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Export Oriented Industrialization Strategies

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Disappointment about the results of import substituting industrialization strategies as well as the spectacular performance of a few newly industrialised countries have led many developing countries to switch in the 1970s to export oriented industrialization. This analysis cautions against any misplaced euphoria with regard to this strategy in a neo-mercantilistic and hegemonic world.

The Industrial Revolution could be regarded as the genesis of the increasing divergence in living standards between the advanced countries and developing countries. The phenomenal difference in economic conditions between these groups of countries, as often measured by GDP per capita, has generally been explained in terms of lack of industrialization. The association of economic prosperity and level of industrialization has been substantiated by many empirical investigations.

Ever since decolonization after World War II, developing countries have consciously pursued the panacea of industrialization to bridge the widening gap with the advanced countries and to overcome the complex problems associated with poverty and underdevelopment. The panacea of industrialization was advocated as a harbinger of economic development and an emancipator from the vestiges of the colonial economy which was characterised by vulnerable dependence on the export of a few primary products to advanced countries' metropolitan markets in return for their manufactured goods. The precariousness of this economic relationship was explained by the controversial Singer-Prebisch thesis. The alleged secular deterioration of the terms of trade provided a powerful rationale for the diversification of the narrow structure of the colonial economy. Industrialization was expected to cure a host of maladies:

☐ Economic dependence was to be reduced in keeping with the newly-achieved political freedom.

☐ The "externalities" or spillover effects associated with industrialization were expected to modernise the economy by transferring "best practice" technology, managerial skills and modern institutional matrices from advanced to developing countries.

☐ Industrialization was expected to accelerate the growth of income and trickle down the benefits of growth to the impoverished masses, thus bringing in its train social equality.

☐ Industrialization was expected to produce sufficient foreign exchange earnings to wipe out the recurrent deficits in the balances of payments.

☐ It was supposed to create employment for the vast surplus population in the rural agricultural sector.

☐ The overall expectation was that industrialization would "blast off" the developing countries from the orbit of vicious poverty to an orbit of self-sustained growth.

The developing countries, despite their disenchantment with the performance of the industrialization panacea in the past, reaffirmed their faith in the need for industrialization in their plea for a New International Economic Order. They emphasised in the Lima Declaration and Plan of Action of 1975 that by the year 2000 they should increase their share of the total world industrial production from 7 % to 25 %. The plan of action to achieve this target foreshadows the need for the relocation of industries from advanced to developing countries or "a new international division of labour". The following factors may have led developing countries to reaffirm their faith in industrialization:

☐ The increasing global interdependence among advanced and developing countries.

☐ The need to resolve the gruelling problems of deprivation of "basic needs" before it is too late.

☐ The implications of modern technology.

☐ The threat of global pollution and "eco-doom".

☐ Mounting international tensions.

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These constitute a complex of theses which support various strategies for industrialization. In the past, industrialization of developing countries occurred according to two broad types of strategies. From about the Second World War up to the 1970s the dominant strategy was import substituting industrialization. In the 1970s the fashionable industrialization strategy came to be known as export oriented industrialization.

Effects of Import Substitution

Most of the newly independent developing countries opted for the import substituting strategy. Its notable feature was invariably the production of luxury consumer goods for a limited domestic market behind a very high tariff wall. This strategy often catered for an urban-elitist market and ignored the basic needs of the vast majority of the population subsisting in the rural hinterland. The elitist-urban sector, stimulated by an international demonstration effect, expressed an increasing demand for imports. The resulting foreign exchange leakage, due to the high marginal propensity to consume, was enormous and this worsened the balance of payments deficit. The consumption liberalisation spree not only affected the balance of payments, but also eroded the savings rate and impinged on growth. The acceleration of import substitution eventually made imports grow faster than the GNP. The composition of imports changed from light to heavy intermediate inputs leading to the demand for large amounts of the scarce foreign exchange resources. Import substitution, instead of saving foreign exchange, became a gobbler of foreign exchange causing indebtedness. The end result was either stagnation or dangerous external dependency. The import substituting strategy also promoted the importation of inappropriate capital intensive technologies which encourage monopolistic behaviour and suboptimal investment decisions.

Countries embarking on an import substituting strategy often invoked the "infant industry" argument to institute temporary protection for nascent industries until they achieved economies of scale. However, these temporary protectionist measures tend to linger on and become permanent features distorting the factor and product markets, thus undermining the economy's comparative advantage. A survey of protection in seven countries during the hey-days of import substitution revealed that in many developing countries the average effective rates of protection in manufacturing industry were staggering. They were over 200 % for India and Pakistan, 100 % for Argentina and Brazil, 50 % for the Philippines, 33 % for Taiwan and 25 % for Mexico[1]. Excessive government intervention in the economy to promote the strategy of import substitution led to red-tape, delay, corruption and waste of resources.

In most countries pursuing import substituting strategies the malignant features of these strategies led to the negation of most of the cardinal objectives of industrialization. Import substitution turned into a foreign exchange swallower rather than a saver and tied the developing countries to a debt tread-mill, often through aid and loans. The high protection, overvalued domestic currency in terms of foreign currency and cheap credit, stimulated cheap capital imports. This led to a bias in favour of capital-intensive technology and dampened the employment creation effects. Import substituting strategies had a distinctive urban bias and the domestic terms of trade were tilted against agriculture. This reduced the attractiveness of the rural quality of life and triggered off mass rural exodus in search of the "bright city lights" and paid employment. Urban unemployment figures soared and the rural-urban dichotomy was exacerbated. The process of import substitution accentuated "vicious dualism" and income inequality between the rich and poor. Import substituting strategies in most developing countries eventually ran out of steam after bequeathing a structural malaise to the economies of the countries concerned.

Genesis of Export Orientation

The failure of import substituting strategies to meet the goals of industrialization in many countries while spectacular growth and development were reported from a few developing countries pursuing an alternative strategy, led to *en masse* shift to export oriented industrialization strategies. The star performers amongst the developing countries pursuing such a strategy accounted for nearly 75 % of the total exports of all developing countries in 1973. The exports of each of these newly industrialised countries as a percentage of the total exports of developing countries, were as follows: Hong Kong 23 %, South Korea 16 %, Mexico 9 %, Brazil 8 %, India 6 %, Singapore 6 %, Malaysia 4 % and Argentina 3 %[2]. The hall mark of the export oriented industrialization strategy was "promotion" in contrast to the

[1] Cf. I. Little, T. Scitovsky, M. Scott: Industry and Trade in Some Developing Countries: A Comparative Study, London 1970.

[2] UNCTAD, Trade in Manufactures of Developing Countries and Territories, 1974 Review, New York 1976.

"protection" that characterised the import substituting strategy. Promotional measures are a direct means of giving industries subsidies to overcome various disadvantages that thwart their achievement of economies of scale. For instance, promotional measures in developing countries for manufacturing industries may include improving financial and credit institutions, expanding infrastructure facilities, rewarding external economies conferred on other industries, and the provision of subsidies for training of labour.

The central message that has been conveyed by the success story of the newly industrialised countries is that developing countries should attempt to harness the prospects offered by international trade by specializing according to the tenets of comparative advantage. Import substitution had distorted the product and factor markets and biased manufacturing towards capital-intensive methods. Empirical evidence from newly industrialised countries showed that nearly 80 % of their exports were labour-intensive[3]. During 1973, the newly industrialised countries accounted for nearly 91 % of clothing exports, 94 % of engineering exports, 61 % of textile, 70 % of wood products, 89 % of light manufactures, 78 % of leather products, and 58 % of food product exports to 21 advanced countries[4]. Thus the empirical evidence suggested that developing countries should specialize in labour-intensive products in which they had a cost advantage. Such specialization would be consistent with the guidelines of the neo-classical trade theories.

Furthermore, empirical evidence based on a regression analysis of 45 nations showed that countries with high protection had lower growth performance than "open" countries. Thus import substituting strategies had lower growth stimuli than export oriented strategies in developing countries[5]. It was also argued that participation in international trade through export promotion would enable developing countries to transcend the narrow confines of the domestic market and reap the benefits of economies of scale. Promotional policies would also overcome the anti-export effects and the bias towards capital-intensive technology induced by import substituting strategies. The adoption of export oriented strategies, it was argued, would generate more employment than

[3] M. A. H. M. Rahman: Exports of Manufactures from Developing Countries, 1973.

[4] Cf. UNCTAD, op. cit.

[5] T. K. Morrison: Manufactured Exports and Protection in Developing Countries: A Cross-Country Analysis, in: Economic Development and Cultural Change, Vol. 25, No. 1/1976, pp. 151-158.

import substitution because of the labour-intensive character of the production technology that an export oriented strategy encourages. It would also remove the loading against agriculture and thus promote the "green revolution". The strongest advocates of export orientation pointed out that the new strategy would expose the developing economies to the fresh air of competition and innovation. Developing countries, by participating in freer trade, could import the most appropriate technology and gain from large flows of foreign capital. International agencies and academia have started chanting the merits of export oriented industrialization with messianic fervour.

Free Trade Zones as a Vehicle

The main vehicle for implementing the export oriented industrialization strategy has emerged as the free trade zone, a combination of the traditional free port concept with an industrial estate, tax credit and labour havens for unfettered exploitation of cheap labour and resources, often backed by constitutional and legal guarantees against the risk of expropriation. The origins can be traced to the Shannon International Free Port in Ireland (1958). However, the first fully fledged free trade zone was Taiwan's Kaohsiung Free Trade Zone which came into operation in 1965. Since then the free trade zone as a vehicle for export oriented industrialization has been actively propagated by international agencies such as UNIDO and the Asian Productivity Organisation (APO). Today there are over 80 such zones and another 40 are in the planning stage. Even China has opened its doors to transnational capital by planning for four free trade zones.

The traditional free trade port was a customs free bonded warehouse, which facilitated the rapid turnover of re-exports. In addition to the free port advantages, a free trade zone offers cheap infrastructural facilities, often in the form of industrial estates with efficient power, water supply, custom-built factories, bitumen roads, good communications and other utilities. Free trade zones also offer a plethora of fiscal incentives such as tax holidays and subsidised credit facilities. Investors' incomes, profits and dividends are exempt from tax; loans and credit are provided quickly at concessional rates; and exchange rate regulations, customs duties and excise taxes are waived. In order to help foreign investors to exploit cheap indigenous labour and natural resources, minimum wage laws are suspended, trade-union activity is banned, strikes are outlawed and trained labour is liberally provided. Finally, political stability is emphasised so as to assure private foreign investors that their investments are secure. Therefore, it is not an exaggeration to say that the free trade zone is "a country within a country", and "a veritable paradise for international capital"[6].

Amongst developing countries there is now severe competition to attract foreign investment by offering a package of inducements through the free trade zones. It has been observed that the "gang of four" (i. e. Taiwan, Hong Kong, Singapore, South Korea) amongst the newly industrialised countries are now branching into the cheap labour and tax havens in South Asia in a deliberate attempt to reap the advantages of the new global quotas offered in the wake of restrictions on imports from newly industrialised countries by advanced countries. Moreover, this "gang of four" are also investing in more capital-intensive metallurgical and chemical industries. A "second wave" of transnational capital investment is sweeping the cheap labour developing countries and it is spearheaded by this "gang of four", the most successful of the newly industrialised countries[7].

The Role of Transnational Corporations

The switch by developing countries from import substituting to export oriented strategies occurred in the 1970s. The transnational corporations played a key role in effecting this switch in strategies. The American transnationals were the pioneers in the relocation of manufacturing activities so that vertically-integrated manufacturing operations could be carried out through wholly-owned subsidiaries or majority-owned affiliates in developing countries. The European, and soon the Japanese multinationals joined the fray to enter the cheap labour and tax havens offered by the free trade zones. Several critical factors explain the emergence of transnational corporations as the major *dramatis personae* in the export oriented industrialization strategy:

□ The "technology component revolution" which facilitated the widespread practice of subcontracting to developing countries of labour intensive parts of highly complex manufacturing processes. International subcontracting was encouraged by offshore tariff legislation (e. g. US tariff items 807.00 and 806.30) and it facilitated the migration of the transnational corporations to the labour and tax havens offered by developing economies.

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[6] T. Takeo: Free Trade Zones and Industrialization of Asia, Special Issue.AMPO: Japan-Asia Quarterly Review, Tokyo 1977, pp. 1-5.

[7] Ho Kwongping: Bargaining on the Free Trade Zones, in: The New Internationalist, No. 85, March 1980.

□ The "communication revolution" caused by containerisation and the developments in teleinformatics led to dramatic reductions in unit transportation costs and trans-border data flows. This made the relocation of manufacturing operations in distant developing countries an attractive economic proposition.

□ The "crisis in capitalism" caused by chronic stagflation made unions militant about any proposals to reduce real wages or any attempt to engage labour in monotonous or dehumanising repetitive production operations. This also prompted transnational corporations to migrate to free trade zones. The docile labour of such zones offered as much as a ten-fold wage advantage even after making allowances for productivity.

The type of products that were manufactured by transnational corporations in the free trade zones of developing economies using cheap labour and infrastructure facilities can be categorised (using a typology from the theory of comparative advantage in international trade) into Ricardian goods, Heckscher-Ohlin goods and product-cycle goods.

□ Ricardian or natural resource-based production occurred in resource-rich developing countries such as Brazil, Columbia, Malaysia, Indonesia and the Philippines. Here transnational corporations were engaged in mineral and lumber extraction and food processing for exports.

□ Heckscher-Ohlin production for export used standardised technology to manufacture a wide range of labour-intensive goods such as clothing, toys, sports goods, footwear and wood products.

□ Finally, in the case of product-cycle goods the labour-intensive components of highly capital-intensive and skill-intensive end products demanded in the markets of advanced countries were assembled in developing countries. For instance, electronic goods such as TVs and transistor radios were manufactured from components assembled under magnification by low-paid female labour in free trade zones.

Benefits and Costs

There are erudite theoretical expositions that confirm the superiority of export promoting over import substituting strategies[8], and equally forceful denunciations of the exacerbation of dualism and inequality in developing countries due to the pursuit of export-led growth policies[9]. Empirical evidence has been marshalled by the National Bureau of Economic Research (NBER) to show the superior growth and employment-creation effects of export oriented strategies. The developing countries' exports to advanced countries were predominantly labour-intensive. This evidence substantiates the neo-classical factorproportions or Heckscher-Ohlin thesis. The exports between developing countries were revealed to be capital-intensive, indicating the bleak prospects for customs unions amongst developing countries[10].

The linkages (mainly local purchasing) and externalities generated by export oriented industrialization varied according to the stage of industrialization, availability of skills and entrepreneurship, the size of world market for the product and the efficiency of government institutions in the host countries. However, it has been observed that potential linkages vary in strength with the type of product: In the case of Ricardian products which are based on use of mineral and agricultural raw materials, weak linkages or local purchasing and collaboration were observed. In the case of Heckscher-Ohlin products which used standardised techniques to manufacture textiles, clothing, footwear, leather and wood products, very strong linkages and partnership with local producers were reported. But in the product-cycle goods, such as electrical goods manufactured by Phillips and General Electric, the manufacturing operations were tightly controlled by transnational corporations. In world-wide sourcing industries, such as electronic components assembly, the linkages were virtually negligible[11].

The entry of transnational corporations, with their massive financial resources, sophisticated technology, market power and superior organisational and managerial practices, leads to denationalisation or the take-over of local firms. The market behaviour of transnational corporations will be predatory and eventually cause the establishment of oligopolistic structures in host countries. The financial prowess of transnational corporations enables them to deprive the local firms of the use of domestic savings by offering

[8] Cf. J. N. Bhagwati: Anatomy and Consequences of Exchange Control Regimes, New York 1978.

[9] G. Chichilinski, S. Cole: Growth of the North and Growth of the South: Some results on Export led Policies, mimeograph. Department of Economics, Columbia University and Science Policy Research Unit, University of Sussex 1979.

[10] A. O. Krueger: Foreign Trade Regimes and Economic Development: Liberalization Attempts and Consequences, New York 1978.

[11] Cf. S. Lall: Transnationals, Domestic Enterprises, and Industrial Structure in Host LDCs: A Survey. Oxford Economic Papers, Vol. 30, 1978, pp. 218-247.

more profitable investment. The claims that transnational corporations are more efficient, more productive, more sucessful than their local counterparts in the adaptation of technology in comparable industries is not borne out by cross-country surveys[12]. The entry of transnational corporations into developing countries can spell take-over, merger and bankruptcy to local firms. Thus an unqualified export orientation can enhance the dependency of host countries on foreign firms. Moreover, the hypothesis that export oriented industrialization leads to skilling of labour and increased welfare for labour is also contentious. Besides, there is evidence indicating that transnational corporations operate in developing countries to gain access to the markets of other advanced countries by complying with the local content requirements of the Generalised System of Preferences.

The export oriented strategies are alleged to lead to dynamic divergence in developing countries as production is for consumption in the markets of advanced countries, while domestic consumption demands have to be met by imports from the latter. The lack of a nexus between domestic production and consumption impedes the development of autonomous growth based on basic needs demands of the indigenous people. Export oriented industrialization makes growth a reflex of the advanced countries' prosperity and thus reinforces the developing countries' dependency.

[12] Ibid.

Neo-protectionist Backlash

The shift to export oriented industrialization has led to an acceleration of manufactured exports at the rate of 14 % per annum. Eight newly industrialised countries accounted for 70 % of this increase between 1970-72. The advanced countries experienced mounting unemployment and inflation after the recession triggered off by the OPEC crisis in 1973. They have reacted to increasing manufactured exports by erecting more and more non-tariff barriers which are clumsy in responsiveness and create uncertainty amongst exporters in developing countries. Non-tariff barriers are the core of advanced countries' neo-protectionism to fend off competition from newly industrialised countries in their markets. These neo-protectionist measures run counter to the spirit of the market mechanism and of the GATT Articles forbidding quantitative restrictions on trade. The non-tariff barriers were instituted as temporary voluntary export restraints on cotton textile exports by a few countries. But the long term cotton textile agreement has now become permanently institutionalised and extended to other products in the form of the Multifibre Agreement of 1974. Besides, voluntary export restraints, government to government orderly marketing arrangements and "organised free trade" are being actively promoted by advanced countries to contain the flow of textile, footwear, electronics, engineering, steel and shipbuilding products from developing countries. Arrangements to cartelise the production of steel, synthetic fibre, and ships have been reported. These neo-protectionist machinisations do not augur well for the pursuit of a successful export oriented industrialization strategy by developing countries.

Neo-protectionism has been viewed as a recrudescence of neo-mercantilism designed to export advanced countries' unemployment, recession and factor market distortions to developing countries in a "beggar thy neighbour" policy scenario reminiscent of the 1930s Depression.

In the United States, the Trade Act in 1974 liberalized the eligibility conditions for assistance to domestic industries threatened with "substantial" injury caused by import competition. In many advanced countries massive revamping operations have been undertaken to make senile domestic industries survive in the face of import pressure in the belief that they might one day become internationally competitive. Massive subsidies of a quarter of a million pounds were paid out in 1977 under the British Temporary Employment Subsidy Scheme to protect the British shoe industry. In France, the ailing Boussac textile empire has received handsome handouts. The OECD shipbuilding industry has been heavily subsidised. The lack of positive adjustment assistance in advanced countries and the proliferation of domestic support schemes make a mockery of international trading dynamics.

Politicians, unionists and academics have found common cause in raising the bogey of unemployment caused by cheap imports from developing countries. Empirical evidence from Britain indicates that unemployment caused by imports in the footwear industry was a mere 0.4 % during 1970-75. In the USA hardly any unemployment was caused by the penetration of manufactured exports from developing countries during the period 1960-75. In Germany no net job losses occurred due to trade in manufactures. During 15 years (1960-75) manufactured exports from developing to advanced countries increased by only 0.8 %. It is noteworthy that 75 % of the increase in textile trade during 1972-75 was due to trade between advanced countries. In clothing the corresponding percentage was nearly 48 %. In 1978 the advanced countries controlled 60 % of their own market in textiles and 86 % of the market in clothing. Thus any unemployment caused by trade in these sensitive labour-intensive goods could be squarely apportioned to trade between advanced countries rather than to manufactured exports from developing countries.

The rising tide of neo-protectionism has also been sanctified by the prestigious Cambridge Economic Policy Group (CEPG). The new Cambridge macro-economics contend that massive controls on manufactured imports would lead to employment generation by promoting import substitution. They argue that neo-classical devaluationist prescriptions cannot rectify the fundamental balance of payments disequilibria of advanced countries as institutional forces (such as real wage demands) would trigger off cost-push inflation. Such inflationary pressures would negate employment creation through exports by undermining the competitive position of the countries concerned. The "siege economy" of CEPG is, however, dismissed with scepticism by mainstream neo-classicists who contend that its implementation would result in stagnation and more unemployment[13]. Even if protectionist policies succeed, it needs to be noted that unemployment is fungible; jobs created by import substitution are likely to be fewer than jobs lost by export shortfalls in the more productive and skill-intensive export sectors[14].

The failure of advanced countries to play the international rules of the game has not been chastised by GATT. GATT's safeguard clauses are eroded by manipulation, and the onus of current account deficits due to export shortfalls is blamed on developing countries by the IMF when financing them through tranch facilities. The prospects for export-induced development are bleak indeed as powerful advanced countries call the tune in the trade game. The predicament of the developing countries is caused by the advanced countries' policies that could be summed up as: "free trade when you are strong: nationalism when you are weak"[15].

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[13] Cf. W. M. Corden, I. M. Little, M. F. G. Scott: Import Controls versus Devaluation and Britain's Economic Prospects, London 1975.

[14] Cf. J. Tumlir: Can the International Economic Order be Saved?, in: The World Economy, October 1977.

[15] S. Lall, op. cit.