional factor just as wages, the income demanded by the receiving countries from companies in the form of taxes or royalties. What happened with this commodity came to give a serious endorsement to the Unequal Exchange thesis. Nonetheless, one must acknowledge as well that the price drops that oil has experienced in some instances since then are due also to the difficulty of maintaining agreements among producers, as in the case of OPEC. The great northern powers, one in particular, the most important of all, know how to exert pressure to make some of the cartel members ignore the agreements. This is what happened with OPEC when in more than one occasion a major producing country exceeded the producing quota to which it had committed to abide by, to rush to help northern consumers who were feeling that their incomes were growing less than expected. In other instances, the breach of the agreement takes place simply because a cartel member attempts to earn more producing more, banking on the hope that the rest will continue to honour the agreement. Game theory and the prisoner's dilemma

in economic science clearly shows how non-cooperative strategies provoke losses for all participants.

The question of mean-productivity differentials in the Centre-Periphery

Today it seems to us to be unquestionable that the mean productivity of labour in industrialised countries is greater than in developing countries, even if this was true only as a consequence of the existing difference in the levels of education and qualifications between the two areas. Statistics about the educational levels attained by the population, which let one observe this empiric truth, are readily available. Thus, it seems to us that it would be a mistake to consider that the papers of A. Emmanuel may induce us to think that average wages would need to be exactly the same in both developed and developing countries in order to end the inequality in the exchanges. Indeed, it would be an exaggeration, at the very least, given the existing gap between the current levels of scientific, technological and educational development between both areas.

More than a hundred and fifty papers have been devoted to the Unequal Exchange thesis; most of them critical, beginning with the prologue and the appendix from the director/editor of the collection that published it, Charles Bettelheim.⁶ The last in the list, COHEN D. (2004)⁷, devotes almost an entire chapter in his last book about globalisation.⁸ Our purpose here is not to analyse the issue, but to encourage the reader to ponder about it in order to detect its eventual presence in the current exchanges between developed and Third World countries. Given that unequal exchanges take place through the goods traded, some overvalued and others undervalued, we must inquire about the components of Centre-Periphery trade in order to assess their presence and importance. A simplified observation allows the following assertions:

a) **On the raw materials or commodities**, notwithstanding we do not mistake the deterioration in the terms of trade for unequal exchange⁹, several studies demonstrate a long-term structural trend towards their deterioration. First, the famous study by R. Prebisch, which we have already referred to, came out. Subsequently, BAIROCH P. (1997)¹⁰, indicated that the terms of trade of non-oil-exporting countries had gone from an index of 115 in 1950/54 to 73 in 1994/95. More recently, a study from the UN Secretariat indicated that the price ratio in the basket of goods exported by the South and of those that it imported from the North, had gone from an index of 100 in 1980, to an index of 48, in 1992 [TOUSSAINT E., (2003)]¹¹. These data as a whole lead us to think that the exchange of commodities for manufactured goods has made a growing transfer of value from commodity exporting countries to manufacturing exporting countries possible, notwithstanding if there have been short periods with an opposite trend. It is deemed feasible to add that the Centre countries are not only exporters of raw materials as well, but that they obtain a value for all of these greater than that obtained by the Third World. Nonetheless, commodities or near commodities –due to their scarce added value, produced

in the Centre, do not suffer the same deterioration than the rest. This is the case of raw materials originating almost exclusively from the South. With respect to the latter, what sense would it make to inquire about productivity differentials? On the contrary, the South's global productivity is far superior to what an equivalent production in the North would have. Could it be imagined for an instant that a northern country, despite its superior science and technology would surpass a southern country, for example, in the production of tropical fruits? What would be the North's global productivity in this kind of productions? Where to benchmark against in order to justify the miserable incomes and wages for those participating in these productions, which cannot be compared to others; and, if they are, the global productivity assessed would be far superior in favour of the traditionally producing countries?

b) **On the goods of the first Industrial Revolution**, – those that globally require low-skilled labour-intensive manufacturing; that is, those where their production has been, or continues to be re-localised during these last decades, from the Centre to the Periphery, namely: textile/garments, toys, shoes, assembly of electronic appliances, etc.– it seems to us that it can easily be asserted that a wide array of them are heavily exported from low-wage countries to rich countries; a situation that consequently gives way to an unequal exchange, given the undervaluation of the built-in wages. It is the process of re-localisation in itself that allows us to make this assertion. Otherwise, how to explain that the originating companies from the Centre would re-localise their production every now and then to low-wage countries to produce the same good, until then produced in their home countries, to continue offering it in the usual markets, if the productivity differential would offset the wage differential? If this were to be, how then could there be any interest for this sort of operation? In fact, there is not much mystery to this respect, for when criticism against this issue grows due to a variety of internal reasons (redundancy, disgruntled trade unions, national elections, etc.) one of the more frequently-used arguments is to complain about the social dumping endured as a

⁶ This is the same person that was the thesis' director of A. Emmanuel regarding this same problem.

⁷ COHEN D. (2004) : *La mondialisation et ses ennemis*. Grasset. Paris

⁸ After acknowledging a great intuition to A. Emmanuel, the author, quoting, CLARK G. (1987) : "Why isn't the whole world developed ? Lessons from the cotton mills". *Journal of Economic History*, identifies the error made by the former, when disregarding the low productivity of India's textile industry vis-à-vis British productivity. The proof is provided by the rejection of Indian workers to work simultaneously with four looms as their British counterparts did. He concludes, therefore, that it is not the greater combativeness of British workers that lets them earn greater wages but their docility in contrast with the feistiness of Indian workers to accept more intensive jobs. The greater British productivity is, thus, justifying the wage increase.

In respect to our current concern, we have an additional reason to justify our approach to the unequal exchange issue. Even assuming that Clark is correct, this does not provide the authority to deny the unequal exchange. Indeed, the issue would not apply in the case illustrated above, at least not meaningfully; yet what about in the case of other goods, other countries, other periods? Therefore, we prefer, as we go ahead, to inquire about the type of goods traded nowadays between the Centre and the Periphery.

⁹ An improvement in the terms of trade can perfectly be compatible with a state of unequal exchange, which indeed diminishes under such conditions; that is, it becomes less unequal. In contrast, a secular deteriorating trend, can hardly indicate anything other than trade is operating in the direction of growing inequality.

¹⁰ BAIROCH P. (1994) : *Mythes et paradoxes de l'histoire économique*. La Découverte. Paris

¹¹ TOUSSAINT E. (2003) : *Les transferts de la Périphérie vers le Centre, du Travail vers le Capital*. CADTM. www.cadtm.org

consequence of the low wages and social protection levels in the exporting countries. Everyone knows that re-localisations make things more complex –opposition of trade unions, and eventually of governments and public opinion in the home country. In particular, re-localisations carry some additional costs, such as the elongation of production processes and transportation costs. Moreover, risks increase – political, economic, delivery terms, production control– for investors. The plain truth is that there is practically no differential in terms of physical productivity. Production conditions in the periphery are the same as those existing in the home country. In this way, re-exporting implies a transfer of value to the Centre.

c) **On the more elaborate goods**, of high-tech components as well as those of refined design –which, more precisely, account for a significant portion of durable consumer goods, aimed at high-purchasing power and, thus, demanding sectors, as well as for a good portion of capital goods– the diagnosis is different. Undoubtedly, these are the goods in which the Centre countries have a quasi-monopoly on their production. To this respect the relationship between high and low remuneration countries is unidirectional. Namely, only the former are capable of exporting them. These goods are not necessarily always manufactured by highly skilled labour, but always utilise high tech capital goods, with a high level of automation and/or robotization. In contrast, in the phases preceding this kind of activity, particularly, albeit not exclusively, in the manufacturing of machinery, and even more in their conception, the incidence of high-skilled labour is on average far higher than in any other kind of production that may be taken by the Periphery. This net and stark difference in the intensive use of highly-skilled labour, justifies the higher wages as we have said already. Yet this last fact does not exempt them forcefully from escaping from what we have referred to as unequal exchange; but, in any case, inequality is proportionally less important than in the preceding instances.

□ Conclusion

To finish, we believe that the fundamental exploitation experienced by the Third World is exerted through trade imperialism, and yet, many Third Worlders, whose good faith we do not put in doubt, centre their blame on financial imperialism from the banks and on productive imperialism from transnationals. Indeed, they verify the interests paid to banks and the profits paid to transnationals, as exploitation indicators. Of course, in trade exchanges, there are no other tracks but the event-

al disequilibrium, surplus or deficit, that can be generated. Exploitation does not appear explicitly, it is hidden in prices, so they do not readily see it.

To be sure, it must be acknowledged, that the set of problems of unequal exchange, or whatever name is deemed appropriate for any effort to revalue Third World exports, unmasks, at least in developed countries, an inescapable truth: the low prices of these exports contribute to the high average living standard in developed countries. We must become conscientious that a general revaluation of the exports from this part of the planet entails forcefully rebalancing living standards in both sides, diminishing in the North and increasing in the South. We assert this not from a static perspective, but because to think that the West's living standard can become the global standard amounts to ignoring the capacity of the planet to provide, at least in the short and mid term, to each of us, for example, the levels of energy consumption prevalent in the North, to quote just one aspect.

We believe we have herein covered the essential points regarding the Unequal Exchange thesis, as well as attempted to answer the more crucial questions emerging from its study. Many other related issues have not been addressed, yet hopefully we can open a dialogue parting from what we have here conveyed.

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Useful links:

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