Export Promotion Policies

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This paper presents the summaries of papers on promotion of non-traditional (manufactured) exports, along with comments presented at a Joint IBRD/ECLA/UNDP Conference held in Santiago, Chile, in November 1976. The Conference was called to analyze the implications for development strategy and policies in several countries of a more outward orientation and the sharp increases in manufacturing output, efficiency and exports which occurred during the past 10 - 12 years. Besides papers on the general aspects of industrial and trade incentive policies and of manufactured export growth, the papers deal with the experience of four Latin American countries (Argentina, Brazil, Colombia and Mexico) and four countries outside the region (India, Israel, Korea and Yugoslavia).

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FOREWORD

Development strategy and the management of economic policy instruments in the Latin American countries are undergoing a profound transformation. Industry is greatly increasing its efficiency, reducing costs and improving quality. At the same time, most of the countries of the region are developing industrial sectors that have remained backward -- chiefly those producing capital and intermediate goods. They have passed through the stage of import substitution with a high level of protection confined to the narrow framework of each national market, although there is still a considerable untapped potential for import substitution and the development of basic industries in the context of broader subregional or regional markets.

The growth rate of exports has risen sharply and there has been diversification into industrial branches and even manufactured goods of some technological complexity, such as durable consumer goods and capital goods. Latin America no longer exports only primary products. Although these still account for a large proportion of total sales abroad, the most dynamic element of those sales is manufactured goods, which consequently have a considerable impact on the growth rate of total exports.

The management of economic policy instruments, particularly those related to the external sector, also is changing. Economies are being opened to the rest of the world, with a decrease and a refinement of protection, and -- as experience is acquired -- improvement of the export promotion systems that were established in the mid-1960s. Foreign exchange policy, tariff and nontariff restrictions, and fiscal and financial incentives are quite different from those of the early 1960s, but also they continue to be modified and improved.

As a result of these transformations, some basic questions have arisen, focusing attention on the design of development policies. The questions can be grouped in two main aspects.

The first aspect is development strategy or policy. Here we find such questions as: Should import substitution and the exportation of manufactures be regarded as mutually exclusive, or as complementary aspects of a development policy for Latin American countries in the years ahead? Is specialization compatible with the creation of a diversified export structure? What criteria should be followed in the selection of the products on which the Latin American countries should concentrate their efforts to export?

The second aspect refers to the instruments through which these elements of development policy can be put into effect. Here we find questions relating to the costs and benefits of incentive systems, their direct effects on the external sector, and their indirect effects on the structure of production and on the development process.

On the initiative of Mr. Dragoslav Avramovic, the World Bank and ECLA worked together in organizing a conference to analyze and discuss these matters from a technical standpoint. ECLA, with the support of the United Nations Development Programme, studied four Latin American countries which are among the most advanced in their policies for the promotion of manufacturing exports: Argentina, Brazil, Colombia and Mexico. These studies were augmented with four others on non-Latin American developing countries (Korea, India, Israel and Yugoslavia), prepared by staff members or consultants of the World Bank. These eight cases provided the basis for a meeting sponsored jointly by the three agencies mentioned, held in Santiago, Chile in November, 1976 (and financed in part under World Bank RPO 671-10).

This paper presents summaries of the revised versions of the studies analyzing the experience of the eight countries mentioned, together with four others dealing with the topic from a more general perspective. A parallel volume, in Spanish, has been issued by ECLA ("Politicas de Promocion de Exportaciones", Santiago, Chile, E/CEPAL/1046, October 1977).

I. Papers on Latin American Exports

EXPORTS OF MANUFACTURES IN LATIN AMERICA: EXPERIENCES AND PROBLEMS 1/

by Angel Monti

This paper brings together the main experiences of the region as a whole, with case studies of Argentina, Brazil, Colombia and Mexico.

In 1974 Latin America exported manufactures valued at US$7.4 billion. 2/ During the past decade the annual increase in the volume of exports was 18%, whereas gross domestic product grew by 6% a year. Exports of manufactures account for about one fourth of total exports.

The growth of exports, though substantial, was not sufficient to offset the increasingly unfavorable balance of trade. Exports of manufactures of the region represent only about 1% of the world total. The deterioration in the terms of trade between 1974 and 1975 meant a loss of US$7 billion in that period alone, equal to the total value of manufactures exported. There are limitations on the purchase of basic products; under present conditions, then, a substantial increase in exports of manufactures is imperative.

The rate of growth of these exports depends on many factors. If an annual GDP increase of 6% is projected to 1980 -- a percentage not necessarily sufficient to generate all of the employment required in the four countries together -- and if an annual increase of 10% in the volume of exports of basic products is projected from 1974 -- which is higher than the historical rate -- the balance of payments would be in equilibrium with a 20% substitution effect coupled with a 23% expansion of exports of manufactures. If the substitution effect is 40%, equilibrium would require an annual increment of 20% in exports of manufactures. These tentative projections serve only to identify orders of magnitude for these variables, and to underscore the role of substitution.

Substitution depends, in turn, on the development pattern. A number of studies indicate that continuation of the prevailing development pattern (with consumption requiring complex and highly processed goods, and little cooperation among the Latin American countries) would result in negative substitution. Should this occur, a GDP increase of 6% could not be financed, or the increase in exports would have to be even greater.

A much greater expansion of exports can be attempted through industrialization with maximum domestic content. The alternative is to provide facilities for the establishment of foreign plants and the importation of their inputs, which benefits local employment in the short run. Nonetheless, such a policy would encourage a new form of factoring; this is not likely to be the best solution, or even an acceptable one for Latin America.

1/ The Spanish text of the complete paper by the author is available from the ECLA office in Santiago, Chile.

2/ According to the UNCTAD classification. Comprises manufactured and semi-manufactured goods.

These general factors, together with the specific aspects pointed out in the study, again underscore the need for greater regional cooperation. In this connection, it is noted that:

(a) The countries must maintain some balance in the decision-making power of their external sector. The dynamic force of that sector cannot continue to be left to the transnational firms, as has been done up to the present. Greater cooperation, with an expanded role for Latin American joint enterprises, would be useful to this end.

(b) Substitution at the regional level -- including a number of ventures combined in a single overall project -- yields better results for all the participating countries, making it possible to reduce protection and the cost of promoting trade with other regions, and to increase exports to those regions.

(c) Protection and promotion are related variables: greater protection means higher export costs. But both have a limit. Protection cannot be allowed to foster domestic inefficiency, nor can promotion exceed a stipulated fiscal and financial cost. Given the two limits, regional cooperation is needed to place operations on an optimum scale.

(d) It is agreed that the factor endowment determines the optimum export pattern; it should be pointed out, however, that the technology factor is essentially flexible. Countries can export goods with a high technology coefficient only through an increase in their capacity to absorb the relevant technology. Working together, the countries of the region would achieve much more in this regard than by acting individually.

Naturally, all of the foregoing poses a more general theoretical question, making it necessary to review thinking on international trade without pre-conceived notions. The economy, as an area of integrated social activity, does not depend only on itself. Other variables -- such as the decision-making structure and technology -- should be taken into account explicitly. If these two sets of factors are kept in mind, the problems of achieving an optimum in the external sector must be approached in a new way and a priori positions cannot be taken in favor of greater freedom or greater innovation in the management of instruments.

Thus, we have such questions as the following: at what level to optimize and with what restrictions (at the regional, or national level or in regard to specific private interests); who optimizes in the design of policy (the government or the private sector); how are conflicting optima reconciled; what basic conditions of international trade must be met; what is the indispensable degree of selectivity, and what noneconomic requirements should be taken into account. All of this means that the instruments must respond to a set of needs; if these functions must be performed, "who" performs them best cannot be determined dogmatically in advance on the basis of doctrinaire preferences in favor of free trade or intervention.

In conclusion, experience suggests that there is need for reformulation of policies on the external sector, based on their role in economic policy. This in turn should be done taking into account that the economy does not depend only on itself, but rather is part of an intrinsically interdisciplinary system. We face a new challenge at a time when the balance of payments is increasingly unfavorable for the region, excepting the oil-exporting countries.

The study includes a number of empirical verifications drawn from a comparative analysis of the four countries considered, as well as a list of points for discussion, which are intended to be of use in the conceptual reformulation that has been mentioned.

EXPORTS OF MANUFACTURES IN LATIN AMERICA: EXPERIENCES AND PROBLEMS

Comment by Norberto Gonzalez

My comments on Angel Monti's paper refer to four points: (i) import substitution and the exporting of manufactures; (ii) cooperation or competition; (ii) similarities and differences among the four Latin American countries analyzed; (iv) subsidies.

1. Import Substitution and the Exporting of Manufactures

I concur with Monti's observations in this regard. I think it well to add some remarks on the complementarity between import substitution and the exporting of manufactures.

(a) As is well known, import substitution has been quite unequal in Latin America. Light industries producing durable and nondurable consumer goods have advanced too far; in these sectors everything has been substituted with no criteria for specialization. At the same time, industries producing capital goods and some basic intermediate goods (such as chemicals and metals) have remained quite backward even in the largest and most advanced countries of the region. In all of the countries there is still a considerable margin for import substitution in these subsectors. It is often said that import substitution is exhuasted; this is an erroneous simplification. It is impossible to make an overall judgement that would be equally valid for all sectors of industry; the different cases must be considered separately. Fortunately, the policies that many countries of the region are applying take this fact increasingly into account. In Brazil the "new phase of substitution" is being carried forward. In Mexico, Nacional Financiere is drawing up a program of import substitution combined with exports of capital goods; in Argentina, progress in basic industries continues to have priority in offical policy.

(b) If the import coefficients of each sector are frozen -- i.e., if the proportion of each type of imported goods remains constant -- Latin America's total imports will increase at a rate 1.3 or 1.4 times that of product. In other words, with "neutral" import substitution (neither increasing nor decreasing in each productive sector) the total coefficient of imports with respect to product would tend to rise. This is due to the change in the structure of demand that accompanies the rise in per capita income -- as income rises it increases proportionately more than the demand for goods with a higher import content -- and to the effect of technological innovation coming from abroad in the form of new goods. If there is no import substitution in any productive sector, even though the degree of openness of the economy does not increase in any sector, a product growth rate of 7% would mean that import requirements would increase between 9 and 10% per year.

(c) If the Latin American countries gradually reduce protection in the years ahead, their sectoral import coefficients will increase. In this case

the elasticity of total imports with respect to product may be even greater than the 1.3 or 1.4 times mentioned for the case of "neutral" substitution. In other words, if projection decreases import requirements will increase even more rapidly than indicated. Some of our projections and analyses show that in this case import requirements would exceed the possibilities of financing them through a reasonably dynamic expansion of exports.

(d) The continuation, during the next ten years, of policies similar to those of the past decade with regard to import substitution (followed despite criticism) or to exports of manufactures and basic products, would mean that the growth rate of exports would be systematically slower than that of imports. It must be kept in mind that although the international economy has completed its recovery from the recent crisis, for the next several years growth rates probably will not match the highest levels of the last decade. This could aggravate the external bottleneck as a factor limiting the development of the Latin American countries. In other words, without bolder, more imaginative and more energetic policy approaches, the rate of reduction of tariff protection -- even for the larger countries -- will be constrained by the need to keep the balance of payments deficit within manageable margins. In this case the import structure would not improve; on the contrary, the relative imported content of basic industries would increase. Imports of goods produced by the metalworking and chemical industries, which now account for two thirds of total commodity imports, would represent more than three fourths in ten years. The export structure would change as it has been doing over the last fifteen years, but even in the second half of the 1980s, basic products and traditional manufactures would continue to predominate. 1/

(e) In summary, unless there is a change in development policy capable of giving even greater impetus to exports of manufactures, and at the same time fostering massive and efficient substitution of imports in sectors where development is lagging, it will be difficult to modify the structural conditions that retard the economic development of Latin America. These changes can be made through the combination of substitution and exports; new sectors can be developed within the framework of the regional market of Latin America rather than in each national market. In this way, the production of each country would be specialized within each sector, through a blend of large-scale exports of certain goods produced by the sector to other countries of the region with imports of other products of the same sector. In this way the scale of production would be such that costs would be internationally competitive, which would make it possible to export to the rest of the world.

Consequently, there is need for further consideration of the role of the regional market in the development of the Latin American countries, and for a combination of import substitution with exports to bring about a greater opening of the economies to the outside, a more rapid increase in efficiency making it possible to reduce protection faster, and advances in the

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1/ See Gerard Fichet and Norberto Gonzalez, "Estructura Productiva y Dinamica del Desarrollo", Revista de la CEPAL, Second semester 1976.

development of backward industrial sectors. The policy on exports of manufactures would be aimed not only at generating more foreign exchange, but also at implementing an industrial development strategy with a much wider scope than the present one.

2. Cooperation and Competition. Monti appears to be right about greater cooperation that will make it possible to take advantage of the regional market and bring about greater specialization among the Latin American countries, instead of producing similar goods. I believe, however, that this point would have to be clarified further in order not to place too much emphasis on cooperation. Cooperation and competition should not be mutually exclusive. It is advisable to develop some specialization among the Latin American countries (on a broader and more intensive basis than what has been achieved through the complementation agreements of LAFTA, the sectoral agreements of the Andean Pact and the actions taken by the transnational firms themselves). But this specialization should take place with sufficient flexibility, following a plan but also retaining a function for the market. The freeing of trade among the Latin American countries and industrial agreements or programming are two elements that should be combined in regional cooperation. The combination must be adjusted to the cases of different countries, in accordance with the conditions and requirements of each. Among the large countries the market can play an important role, with some coordination enabling each of them to know that it can rely on the market of the others in order to develop certain industries. In the case of relations between large and small countries the programming aspect will be more important, for only this can permit an acceptable balance in the distribution of benefits. In other words, the combination of competition and cooperation, and the manner in which the latter is effected, will vary from one situation to another.

3. Comparison of the Four Latin American Countries Analyzed. Monti's paper points out some similarities and some contrasts among the national promotion policies applied in Latin America. This comparison is useful and it should be broadened and extended in future studies. See, for example, Chapter I, section 16, and much of Chapter II.

Together with important similarities, there are differences, at least in emphasis, among the Latin American countries with regard to:

(a) Strategy (to give greater or lesser emphasis to the employment of labor and greater attention to specific markets);

(b) Instruments and policies (differences in the role of the public sector, which apparently has been greater in Brazil; in the setting of export targets for firms so that they can produce for the domestic market, as in the case of Mexico; in the extent of promotion; in the index of competitive capacity with price effects and fiscal and financial incentives; and in the formation of exporting companies.

4. Subsidies and Developed Countries. The problem is to determine whether the use of subsidies by developing countries justifies the imposition of compensatory duties by the developed countries. In Chapter III, and partly in Chapter II, Monti notes that subsidies are not the only unfair practices. He also points to the sale of outmoded technology by the developed countries, monopolistic or oligopolistic practices in international markets, etc.

What the author says is true, but it seems to be more correct to approach the problem from a different standpoint. First of all, a determination should be made of the extent to which promotion is limited to offsetting the effects of protection of the inputs used in the production of exported goods. Second, the extent to which it compensates for the effects of policies applied for other purposes by each developing country (overvalued national currency, domestic taxes paid on the exported goods when destined for the domestic market). Third, the extent to which promotion neutralizes the effects of certain practices of transnational companies which have an adverse effect on the competitive position of the developing nations (restriction of exports, setting of prices under monopolistic or oligopolistic conditions, sale of obsolescent technologies). Even if promotion goes beyond offsetting these circumstances, one can argue that it is proper to apply promotional measures to incipient export activity; there is need to offset the initial disadvantages that a country faces while it sets up a distribution network, penetrates foreign markets and learns how to operate in them. Nonetheless, this promotion for incipient exporting activity should be kept at reasonable levels (so as to offset the initial disadvantage but no more) and for a certain period (not permanent). Subsidies are not justified beyond these limits.

EXPORT GROWTH IN THE NEW WORLD ENVIRONMENT: THE CASE OF LATIN AMERICA

by Barend A. de Vries

In 1973 Latin America had reached a relatively strong position for adjusting to the problems which would be caused by the increase in oil prices and the subsequent recession in the industrial countries. The growth of exports, especially of manufactures, had accelerated; the resource gap had been reduced to only 0.5% of GDP; creditworthiness was strong and external capital was available in large amounts and on relatively favorable terms. In the 1974/75 recession, external credits helped smooth the adjustment process, financing imports and investments at higher levels than would otherwise have been possible. At the same time, however, the growth of exports decelerated in 1974 and exports actually fell in 1975, while external debt accelerated, outpacing exports in these two years. In the adjustment process those countries fared best which had been successful in diversifying their domestic economies and exports (in effect bearing the fruit of earlier industrialization efforts) and which continued encouraging exports, particularly by flexibility in their exchange rates, to offset domestic inflation. In contrast, countries which are still in the early phases of diversification and which, for various reasons, delayed the necessary adjustments, suffered most. Lags in adjustment measures turned out to be costly, especially in terms of accumulated debts and foregone investment opportunities.

In the 1974/75 recession, manufactured exports generally declined less than the more traditional staple products. Even so, export growth of many industrial products decelerated and some exports declined, whereas certain non-traditional agricultural exports performed better than manufactures. Exports suffered least, and in previous years had often increased most, where multinational firms provided close links with marketing facilities in the large industrial economies; this was especially true in Brazil. General export incentive measures affecting a broad range of products, including flexible exchange rates in an inflationary environment, were essential in achieving a dynamic export performance.

In the years ahead, Latin America will need to adapt itself to major shifts in its external position -- e.g., those caused by the higher cost of oil, the increased external indebtedness of some countries and the pressure on available capital resources, changes in comparative advantage, and the development of new export products, including major new resource-based exports. A resumption of the export momentum is crucial for the maintenance of a viable balance of payments in an environment of growth and continued structural transformation.

The scenario for medium-term growth of the major Latin American economies presented in this paper envisages that total exports will grow at 9-10% by 1980 and after, with manufactured exports growing by 10-15% in real terms. The increase in imports would be contained by current adjustment measures as well as new economic import substitution projects - making it possible for imports to fall from 11% of GDP in 1974/75 to less than 9% in

1980; this would compare with 10% for 1972/73; (imports in 1974 were unusually high as a result of inventory building in some countries). The growth of GDP would accelerate, reaching 7% by 1980, whereas the resource gap would be sharply reduced (and in fact turned into a small surplus). 1/

Although these are reasonable growth rates, Latin America could achieve considerably more vigorous growth, particularly of manufactured exports. Higher manufactured export growth is possible if Latin American suppliers continue to capture a larger share of OECD markets by displacing imports from industrial countries. Moreover, as outward looking policies are pursued, it is quite feasible that imports will continue at higher levels than projected even though countries are successful in implementing economic import substitution projects. In pursuing adjustment-cum-growth policies, Latin America could achieve a new balance of payments equilibrium with higher levels of exports and imports. This would also enable the major countries' GDP to grow at a higher rate and at the same time create more employment opportunities.

The growth scenario envisages that total exports will grow by 9% or more per annum in 1978-80, i.e., much higher than in 1971-73 when the average was 5.6%. This improvement came primarily from exports of staples, both agricultural and mineral, in an environment of marginally improving terms of trade. Manufactured exports growth alone will not be sufficient to cover the increase in Latin America's foreign exchange needs. It must be supplemented by development of resource-based exports (e.g., in Peru and Colombia) as well as agricultural exports, especially from Argentina, Brazil, Colombia, Paraguay and Uruguay.

The realization of these growth rates will depend considerably on external market conditions and the ability of countries to continue diversifying their manufactured exports. The demand of industrial countries (which take some 60% of Latin American manufactured exports) is expected to remain reasonably strong. Their growth performance, however, may be dampened by the efforts of reducing persistent inflation. Liberalization of tariffs and other restrictions could be tempered by the prevalence of high unemployment rates. However, absence of renewed import restrictions in the 1974/75 recession augurs well for a continuation of liberal policies by the industrial countries. And, based on present OECD growth projections and available estimates of income elasticities of imports, total imports of the OECD countries could grow by 15% per annum.

A new Brookings Institute study estimates that the Tokyo round of trade negotiations could induce, by the early 'eighties, an increase in LDC exports equivalent to 3-6% of total 1974 exports. If, as is likely, textile imports would not be significantly liberalized, the impact of new liberalization measures would be only about 3% of total 1974 exports -- this

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1/ Details are given in Barend A. de Vries: "Exports in the New World Environment: The Case on Latin America", ECLA Review, First Semester, 1977, and Weltwirtschaftliches Archiv, Band 113, 1977, Heft 2.

would still be equivalent to 12% of manufactured exports, i.e., about one year of projected growth, a not inconsiderable impact. Although LDCs have increased their shares of import markets in developed countries, particularly for items which grew most rapidly in the past decade, their shares of total markets are as yet very small. Therefore, considerable scope exists for substitution of imports from LDCs for products now supplied by developed countries. If Latin America were able to displace imports from other developed countries, her exports would not be affected by import restrictions of the industrial countries.

To successfully displace imports from developed countries and to accelerate growth of manufactured exports, Latin American countries must concentrate on developing new specialties and products. Some of these, such as non-electrical machinery and other capital goods, have large market potentials. In these new lines, adjustment problems and labor displacement in the importing markets could be overcome more easily than in such items as automobiles, textiles and leather goods. Exporters will need to be encouraged to search new markets and develop new products -- hence, incentive measures should cover a broad spectrum. The experience of the past eight years, in which the leading exporting nations developed very rapidly a wide range of new items, augurs well for their ability to continue doing so; provided, of course, that policies will encourage relevant investment and marketing efforts as well as the absorption of new technologies available from abroad.

Resumption of vigorous export growth rates will require the continuation of outward-looking policies -- especially flexible exchange rates and relatively simple and uniform export incentives. Export incentives will need to fit into a broader framework of development policies, including those aiming at improvements in labor productivity and employment. In the last two years, as part of the adjustments to the recession, certain countries have reverted to intensifying protection and import controls, but one would hope that this is a transitional phenomenon. It is possible, however, that the control of domestic price increases -- in several countries well above the international rate -- could run contrary to be flexible exchange rate policies which are an essential part of any export policy in an inflationary environment. Furthermore, compared with most manufactured exports, resource-based export projects are less dependent on domestic input and labor costs, and exchange rate flexibility may seem less important for them. In Brazil, and elsewhere, the development of import substitution industries (capital goods, fertilizers) initially producing primarily for the domestic market may also, in the present stage of development, be less dependent on favorable export policies and therefore may involve a trade-off with these policies. Hence, countries must weigh consequences which alternative policies hold for accelerating export growth and domestic diversification.

The growth profile for the next five years or so suggests that compared with their relatively strong position in the early 'seventies, Latin American countries are, in some respects, becoming more vulnerable to recessions in external demand: their debt burdens have increased while external capital may be available on less favorable terms, their reserves are lower, and their imports have declined in relation to GDP, and hence, may be harder to "compress." Clearly, the more vigorous the resumption of export growth and

the more successful the domestic diversification efforts, the stronger Latin America will be in withstanding the adverse impact of external recessions. This will be particularly important inasmuch as the major Latin American countries are now exporting a larger share of their manufactured goods to industrial markets than in the late 'sixties. The forces that have been drawing Latin America into the world economic system will continue to be strong. Export to the region have lagged behind exports to industrial countries; and the proportion of exports going to LAFTA has declined significantly, particularly for the most rapidly growing items.

The vulnerability to external fluctuations emphasizes the importance of improving the availability and terms of compensatory finance, both private and public, and international as well as regional. More adequate compensatory financing would put countries in a stronger position to develop export industries along the most economic lines. Furthermore, to assure strong and stable growth, exports should be directed to the most rapidly growing markets. This would include the regional market, because the Latin American economies are projected to grow at rates 40-50% or so above the OECD countries.

Given differences in location and transport costs, regional trade will necessarily continue to be distributed quite unevenly over various countries. And so will the measures taken to encourage it. Encouragement of exports within the region should cover both agricultural and industrial products. Agricultural exports would exploit the considerable differences in natural endowments existing even among neighboring countries. The emphasis on regional exports of industrial products would involve development of greater complimentarity of export production. This will require closer sub-regional cooperation in the location of production of intermediate goods, machinery and transport equipment, especially among the middle-sized countries. In this context, the coordination of investments in key industries within the Andean sub-region is particularly important. Assuming investment is carried out without excessive intra-regional protection, industrial coordination of this kind could, certainly over the longer term, make an important contribution to export development.

EXPORT GROWTH IN THE NEW WORLD ENVIRONMENT: THE CASE OF LATIN AMERICA

Comment by Raul Prebisch

I should like first of all to say how much I appreciate having been invited to participate in this meeting: both on account of the meeting itself, which has proved extraordinarily interesting, and because of the opportunity it affords me to comment on an excellent document, on the content of which I unhesitatingly congratulate Mr. de Vries. It is not often that we see economists from the centres discussing questions relating to Latin America and the periphery with Mr. de Vries' lucidity and skill.

I am going to concentrate on the three subjects he chose in the talk we have just heard: projections of the foreign trade of Latin America, trade between the Latin American countries and the external vulnerability of the countries of the region.

With regard to the projections, it is very interesting to note that in view of the limitations which the industrial centres will impose on exports from Latin America in the next few years - because of their inflationary situation, their scant likelihood of recovering high growth rates and the resurgence of protectionist policy by which they are adding to the traditional obstacles - Mr. de Vries projects a conservative annual growth rate of 8 to 10% for Latin American exports. This is a satisfactory figure -- a few years ago we should even have considered it illusory -- but it is not sufficient to ensure an annual growth rate of Latin America of more than 6 or 7%. If it is compared historically with other rates it could be considered high, but it is not so from the standpoint of the need to absorb an increasing labor force at rising levels of productivity.

I should like to digress here and recall some of the remarks which were made yesterday on what we have come to call the consumer society. The consumer society is incompatible with a socially meaningful dynamic economy; if we are not capable of demolishing it, to a greater or lesser extent according to countries and situations, we shall not be able to attain an annual growth rate of more than 6 or 7%. I do not wish to enter into a discussion of this intricate subject, however, and will merely draw attention to the significance of the figures presented in Mr. de Vries' paper.

Although he said that he had estimated the annual growth of exports at between 8 and 10%, he stresses the need to reduce the import coefficient from 11% of the product - in 1974 and 1975 - to 9% by the end of the decade. Mr. de Vries accepts with admirable composure the concept of import substitution, which until recently was eyed askance as hardly decent.

CEPAL has been the target of all kinds of criticism - which, albeit diminishing, still persists - with respect to what has inappropriately been called the import substitution model, although never has the existence of such a model been recognized by me. I will return to this subject later. For the

moment I should merely like to stress that it is interesting and very significant that the need to lower the import coefficient should be admitted in spite of the satisfactory export growth rate envisaged; this means a return to the vigorous promotion of import substitution policy, accompanied by the provision of incentives to the growth of exports.

One feature of this meeting has been that hardly anyone has seen any incompatibility between import substitution and the expansion of exports, the need for both having been asserted. It is worth recalling Mr. de Vries' very interesting remark that Brazil would not have been able to launch a thriving export trade in manufactures without previously having established a solid industry based on import substitution.

I think that the projections put forward by Mr. de Vries afford an objective indication of the factors which come into play, given the high elasticity of demand for imports in our countries. There are two basic ways of satisfying this import demand: either by inducing the centres also to increase their import coefficient through liberalization of their trade with the periphery, or by simultaneously combining import substitution with the promotion of exports in various ways. In so far as the first alternative is not achieved, the only other possible solution is the second, if a satisfactory rate of development is to be attained.

There is one objective fact which cannot be bypassed: the difference in elasticity between our demand for imports from the centres and the demand of the centres for our traditional exports. The combination of export incentives with import substitution is something which CEPAL has advocated for many years, and if I now say so again it is because our views in that respect have been conveniently forgotten in order to cast the supposed import substitution "model" in our teeth. Allow me to read one or two paragraphs from a report which CEPAL submitted to the governments in 1961, entitled Economic Development, Planning and International Co-operation. It contains a section on "The basic flows in industrialization" which includes the following statement: "The excessive channeling of industry towards the domestic market is a result of the development policy pursued in the Latin American countries and of the lack of international incentives to exports of industrial goods from the region". And it adds that "the development policies have been discriminatory as regards exports. Assistance has been given - through tariffs or other restrictions - to industrial production for internal consumption, but not to industrial production for export. The production of many industrial goods has thus been developed at a cost far above the international level, when they could have been obtained with a much smaller cost differential in exchange for exports of other industrial products which might have been produced more profitably".

I believe that this is a sound theory, but the possibility of applying it depends not only on the wisdom with which economic policy is pursued in our countries but also on the attitude of the centres, and it is apt to be forgotten that their policy has been and still is restrictive. As Anibal Pinto said to me a few days ago, the centres invite the peripheral countries to sit at the sumptuous table and to enjoy the pleasures of their prosperity, but when the

peripheral countries arrive, those issuing the invitation look at their guests' shoes or the material of their shirts and begin to establish restrictions, relegating them to another table where the food is less abundant and less tasty, and, what is more, imposing quotas on those who had naively believed that they could share in the advantages of the first more sumptuous table.

It is very understandable that the centres, in the situation they are facing, cannot enjoy the freedom of action that we should wish. I am the first to understand such problems, particularly where agriculture is concerned, and it is significant that I who come from an agricultural country should recognize that the centres justify their policy with some cogent arguments, although not all of them carry the same weight. What I cannot understand, however, is how there can still be people in our countries who think that the table is open to all, and that breaking down tariff barriers and advocating the free play of economic forces will suffice to resolve our fundamental growth problems. It is this theoretical anachronism that troubles me, this reversion to formulae that the world depression led us to reject so many years ago. These formulae are cropping up again and making for the commission of tremendous errors in our countries' economic policy. I therefore believe that it is very salutary to have at hand documents like Mr. de Vries' study which drive home the fact that the solution of our foreign trade problems does not depend on our policy alone, but also on the policy of the centres. This does not exempt us from efforts to implement a sound policy, but obliges us to take into account the obstacles imposed by the situation in which the centres are placed.

Mr. de Vries mentioned the transnational corporations, and accordingly the stumbling-blocks that have been encountered in this field should also be recalled. The transnational corporations were attracted by import subsitution policy. It must be remembered that, in general, they used to be reluctant to export, and still are in some sectors. Incentives, subsidies and other measures are changing this state of affairs, but I am not altogether encouraged by what has happened in recent years.

As can be seen in the country studies which have been presented at this seminar, and in an unpublished study by Cristobal Lara which is in the course of preparation. The proportion of traditional manufactures in exports to the centres is quite high. The transnationals have tended to export from one Latin American country to another, which is all very well, but to what extent can we rely on them to export to the centres? - not, at this stage, footwear and textiles, since the periphery is perfectly capable of exporting these, but the products which the transnational corporations can efficiently produce and export. How far can we expect vigorous export activity on the part of the transnationals in the articles that Mr. de Vries mentions, such as capital goods, non-electrical machinery, etc.? These are products of a higher level of technology: not of the most advanced, for which we are possibly not prepared, but of those intermediate technologies which Latin America is learning fairly fast. That is the unknown quantity I wonder about: what will the transnationals do towards enabling the projected export growth rates of 8 to 10% to be attained and, if possible, surpassed?

With regard to Latin American trade, it is very encouraging to note that, despite the defects of LAFTA and other groups, and perhaps irrespective of their policies, intra-regional exports of manufactures have considerably increased. I have seen the figures for Mexico, Brazil and Argentina, and what they have done in respect of exports to other Latin American countries is impressive, particularly in the case of Brazil.

Not everything is satisfactory, however, as although from the point of view of these three countries the success they have enjoyed is substantial, it must also be noted that they have not pursued a policy permitting the importing countries to pay for their purchases with goods. On the side of the latter there is an increasing deficit, so that in the relations between Latin American countries much the same pattern is being reproduced as has always existed with respect to the centres, especially the United States: a strong propensity to import, and a persistent deficit because exports have been insufficient to pay for these imports. This should arouse our concern, because it does not seem to me that consistently unbalanced development can provide us with solid bases for growth. In my opinion the countries exporting such manufactured goods are responsible for progressively resolving the importer countries' deficit problems.

I am increasingly convinced that in view of the prospects of the centres it is of essential importance that we should develop trade between Latin American countries. Its expansion would not take the place of extra-regional trade, but would represent additional trade flows and would make it possible to deal with certain problems on rational lines. For example, as Mr. de Vries has already said, an agreement could be reached on the development of certain basic industries in which various countries could share responsibility by products, so that the less developed countries and those which are at a disadvantage in any way would thus be given an opportunity to participate in these high-demand industries and in this abundant flow of trade. There is no doubt that the Andean Group would have avoided major obstacles if it had carried out this kind of industrial division of labor. It is to be hoped that the idea of such a policy can be taken up again, perhaps by seeking formulae for the integration of the Andean Group and the Central American Common Market under a general agreement on the LAFTA bases or others. For if the LAFTA agreement is found to be inadequate it can be amended by additional protocols or changed altogether. In short, while admittedly the pace of the integration process has been slow, especially in the case of LAFTA, there can be no denying that it has been a very positive instrument. It has not been as effective as we might have wished, but could be much more so.

The last point on which I wish to comment is the question of vulnerability. This has already been touched upon: Jose Pinera has made a very interesting reference, which if I remember rightly occurs in the report prepared by him and R. Ffrench-Davis, to the idea that the criterion of economic viability in export promotion policy should also take into account the cost represented for a country by fluctuations in exports.

I have been a government official in a country which has experienc such fluctuations, and at one time I too had to recommend emergency measures

to confront them. But I believe that Latin America has never been more externally vulnerable than it is today - and external vulnerability, from the economic and financial angles, also means considerable political vulnerability. It even implies vulnerability vis-a-vis the bankers, especially since the revolution which Carlos Massad describes in an article appearing in the second issue of the CEPAL Review. The countries no longer depend on the International Monetary Fund for their short-term financial operations, but on a group of private bankers.

We have never been over-enthusiastic about IMF in CEPAL, even though it has improved greatly in comparison with what it was 20 years ago, but I fear that with the way things are going in the world Enrique Iglesias will find himself compelled to praise the Fund. Nor shall I find fault with him - I might even join my voice to his - in view of the contrast between the lines followed by IMF and what these bankers are doing today. They are the product of circumstances, and of the current international monetary and financial chaos.

I mentioned my previous experience because I think our countries are now defenceless on both flanks - the economic side and the financial side. Unfortunately the safety net devised by Enrique Iglesias has not so far materialized. Moreover, the chief architect of the international program for the stabilization of commodity prices, Dr. Avramovic, is participating in this Seminar, and I do not think he looks particularly optimistic, unless I am misinterpreting his expression.

No progress has been made. The most disastrous aspect of all this is that every measure which the developing countries propose encounters a negative attitude on the part of the centres. I should like to see other options put forward, if the solution proposed for primary commodities and the suggested safety net are not considered appropriate. They are rational solutions, however, formulated by people who know the problems and are inspired by a sense of responsibility.

The worst of all is that our countries have lost a formidable instrument for lessening vulnerability; they used to have a reducible margin of imports, as imports of non-urgent or non-essential articles existed which in the event of external difficulties could be restricted. I acknowledge that I was myself the agent of ruthless control of many items, beginning in an evil hour with French wines and Scotch whisky. However, it was necessary to find a way out of serious situations, and a way was found.

All in all, utter heterodoxy; but it is better to have committed this type of deviation from the orthodoxy of those days than to perpetrate a violation of orthodoxy much more serious than the restriction of imports. I refer to the heterodoxy of resorting to short- and medium-term credit in order to finance imports destined for consumption and not for capital formation. A large part of the debt which Latin America has accumulated in recent years has served to pay for imports of consumer goods; this has gone against all the prudent norms which guided us of old when we resorted to foreign capital.

We no longer have the reducible margin I spoke of, and attention was drawn to this in the 1961 study quoted. We pointed out to the governments that we were taking a misguided course, inasmuch as we were extending substitution to all durable and non-durable consumer goods, creating industries and employment for the labor force in the production of these goods, and at same time neglecting the intermediate goods which would serve to produce them. Thus when such a situation supervenes as many countries are now faced with, there are no imports that can be reduced, because if any are restricted it will be at the expense of employment. Forgive me for saying 'at the expense of employment', such concern is perhaps unjustified, since the other day I read a leading article in a newspaper whose name I do not wish to recall, saying that unemployment is a problem of wages: if wages are allowed to fall to their natural level all the available labor will be absorbed. Yet another example of the invasion of theory to which we are being subjected in the Latin American countries, and which so grossly oversimplifies our situation.

I consider this concern for external vulnerability to be of fundamental importance. We are not going to be able to solve the problem immediately, but I believe that the lesson to be drawn from events today should prevent us from forgetting the economic cycle. CEPAL has forgotten it, and I blame myself here as a CEPAL man. Preoccupied by such questions as the rate of growth, and structural changes, we have lost sight of the cycle, and the countries have lost sight of it too. In the boom period prior to 1973, we believed that economic growth would continue without major interruptions, and it has not been so. The cycle is, in the final analysis, the growth pattern of the capitalist economy. In default of international measures, we should reflect seriously on the internal measures which we could take to cope with this phenomenon.

II. Papers on Exports of Developing Countries

EXPORT INCENTIVES AND EXPORT PERFORMANCE IN DEVELOPING COUNTRIES: A COMPARATIVE ANALYSIS 1/

by Bela Balassa

Export Incentives and Export Expansion

This paper provides a comparative evaluation of export incentives and their effects on exports and economic performance in eleven major developing countries that have already established an industrial base. The time period covered is 1960-73, with particular attention given to the experience of the 1966-73 period when the export incentive schemes of the individual countries were by-and-large in full operation. 1973 was chosen as the terminal year because of the effects of the oil crisis in subsequent years.

The countries under consideration are Argentina, Brazil, Chile, Colombia, Mexico, Israel, Yugoslavia, India, Korea, Singapore, and Taiwan. They have been classified in four groups, depending on the timing and the extent of their export promotion efforts. In 1973, these countries accounted for 68% of the exports of manufactured goods of the developing countries. 2/ Another 16% came from Hong Kong, which started exporting manufactures at an earlier date; no other developing country accounted for more than 3% of the total.

The countries of the first group comprising Korea, Singapore, and Taiwan, adopted export-oriented policies following the completion of the first stage of import substitution. These policies entailed applying a free-trade regime to non-traditional exports, with additional incentives provided to manufactured exports largely on an across-the-board basis, and considerable stability in incentives assured over time. Also, on the average, incentives accorded to import substitution in manufacturing and considerable stability in incentives was assured over time.

The early application of export-oriented policies by the countries of the first group may explain that they had the highest incremental export-output ratios in manufacturing during the period 1960-66. With the subsequent intensification of their export promotion efforts, all three countries further increased their incremental export-output ratios in the 1966-73 period and

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1/ The major part of this paper has been published under the above title in Weltwirtschaftliches Archiv, Band 114, Heft 1 (1978), pp. 24-60. One of the sections has been published under the title "Exports and Economic Growth: Further Evidence," in Journal of Development Economics 5 (1978), pp. 181-89. Both articles have been reprinted in the World Bank Reprint Series.

2/ The group of developing countries has been defined to include the countries of Latin America, Africa (except South Africa), Asia (except Japan) and Yugoslavia.

experienced the highest rates of growth of manufactured exports among the eleven countries under study. And although in Korea manufactured exports increased even more rapidly during the 1960-66 period, this had been attained starting from a base year figure of $5 million as compared to manufactured exports of $151 million in 1966. Correspondingly, the share of exports in manufacturing output tripled in Korea: from 13.9% in 1966 to 40.5% in 1973. In the same period, export-output ratios in manufacturing output rose from 20.1 to 42.6% in Singapore and from 19.2 to 49.9% percent in Taiwan.

In contradistinction to the first group, the second group of countries comprising Argentina, Brazil, Colombia, and Mexico, began export-promoting efforts after import substitution had been extended to capital-intensive intermediate products, durable consumer goods and machinery. They also differ from the first group in that, with few exceptions, the use of imported inputs was limited to cases when comparable domestic inputs were not available. Correspondingly, subsidies to value added in exports varied to a considerable extent from industry to industry and, on the whole, the bias against exports and in favor of import substitution was reduced but not eliminated.

Within this group of Latin American countries, in the 1966-73 period manufactured export growth rates were the highest in Argentina and in Brazil, which introduced considerable export incentives at the beginning of the period. Apart from the increased use of existing capacity, these incentives gave impetus to the establishment of new facilities for export production whereas in the preceding period exports mostly took up the slack in domestic production.

As a result, between 1966 and 1973, the share of exports in manufactured output rose from 0.9% to 3.6% in Argentina and from 1.3% to 4.4% in Brazil. Nevertheless, in terms of both average and incremental export-output ratios in manufacturing, Argentina and Brazil were surpassed by Colombia that started export promotion at an earlier date; exports from Colombia accounted for 3.0% of manufacturing output in 1966 and 7.5% in 1973.

In Mexico's case, proximity to the United States may explain the 2.9% share of exports in manufactured output in 1966. The subsequent introduction of an export incentive scheme led to an increase in this share to 4.4% in 1973. However, given the relatively low level of these incentives, the rate of growth of manufactured exports and the incremental export-output ratio in manufacturing were lower in Mexico than in the other three countries of the group during the 1966-73 period.

The countries of the third group, Israel and Yugoslavia, started their export promotion efforts at an early date, although they did not accord free trade status to manufactured exports. By 1966, in terms of the share of exports in manufactured output, the two countries surpassed the second group of countries while falling behind the first. But, with a slackening in their export promotion efforts after the mid-sixties, the share of exports in manufactured output increased only from 12.8% to 14.1% in Israel and from 13.8% to 16.9% in Yugoslavia during the period 1966-73.

Correspondingly, by 1973, Israel's manufactured exports ($495 million) were exceeded by Argentina, Brazil, and Singapore, while Yugoslavia ($2,031 million) was overtaken by Korea and Taiwan. Nevertheless, the average and the incremental shares of exports in manufactured output continued to be higher in the two countries than in the countries of the second group.

India and Chile, classified in the fourth group, continued the oriented policies during the period under consideration. As a result, while India traditionally exported textile products, it lost ground in these exports and was slow to develop new manufactured exports. Thus, its share in the manufactured exports of the eleven countries under consideration declined from 65.4% in 1953 to 50.7% in 1960, 31.2% in 1966, and 10.2% in 1973, while the share of exports in India's manufactured output fell from 9.7% in 1960 to 9.4% in 1966 and 8.6% in 1973. In turn, following earlier increases in the exports of woodpulp, paper, and fabricated copper products, manufactured exports remained at the 1966 level in 1973 in Chile. Correspondingly, Chile's share in the combined exports of manufactured goods of the eleven countries declined to 0.5% in 1973 as compared to 3.0% in 1953.

Export and Economic Growth

Exports provide advantages over import substitution inasmuch as they contribute to resource allocation according to comparative advantage, increased capacity utilization, the exploitation of economies of scale, and improvements in technology stimulated by competition in foreign markets. To the extent that exports provide a more rapid increase in output than import substitution, the indirect effect of export growth, too, will also be larger in countries where resources are not fully utilized.

Export orientation may also lead to savings in capital that, in turn, permit increasing output through greater employment in countries with unemployment or under-employment of labor. Also, increased foreign exchange earnings can contribute to the growth of the national economy by easing the foreign exchange bottleneck that has often been an obstacle to economic growth in the developing countries in limiting the importation of intermediate products and capital goods.

The impact of the increased availability of foreign exchange through higher exports is apparent in the continued rise of the share of imports in the gross national product in Korea, Singapore, Taiwan and Israel, 1/ and in the reversal of the decline in this share in Argentina, Brazil, Mexico, and Yugoslavia. By contrast, import shares declined to a considerable extent between 1966 and 1973 in both Chile and India. For the sample group as a whole, the Spearman rank correlation coefficient between incremental import-GNP rates and the growth of GNP was 0.91 in 1966-73.

1/ In the case of Korea where the relevant data are available, we find that the results are little affected if we adjust for the import conten of exports. Thus, while the share of imports in GNP increased from 18.7% in 1966 to 34.3% in 1973 in Korea, adjusting for the import needs of exports the relevant shares will be 16.0% in 1966 and 24.5% in 1973

The described influences are expected to lead to a positive relationship between export growth and the growth of GNP. The results for the countries under study tend to conform to these expectations. During the 1966-73 period, growth performance among the eleven developing countries was closely linked with export growth, except that the inflow of foreign private capital enabled Mexico to reach a higher rate of growth of GNP than expected on the basis of export figures. The relationship had been somewhat weaker during the 1960-66 period, when several of the countries concerned had started out with a low absolute export figure.

For the entire sample of countries, the Spearman rank correlation coefficient between the growth of exports and that of GNP was 0.82 for the 1960-66 period and 0.93 for the 1966-73 period. The estimated results are hardly affected if the rate of growth of exports is replaced by the incremental export-GNP ratio. For the eleven-country group, the Spearman rank correlation coefficient between incremental export-GNP ratios and the rate of growth of GNP was 0.71 in 1960-66 and 0.86 in 1966-73.

It would appear, then, that trade orientation has been an important factor contributing to the intercountry differences in the growth of GNP. At the same time, income increments have been achieved at a substantially lower cost in terms of investment in countries that have followed a consistent policy of export orientation. Thus, taking the 1960-73 period as a whole, incremental capital-output ratios were 1.76 in Singapore, 2.10 in Korea, and 2.44 in Taiwan. At the other extreme these ratios were 5.49 in Chile and 5.72 in India.

In the same period, incremental capital-output ratios were between 3 and 5 in the countries of the second and the third group, with improvements shown over time in line with their increased export orientation. While figures for subperiods are subject to considerable error, it appears that the greatest improvement was experienced in Brazil following its pronounced policy change. Brazil's incremental capital-output ratio declined from 3.84 in 1960-66 to 2.06 in 1966-73, when the low figure for the second period presumably also reflects increased capacity utilization at higher export levels.

Effectiveness of Export Incentives

Our results indicate that export orientation in the system of incentives had beneficial effects on economic growth in the countries concerned. For one thing, in an intercountry context, greater export orientation tends to be associated with higher export growth rates and better growth performance. For another, in the individual countries, the growth of exports and GNP generally accelerated following the introduction of export incentive schemes.

Also, we have provided evidence that export orientation has had beneficial effects on employment. These effects may in part explain that income distribution is much less unequal in countries such as Korea and Taiwan, which adopted an export oriented strategy at an early date, than in countries where import substitution policies continued beyond the first stage.

Export incentives include all measures that increase the profitability of exports by reducing costs or increasing revenue, such as export exchange rates, subsidies to export value, tax and duty concessions, foreign exchange retention schemes, and preferential credits. Automaticity in providing subsidies and government attitudes towards export promotion are further influences affecting exports. Finally, exporters may obtain benefits from direct government action in the form of government-sponsored market research and information services.

More generally, importance attaches to the general policy "climate" in which the incentive scheme is applied and the removal of distortions in factor markets. The liberalization of economic policies has provided a boost to exports whereas continued constraints on investments and import allocation have mitigated the effects of export incentives as in India.

While export incentives provide inducement for increasing exports in a market economy, the question has been raised what role government interventions in the form of planning or programming may have played in inducing firms to export. A few of the successful exporting countries did prepare medium-term plans. However, the influence of these plans on resource allocation and on the composition of exports appears to have been minimal. At any rate, the plans were prepared on an aggregate level so that there was no direct link to the exports of specific commodities.

And, although Korea used export targets in a disaggregated framework, the application of a free trade regime to all exports was in no way related to the fulfilment or the non-fulfilment of these targets. Furthermore, preferential export credits were provided according to predetermined rules while wastage allowances were set on a product-by-product rather than on a firm-by-firm basis. Thus, by-and-large, the fulfilment of export targets did not modify the firm's access to incentives, although it has been reported that successful exporters enjoyed advantageous treatment in e.g., pending tax cases. Note further that while the existence of export targets may have exerted pressure on some firms, most firms were exceeding their targets. A recent instance is the increase of Korean exports by two-thirds between the second quarter of 1975 and the second quarter of 1976 that exceeded expectations by a substantial margin.

In turn, there were no export targets in Hong Kong, Singapore and Taiwan that had an export performance comparable to that of Korea. And while in a few cases export obligations were imposed on firms in Latin America (e.g., automobiles in Mexico), programming or export targets hardly played a role in the expansion of exports in the countries of the second group. Thus, success in exporting and the acceleration of the rate of economic growth can in large part be ascribed to the incentives applied.

We come finally to the question of whether an import substitution phase is necessary for the subsequent expansion of exports and, if so, for how long and at what cost. The experience of Hong Kong indicates that exports may expand rapidly without a previous import substitution phase. Rather, with the increased sophistication of its industrial structure brought about by the

expansion of exports, "natural" import substitution has taken place in Hong Kong in several industries under free trade conditions.

Also, the import substitution phase in non-durable consumer goods and their inputs was of short duration in the first group of countries. It lasted barely six years in Singapore while it covered largely the period of postwar reconstruction in Korea and Taiwan. And, in all three countries, the bulk of their present exports, including plywood, wigs, synthetic textiles, electronics, and ships did not go through an import substitution phase. Finally, the expansion of exports cum import substitution is envisaged in machinery where reliance on import substitution alone would not permit exploiting economies of scale and would raise costs for user industries.

It has been suggested that, without the preceding import substitution phase, export expansion in Latin America would not have occurred at the rates observed. At the same time, as we have seen, the rapid expansion of exports took place from a small base, and the absolute value of manufactured exports and share of exports in manufactured output remained relatively low in the countries concerned. This, in turn, may be explained by the establishment of high cost firms and by the lack of sufficient vertical specialization in the production of parts, components, and accessories behind high protection. In particular, the lack of efficient industries producing inputs for export production was an obstacle to export expansion as the importation of substitutes was not generally permitted.

This is not to say that the manufacturing industries of developing countries would not need preferential treatment vis-a-vis primary activities. But the question is what is the desirable extent of such preferences and how exports and import substitution are to be treated. This, in turn, brings us to the consideration of "ideal" trade policies in the developing countries.

Ideal Trade Policies for Developing Countries

An "ideal" scheme of export incentives should aim at assuring that the expansion of exports, and resource allocation in general, conforms to the requirements of social profitability. It should further aim at minimizing the chances of retaliation on the part of the importing countries. Finally, the export promotion scheme should have an across-the-board character and should provide certainty and stability to exporters. These questions will be taken up in turn.

Social profitability considerations call for providing equal incentives to exports and to import substitution. For one thing, from the point-of-view of the national economy, a dollar earned in exporting is equivalent to a dollar saved through import substitution. For another, as noted above, equal incentives to production for domestic and export markets are necessary for exploiting economies of scale and for contributing to technical progress.

It has also been suggested that higher tariffs should be applied to protect infant industries. But infant industry protection should apply to

exports as well. In fact, it may be desirable to grant additional incentives to new export activities. For one thing, there are additional costs of entering foreign markets, including the cost of the collection of information and marketing; for another, the risk to individual exporters tends to be greater than to the national economy that has a diversified export structure. However, just like infant industry protection, additional incentives aimed at new exports should be given on a temporary basis until new markets have been established.

Setting tariffs and export subsidies at equal rates on all products would be equivalent to free trade. This would not be the appropriate policy in developing countries, however. For one thing, in the case of exports facing less than infinitely elastic foreign demand one should apply optimum tariffs that equate the marginal revenue derived from the exportation of the commodity in question to marginal costs. For another, the existence of externalities in the manufacturing sector warrants the preferential treatment of this sector in developing countries.

Manufacturing activities provide social benefits in the form of the "production" of skilled labor and technological change that are not fully captured in the entrepreneur's profit calculation. There is a difference in this regard between manufacturing and agricultural activities as the latter generally use less skilled labor, and technological change is promoted chiefly by agricultural stations rather than by individual producers. At the same time, preferential treatment should be commensurate with the external economies manufacturing activities generate, which do not justify the high protection often observed in developing countries.

Given our ignorance as regards interindustry differences in social benefits, it is suggested here that, infant industries apart, as a first approximation one should provide equal incentives to all manufacturing activities. This amounts to the application of the "market principle" that will ensure that efficient activities will expand at the expense of inefficient ones. Exceptions from this rule should be made only in cases when it is well established that an industry generates substantially greater (lesser) external economies than the average. In so doing, one should avoid the use of "tailor-made" tariffs benefiting a particular firm in response to pressures by special interest groups. In general, the burden of proof should be on those requesting special treatment.

At the same time, to the extent possible, exceptions should be made, and considerations other than economic efficiency introduced, in the form of direct measures rather than higher rates of protection. Thus, in industries which show exceptional promise for technological improvements, the direct application of research and development is preferable to additional protection that may lead to the establishment of high-cost firms. Also, measures taken to reduce the cost of labor will be a more appropriate way to encourage employment than the protection of labor-intensive industries that promotes the use of both labor and capital in these industries.

Concluding Remarks

The application of the proposed incentive scheme has been objected to on the grounds that the primary exports of developing countries encounter market limitations and their manufactured exports face high protection in the importing countries, in particular the developed nations. Experience shows that these objections have been exaggerated.

Apart from tropical beverages, the factors limiting the expansion of primary exports by the developing countries have been on the supply rather than on the demand side. In turn, notwithstanding the application of tariffs and other restrictions in the developed nations, manufactured exports from the developing countries have risen much more rapidly than it had been foreseen. Between 1960 and 1966, these exports increased at an average annual rate of 12%; they rose 25% a year between 1966 and 1973 as against an annual rate of increase of 17% for the manufactured exports of the developed nations.

The possibilities for the further expansion of manufactured exports from the developing countries are indicated by the fact that these countries account only for 7% of the imports of manufactured goods by the developed nations and for 1% of their domestic sales of manufactured goods. If the domestic market for manufactured goods in the developed nations were to increase at an average annual rate of 5% during a decade and the developing countries were to supply one-twentieth of this increment, they could increase their exports of manufactured goods to the developed nations from $16 billion in 1973 to over $61 billion (in 1973 prices) ten years later.

An increase of such magnitude would, however, necessitate a considerable degree of diversification in the manufactured exports of the developing countries. Such a diversification is under way in Korea, Singapore, and Taiwan with the upgrading of their existing exports and increased reliance on the exports of machinery and equipment. For other developing countries, such as Brazil, the exports of automobiles and steel may provide promise. Finally, developing countries may increase their participation in the international division of the production process by manufacturing parts, components and accessories of durable goods.

In a number of products, the developing countries could take over markets from countries which have recently become developed, such as Japan, whose comparative advantage is shifting to more advanced products. At the same time, the acceptability of manufactured imports from developing countries is greater if these replace imports from other developed countries rather than domestic production.

At the same time, the danger exists that in response to adverse changes during the world recession of 1974-75, developing countries may again turn to import substitution. Yet, the particularly severe recession reflected a confluence of circumstances - the quadrupling of oil prices together with after effects of the super-boom of 1972-73 - that cannot be expected to recur.

Aside from the resulting misallocation of resources, adopting an inward-looking policy would compromise chances for participation in the renewed growth of world trade. In fact, it apepars that the policies followed have affected the success of the individual countries in resuming export growth following the recession. Thus, the exports of manufactured goods increased by two-thirds between the second quarter of 1975 and that of 1976 in Korea, which maintained a policy of export orientation. In turn, increases were considerably smaller in Brazil, Colombia, and Mexico which have adopted measures entailing increased discrimination against exports.

Apart from exporting to the developed countries, Korea and Taiwan have been successful in the rapidly-growing markets of the oil-exporting countries, particularly in the Middle East, whose total imports rose from $20 billion in 1973 to $55 billion in 1975. With the continuing rapid expansion of imports of the oil-exporting countries, the oil-importing developing countries could derive considerable benefit from efforts aimed at these markets.

In turn, the prospects for trade among the oil-importing developing countries appear modest. Countries that have established an industrial base have similar product specialization while countries at lower levels of industrialization tend to protect the products of industries where the more advanced developing countries have export potential. At any rate, the combined manufactured imports of all the oil-importing developing countries have been less than the annual increment in the imports of manufactured goods by developed countries.

At the same time, the expansion of exports by developing countries to the developed nations would be greatly helped by reductions in existing barriers to trade, and the avoidance of the imposition of new barriers in the latter. The pursuit of such a policy is also of interest to the developed nations, in part because they benefit from the reallocation of resources according to comparative advantage and in part because more rapid growth resulting from the application of export-oriented policies in the developing countries increases demand for the products of their technologically-advanced industries.

EXPORT PROMOTION POLICIES IN DEVELOPING COUNTRIES

by Ricardo Ffrench-Davis
Jose Pinera

A suitable strategy for the promotion of nontraditional exports can help to overcome some of the most serious problems of developing economies, such as excessive fluctuations in export income, possible deterioration of the terms of trade, smallness of the domestic market with its consequent unfavorable effect on the efficiency of industrial activities, and chronic shortage of external resources.

In the middle of the last decade, some Latin American countries began to apply aggressive outward-looking development strategies involving policies aimed at stimulating nontraditional exports. In some of these strategies, a certain change in mentality was discernible in the sense that foreign markets were now considered as an important variable in the design of new investment projects. This explains, even though only partially, why industrial goods amounted to 18% of the total sales of the region to the rest of the world in 1974: three times their share in 1950.

After the initial impulse, doubts have arisen about the cost of such policies and the significance of the benefits obtained. Furthermore, experience has shown the developing countries that the international markets for certain products suffer from defects which make it difficult to secure a major increase in exports on conditions which are beneficial and profitable to the exporting country. These considerations indicate that the development of exports must not be based on the proliferation of every kind of incentive without taking into account the repercussions that this can have on the rest of the economy, nor should it consist solely of the mere manipulation of exchange policy.

A strategy designed to contribute to the integral development of the national economy calls for a more elaborate approach to export promotion policy. It is in this context that public policies in general and those aimed at promoting sales abroad in particular must be situated. They must be based on an examination of the role to be played by exports in the national economy, the objectives to which exports are to be subordinated, and the most effective tools and mechanisms for achieving this.

The results of export promotion for national development ultimately depend, however, on the instruments employed and the manner of their use. As in other areas of economic policy, there is a wide range of promotion instruments and mechanisms from which to choose. The choice of the mix used, and the intensity with which they are operated, will be determined by the objectives pursued, the nature of the external markets, the degree of freedom to have recourse to one or another of those instruments, and the impact they might have on the rest of the national economy. The paper describes and examines each instrument, relating it as far as possible to the specific problems that characterize the Latin American countries and to the forms most frequently adopted in the export policies of the region.

According to the agencies participating in their design and implementation, they can be divided into internal and external instruments. The former include exchange, import, fiscal and financial policies, all of which affect the conditions of production and consumption of exportable goods. The latter, which act on the external framework within which goods are exported, comprise marketing and other policies which, through bilateral or multilateral negotiation, seek to achieve easier access for national exports to foreign markets, including integration agreements among developing countries.

Domestic policy instruments can be used to compensate or overcompensate. The first seek to compensate for discrimination against the nontraditional exports of the developing countries which derives from an excessive emphasis on import substitution oriented exclusively toward the national context, and also from the distortions caused by unsuitable economic policies and the imbalances which affect the markets of these countries. The compensatory policies aim to treat these exports in such a way as to put them on a level with the other sectors of the economy; for this reason they are termed policies of equalizing-compensation in the paper. Policies of overcompensation aim to establish preferential treatment for nontraditional exports by giving them more favorable treatment than that granted to the other sectors of the economy.

This grouping of policies does not depend on the mechanisms used in each case, but on the degree to which they compensate for the initial discrimination against nontraditional exports. Therefore, one instrument used too intensively converts an equalizing-compensation policy into an overcompensation policy. Moreover, it is not enough merely to graduate the intensity with which a specific export is promoted. The manner of compensation is equally important. The same incentive to the gross value of production can be provided in different ways, which have different effects on the level and structure of the value added generated in the country.

It is essential that the promotion policy be harmonized with other areas of public policy, such as industrial and technological development, employment, and income distribution. To this end, appropriate import substitution and export promotion policies must be made compatible with each other. It is often suggested that there is a distinct cleavage between these policies. In actual fact, however, that is so only in certain circumstances.

The argument developed in the paper underscores the need to discriminate deliberately between different commodities, because in practice the divergences between social and market values due to the nature of the production processes are not uniform in all activities. Hence, the aim should be to provide for compensation related to such characteristics as the absorption of labor and the generation of external economies; compensation, therefore, rather than consisting of an overall incentive for all exports, should depend on the nature of the production processes involved, taking into account costs and benefits at social prices.

The general recommendation derived from the analysis is that the pattern of tariff protection should resemble that of the export incentives.

Trade policy should not discriminate in favor of a good, whatever the market to which it is destined, except on account of the heterogeneous nature of the imperfections of external markets, and the shortage of fiscal resources. Thus there is no need to make a specific choice between exporting and import substitution; the goal should be to achieve a level and an optimum structure of resources channeled to the industries producing for each of the markets.

At the international level, acceptance of the concept of equalizing-compensation policies would weaken the argument of some industrialized nations that the fact that the developing countries granting subsidies for their exports justifies the application of compensatory tariffs on these products in the markets of destination. Thus, the concept of dumping should be reconsidered, taking into account the discrimination which exists against non-traditional exports of the developing countries, so that policies entailing compensatory subsidies do not constitute "unfair competition," but merely represent a neutralization of the repercussions of other economic policies and of the export market distortions of the developing countries. The GATT rules and the new United States Trade Act contain clauses which provide for the imposition of compensatory duties on subsidized exports, including those from developing countries. It should be stressed once again that in these countries there is a much greater initial bias against exports than in the industrialized nations, so that a certain level of subsidy is justified if it is not possible to eliminate the sources of discrimination. One of the aims of the policy of negotiation is thus to bring about acceptance of the distinction between justified and unjustified subsidies in the appropriate world forums.

In a world of imperfect markets in which information on actual or potential opportunities for placing new exports is scarce and costly, the marketing policy adopted can have an appreciable effect on the volume, stability and price of export products.

"Marketing" policy should comprise much more than the organization of the sale of export products. In many cases it is essential that the governments of developing countries take decisive, systematic and continuing action to improve access to external markets. This may require negotiations with other governments, measures relating to transnational firms, and participation in integration programs and in joint actions with other developing countries. Owing to the marked heterogeneity which characterizes external markets, the strategy implemented in this connection should be selective in terms of products and of the geographical markets in which the negotiating and marketing action is concentrated.

It is well to close this summary with a warning. In the past there was a trend in favor of import substitution which, owing to the failure to consider the costs of the process, culminated in overprotection for some products at the expense of others, and in the inefficient use of foreign trade instruments and mechanisms. What must be pointed out now are the dangers of overpromotion of exports. Their optimum development must be pursued as an integral part of a national development strategy, rather than as a mere attempt to expand them. It is necessary, therefore, to define the objectives

sought and the structure, frequency, duration, and level of the indirect incentives and direct mechanisms that will be used. This involves an attempt to evaluate quantitatively or qualitatively, the costs and benefits of each policy option in terms of national development.

The criteria presented constitute a basis for objective consideration, as far as possible, of systems for the protection of domestic economy activity. They therefore represent an effort to provide a conceptual framework which takes into account the main characteristics of the developing countries. The strict and systematic application of rational criteria for protection and promotion is difficult. It requires training, the gathering of reliable and disaggregated statistical data, and the overcoming of strong vested interests. Nonetheless, the best can be the enemy of the good. Therefore, considering the difficulties that this entails, the aim should not be to design a completely new system, but rather to bring about changes in existing systems that are framed within the broad lines mentioned. It is most probable that this will lead to a system which, although imperfect, will prove preferable to the traditional alternatives which offer the extreme options of free trade and arbitrary protectionism.

III. Studies of Latin American Countries

EXPORTS OF MANUFACTURED GOODS: ARGENTINA 1/

by Angel Monti

In 1974 Argentina exported almost US$4 billion worth of goods, of which US$1.3 billion were exports of manufactures (manufactured and semi-manufactured goods, according to the UNCTAD classification). Sixty percent of these exports received fiscal incentives; 25%, financial incentives. One half of the manufactured exports were produced by the metalworking industry.

The complexity of the technology used has increased constantly, to the point where "turnkey" plants are being exported. During the period from 1969 to 1974 the 25 items with the greatest technological complexity in the export nomenclature increased from 10% to 20% of total exports in manufactures.

Between 1969 and 1973 exports of manufactures rose from 3.5% of gross domestic product to 7%. Nearly one half of exports -- chiefly non-agricultural products -- are destined to the LAFTA area. Manufactures of agricultural origin go primarily to the EEC countries. However, the actual situtiion may be somewhat different because there has been underinvoicing of exports and some leakage in quantitative terms.

In the Argentine experience with manufacturing exports, certain aspects tend to appear together, and to some extent in association. They are greater technological complexity, higher income elasticity of world demand, a larger nonagricultural industrial base, a higher export/production coefficient in the activity, a greater increase in the volume exported, a greater concentration by products and by firms, and the presence of foreign firms.

The export performance contributed to a balance-of-payments surplus from 1971 to 1974, with an annual increase of over 3% in gross domestic product. Thus, Argentina seems to have reached a point at which it generates more savings than it uses for investment, although there are problems in the concentration and channeling of those savings.

Per capita income, which exceeds US$2,000, evidences the capacity to combine resources; nonetheless, this capacity is underused. Greater use would permit higher levels of manufactured exports and obviously would require more efficient selectivity. Even when the aim is the greatest possible degree of selectivity there is always a necessary minimum which requires the management of economic policy by sectors.

The high inflation of recent years caused uncertainty regarding the price level and domestic costs expressed in international currency, which determine the actual supply of exports because exchange rate policy has fluctuated. The index of competition (rate of exchange/domestic prices) from 1930 to 1960 was about twice that of 1960 to 1975; from 1969 to 1975 it fell

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1/ The Spanish text of the complete paper by the author is available from the ECLA office in Santiago, Chile.

to one half of the latter figure. There were cases in which long-term exports were not transacted for this reason, and some commitments were canceled. Experience has constantly shown that the rate of exchange must be flexible, realistic and trustworthy.

The variability of the index of competition, together with the large profits realized in the domestic market, meant that the structural inducement to export was limited. Nonetheless, exporting activity made substantial progress. The continuing monetary restrictions, which significantly lowered the liquidity coefficient of the economy as a whole in terms of bank money, was a comparative disadvantage for medium and small-scale enterprises, chiefly domestic. Other factors explaining the underuse of the exporting capacity of the Argentina economy are the scant public expenditure for promotion and for information and marketing mechanisms, the variability of general economic policy itself, and the fact that substitution policy made no provision for exporting what was substituted. All of this had an adverse effect on export costs, equivalent in 1969 to 40% of the value added of real exports.

A great deal of technology has been amassed, although the policy followed has not been sufficiently selective. Technological advances have made it possible to export complex goods, but also have increased the cost of such exports, making them dependent to some extent on decisions of foreign firms (which in recent decades have been the leading holders of exportable technology), and in many cases have created limitations due to patent and trademark licensing contracts. In admitting foreign investment Argentina did not separate the inflow of savings from that of technology; consequently, the structure and possibilities of manufactured exports have been decided to a great extent beforehand, at the level of industrial policy on the production of exportable goods, and at the level of technological policy. Interestingly, 85% of the trademark licensing contracts, and 50% of the patent licensing contracts, prohibit exportation. The removal of these restrictions in itself is an accomplishment. Because the country did not devise a policy for the control of decision making, this accomplishment largely benefited foreign companies.

Taking 1974 as a base year and projecting the performance of certain aggregate variables through 1980, we find that an annual increase of 16% in the volume of manufactured exports -- equal to the historical rate -- would make it possible to maintain a growth rate of 6% of total gross domestic product and to ensure a positive balance on the current account of the balance of payments equivalent to 10% of the total outstanding foreign debt, with a substitution effect equal to zero and provided that the physical volume of exports of basic commodities increases by 3% a year. If the substitution effect is 40%, 1/ a 12% annual increase in manufactured exports would be sufficient, and would be an attainable goal.

1/ For this purpose the substitution effect is defined as the quotient between the substitution effect itself (with respect to 1974) and the increase in the demand for imports prior to substitution (holding the 1974 import coefficient constant).

Nevertheless, the substitution effect depends on the development pattern. Projections made for the Argentine case with a quantitative experimental model indicate that if the "consumerist" pattern is maintained, negative substitution will continue. This will be due, among other reasons, to the impossibility of financing total expenditures for the consumption of highly complex and processed goods, and the consequent increase in investment. In contrast, if there is a lessening of the technological complexity of products, and a greater demand for culture than for material goods, the substitution effect could reach maximum levels.

It can be seen, therefore, that there is a basic question. If the country continues to follow and expand its consumerist pattern it will be obliged to increase its exports to the maximum in order to offset negative substitution. In such a case manufactured exports would be an instrument for entry into a system which, to be sure, does not depend on Argentina. And if it cuts back its consumption pattern somewhat, it will have less need to export, but would likewise have to do so in the case of goods suitable to meet the demand at certain levels of technological complexity. Together with a basic decision regarding these patterns of production, consumption and trade, there is need for a strategy of manufactured exports by countries.

Considering exports by activities, the maximum impact is obtained from the capital goods industries, machinery, and electrical equipment in general. But the largest net foreign exchange earnings (exports less imported inputs), employment and value added are generated by the traditional industries. Argentina therefore needs an explicit policy that also takes into account the structure of control of decision making and technological advance. Up to the present there has been a tendency to seek higher export levels with a greater technological content and a greater diffusion effect (in relative terms, to be sure), but detrimental to the decision-making capacity. As a result, foreign exchange has been measured only in terms of value exported less value of inputs imported. The return would have been less if account had been taken of remittances of factors and the cost attributable to imported capital goods (it should be recalled that there has been a tendency toward negative substitution). It is therefore highly important that future policy be more explicit and the selectivity of its instruments greater.

A problem related to the foregoing is the level at which to optimize. Each agent optimizes at a different level: multinational firms at the world level, economic policy at the national level, etc. There is no evidence that the results of these exercises tend to be congruent.

It has been said that the factor endowment has changed considerably, owing to the incorporation in nontraditional manufacturing of technology that allows Argentine products to be exported under competitive conditions. The country faces no major limitations in terms of its natural resources, the technical capacity of its workers, or savings. The expansion of its export capacity depends largely on its ability to absorb technology that does not constrain exports, on the effectiveness of its information services (which are limited at present) and the effort it makes to set up adequate marketing systems aimed at protecting national interests. This action, the need for which is evident, should be taken within a reasonable period.

In foreign markets -- because most of the exports go to LAFTA -- the generalized system of preferences have not had a major effect. However, the impact of the worldwide recession has definitely been felt.

The instruments used were those of a promotion policy which basically served the exporter and gave primary consideration to his interests. The alternative is a policy under which the government represents and takes the general interest into account. Certain mechanisms have been institutionalized. In response to declining competitiveness, reimbursements were used, to some extent selectively but essentially as a means of correcting for the exchange rate. In view of the adverse effect of protection on costs, as well as the lower level of competitiveness, the average level of reimbursements does not constitute a subsidy. As for financing, Argentina has by and large limited itself to matching the conditions granted by competing countries for manufactured exports. Both sets of instruments have performed key functions of promotion, either as incentives or as simple basic conditions allowing exports to be transacted. There have also been tax reductions and exemptions.

The overall assessment of effectiveness -- defined as the relationship between the instrument and its results -- is generally positive but there is much room for improvement, especially in regard to information and marketing system, and the selective and coordinated use of the various instruments. At present these are applied by different agencies, although there are some links among them.

Efficiency, defined as the relationship between benefits and costs (direct and indirect of all kinds), may be assessed qualitatively with consideration of many more variables than those that can be measured. In terms of the balance of equivalent foreign exchange, with costs defined as fiscal and financial incentives, efficiency seems to be acceptable but also susceptible to improvement. Naturally, the measurement of efficiency has meaning only above a certain level of competitiveness. Greater efficiency depends on the factors that increase effectiveness and the other mentioned, such as attention to technological interests proper and to a certain structure of decision-making capacity.

DEVELOPMENT POLICY FOR EXPORTS OF MANUFACTURES IN BRAZIL

by Hector A. Garcia

The dynamic growth of Brazil's exports of manufactures during the decade from 1964 to 1974 coincided with the application of a foreign trade policy deliberately aimed at this result, and with a marked expansion of international trade.

Comparison of the development of exports with the pattern of foreign trade policy points up the fact that this policy was highly successful in achieving its objectives: the expansion and diversification of total exports, an increase in exports of manufactures, diversification of markets, and winning of new markets.

Although high rates of economic growth and export growth were maintained, incentives to the exportation of manufactures do not seem to have had an adverse effect on government revenue, and it is probable that indirectly they generated a net fiscal benefit. Moreover, the policy was aimed above all at correcting deficiencies in the application of economic development policy, and at compensating for inadequacies of the infrastructure and the institutional apparatus of the State, eliminating obstacles to the exportation of manufactures. In placing Brazilian industrial production on a footing of international competitiveness, fiscal and financial incentives were much less important than this elimination of obstacles. The promotional effort required to gain markets for manufactures in the developed countries would have been much greater if the latter did not tax manufactured imports -- especially those of the traditional industrial sector -- with much higher duties than those on raw materials.

The application of the promotion policy -- which was consistent with other sectoral policies and with development strategy and was subordinated to the objectives of the latter -- was general throughout the entire industrial sector. The increasing exports of manufactures therefore reflected a lack of selectivity, insofar as there was no sign of any specialization in exporting. At the same time, the domestic market continued to absorb an overwhelming proportion of industrial production, evidencing a large and dynamic capacity for expansion. The important role of the domestic market in economic growth and its prospects called for renewed efforts to update and refine the policy on manufactured exports in order to increase their contribution to the formation of a greater import capacity, essential for the maintenance of satisfactory rates of economic expansion. The increase in foreign trade was accompanied by a sustained economic expansion, so that the degree of openness of the economy remained practically unchanged, and exports of manufactures did not account for a major proportion of industrial production. Nonetheless, these have nearly doubled and their volume is not negligible for business, the level of economic activity, and the equilibrium of Brazil's external accounts.

The promotion of exports of manufactures took place in the context of a policy of accelerated development with external borrowing. The development of a greater import capacity, needed to relieve the external bottleneck of a semi-industrialized economy undergoing rapid development, was supported by dynamic exports and an intensive and increasing use of external resources in the form of direct investment and particularly of loans. These resources were attracted through the establishment of facilities for their use, which coincided with an abundance of private financial resources. The increasing external indebtedness also contributed to the formation of monetary reserves, essential for the maintenance of a growing volume of trade and financial relations with the rest of the world.

The resulting pattern of economic expansion means that Brazil's economic growth will continue to depend heavily on massive and increasing imports of strategic goods for its industrial sector. Given the high economic growth rate, it might have been expected that the Brazilian manufacturing sector would achieve a greater degree of integration, and that this would be reflected in the composition of imports, with a lessened external vulnerability. Nonetheless, ten years is a comparatively short period for making substantial changes in the foreign trade structure, which itself is based on significant changes in the structure of production - all the more so if it is kept in mind that incentives to capital formation do not seem to have operated efficiently to channel investment into the essential sectors. This is so much the case that despite the extraordinary dynamism of exports of manufactures, primary products continue to generate the bulk of current foreign exchange earnings, whereas massive imports of basic industrial inputs and capital goods attest to a continuing lag in the development of these productive sectors, as well as the reopening of the import substitution process, supposedly exhausted. To be sure, this is not a cyclical process in which economic policy periodically emphasizes import substitution or the promotion of manufactured exports in order to sustain satisfactory levels of economic growth with reasonably balanced external accounts. The composition of these external accounts shows that, in addition to the use of external resources and the substitution of imports of basic industrial inputs and capital goods, their balance depends on the dynamic expansion of exports of goods. Such dynamism can hardly be expected from primary products, which means that new demands are made on the industrial sector as the supplier of current foreign exchange earnings.

If the expansion of foreign trade had continued, the negligible share held by Brazilian manufactures, as well as their broad diversification, could have percluded major problems of access to the markets of the industrialized countries. However, market restrictions have proliferated recently with the decline in the growth rate in the industrialized countries, their anti-inflation policies, and the ensuing slowdown in international trade. These new external conditions are quite different from those that permitted the striking success of Brazilian manufactured exports, and are determining factors in the continuation of that successful performance. Note also that restrictions on access threaten, first of all, manufactures of the "traditional" industries, and that local private firms are affected to a greater extent than transnational firms, which are concentrated in the chemical and metalworking industries.

Thus, another stage of transition has begun in the development of economic policy aimed at transforming Brazil into an industrialized nation. The previous decade (1964-74) was marked by success in breaking the vicious circle of the import substitution process (supposedly exhausted) and by the opening up of industry to export activity. The new external and industrial development conditions in Brazil demand a closer link between investment and export policies, allowing a transition to be made toward a gradual modification of the policy instruments for the promotion of manufactured exports. Given the new requirements for the development of such exports, it is likely that direct action on the capital formation process will take on greater importance, so that the industrial sector may compete in the most dynamic flows of international trade. To be sure, spectacular changes are not to be expected, because the continuation of a positive response by the exporting sector requires stability of business expectations concerning the determination of export prices.

The study discusses the forms of development of exports and their relationship with production and the balance of payments. It describes the general lines of economic policy within which exports of manufactures have taken place, and presents and analyzes the export promotion policy. Further details on these aspects are given in eight annexes.

COLOMBIA'S EXPORT PROMOTION POLICY

by Ricardo Ffrench-Davis
Jose Pinera

In the past 25 years the Colombian economy has undergone substantial changes in the level and structure of exports. In 1952 coffee accounted for 83% of the country's total exports; in 1975 that product generated less than 50% of Colombian sales abroad. During this period coffee exports increased at an annual rate of 0.5%. However the physical volume of exports other than coffee and petroleum grew at an average annual rate of 15% from 1952 to 1975, which was three times the average growth of the Colombian economy during that 23-year period.

The paper presents the following principal conclusions:

First, the type of exports that should be promoted is determined by the objectives of the development strategy of each country and the problems of its economy. In Colombia the basic problem that gave importance to export promotion was the very heavy concentration of its exports in a single product -- coffee. This product has two disadvantageous features: first, its price is subject to sharp fluctuations in world markets, which has a destabilizing effect and entails high costs for the economy; second, the world demand for coffee has very low price and income elasticity. The consequent instability, as well as the nature of the coffee economy, make it impossible to offset the situation solely through financial policies aimed at maintaining international reserves and access to the short-term capital market. For this reason, diversification of products and markets has been the primary objective of export promotion policy in Colombia.

Exports have been divided into major and minor. The major exports are basically coffee and petroleum; the rest are "minor" exports, at which the promotion policy is initially aimed.

It is worthwhile to note, then, that Colombian policy has promoted not only exports of industrial goods but also agricultural products, and in general, raw materials other than coffee and petroleum. In essence, the policy assumed that the characteristics of many of these agricultural exports -- generation of employment and high domestic value added -- place them in the category of favored exports, together with those of industry, which generate external economies for the entire economy. In Colombia agricultural exports and those of other raw materials have experienced a high growth rate, even when their world demand has not increased at high rates. This is explained by the fact that Colombia, thanks to its comparative cost advantages, has been able to increase its share of the world market, so that the demand for its products has remained extremely buoyant.

The objective of increasing the contribution of the industrial sector to development also has been a feature of Colombian policy. Mechanisms have been devised -- such as the Vallejo plan -- to make use of idle installed capacity in industry and thereby to promote exports of manufactures.

Diversification has made it possible to dampen fluctuations in the country's foreign exchange earnings; the average annual variation in the unit value of minor exports in 1953-73 was clearly less than that of coffee. This is not surprising; no matter how variable the prices of new products -- such as those of certain raw materials -- their inclusion in the calculation necessarily reduces the variability of total exports.

The second conclusion is that the export sector has high elasticity. For a long time exports were viewed pessimistically, on the assumption that the supply of exportable products was quite inelastic and that therefore promotion would generate only quasi-rents for the export sector. The experience of Colombia contradicts this assumption. Actually, the change in relative prices in favor of the export sector, and direct action taken by the State, had a noteworthy impact on the growth rate of minor exports. Thus, in the 1960s, when the effective rate of exchange had its largest increase, there was a boom in Colombian exports; minor exports increased at an average annual rate of 18% during those ten years, in terms of constant dollars.

A third conclusion refers to the key role of foreign exchange policy in the promotion of exports. In 1967 a policy of programmed exchange rates was adopted, with frequent minidevaluations, reflecting changes in the relationship between domestic and external prices; that policy is the most important advance in this field. The Colombian experience shows that the main support of the system must be the level of the exchange rate, and that other fiscal, tariff and financial incentives will determine only the dispersion of the promotion effort. Since 1967 Colombia has had a fiscal incentive (the Tax Credit Certificate or CAT) which makes no distinction among minor exports. At its maximum, this incentive represented the equivalent of 8% of the government's total tax revenues; its fiscal cost is high, taking into account that exports could have been increased in any case through an upward adjustment of the real rate of exchange.

It also was found that exports are highly sensitive to fluctuations in the exchange rate, and that exchange rate instability affects the growth rate of minor exports. Hence the real rate of exchange should be stable, with the objective of medium-term equilibrium in the balance of payments, ignoring its short-term fluctuations, especially those caused by rises and falls in the price of coffee.

A fourth conclusion is that there is a link between protection of the import substitution sector and the promotion of exports. Without taking into account the incentives of the promotion policy, export products showed highly negative rates of effective protection, which prevented them from competing in world markets. Because of this and other distortions there is need for compensation policies aimed at eliminating discrimination against the export sector and placing it on an equal footing with the other sectors of the economy.

A fifth conclusion refers to the form of compensation and the need to make the import substitution policy compatible with the export promotion policy. Discrimination caused by protection can be offset through a subsidy

which returns to the private exporter that part of the cost of inputs -- whether imported or produced locally -- which exceeds the international price; if this is not done, and if instead there is a relaxation of duties on the importation of inputs for export purposes, an inconsistency arises between the substitution and promotion policies. Thus, the Vallejo plan, which provided for the refund of duties paid when an exporter imported inputs for the production of exportable goods, favors exports, but particularly those which use more imported inputs; if the currency is overvalued it virtually subsidizes the importation of these inputs in detriment to domestic production. It would be more advisable for the decision of the exporter to purchase the input in the domestic market or to import it to be in conformity with the general policy on import subsitution, and that in both cases he be refunded, through a direct fiscal incentive, the higher cost that he has incurred.

A sixth conclusion refers to the selectiveness of the policy. Because degrees of discrimination against certain exportable products are not uniform in practice -- given the differences between private and social prices -- the compensation policy must be selective. Selectivity should not consist in the a priori selection of products to be exported; it is impossible for the authorities to visualize the range of products that can be exported, because this task is best performed by the market. A distinction also should be made between a selective policy that provides more incentives for inefficient activities, not only at market prices, but at social prices as well -- which leads to an erroneous allocation of resources and an artificial competitiveness based on subsidies -- and a selectivity based on real differences in social and market prices between sectors and products. Incentives should be provided preferably for those activities that generate the most domestic value added, employment, technology, and other external effects, to the extent that market values do not entirely reflect their social benefits.

Likewise, the external marketing policy must necessarily entail some selectivity. In Colombia, PROEXPO has performed the task of promoting Colombian products abroad. Because it is impossible to compile information and to negotiate on the entire range of products, there is need for a prior selection of information showing external economies and economies of scale. It is therefore recommended that a state agency take direct action to complement (but not replace) the efforts of exporters to gain access to foreign markets. The promotion agencies should help to finance the initial costs of market penetration and to create an export mentality within the country.

In the Colombian case, selectivity has sometimes been mistaken. For instance, the financial policy with negative real interest rates favored those activities which made more intensive use of working capital; the fiscal incentive (CAT) related to the value of exports did not give preference to value added, and the Vallejo plan and the free zones discriminated in favor of exports making intensive use of imported inputs.

A seventh conclusion refers to the growing importance of policies on marketing, access and negotiation. Success in exporting creates frictions that must be alleviated through negotiation. Nonetheless, the existence of certain markets to which access is imperfect does not mean foregoing exports,

but rather adapting policy instruments to overcome the barriers. In the Colombian case there have not been many products with problems of access to the markets of developed countries. The most important cases have been textiles, flowers and meat. Although the restrictions have coincided with the worst recession in the industrialized world since the crisis of the 1930s, there should be no curtailment of efforts to forestall possible problems in this field. The fact that exporters see the possibility of uncertain access, even though this may be due to only a few measures but with a great psychological impact, may be as damaging to the future of investment and export projects as the instability itself. For this reason, the State should negotiate clear, stable and nondiscriminatory rules of the game for international trade, and should demand that the developed countries make these rules consistent with their statements in favor of freer trade and international specialization based on comparative advantage. Also in this connection, we have stressed that there should be a reconsideration of what is meant by an export subsidy in order to adapt it to the actual conditions of the developing countries, where, within certain margin, such incentives merely compensate for other discriminatory measures, and therefore do not constitute an unfair trade practice.

THE EXPORT OF MANUFACTURES IN MEXICO AND ITS PROMOTION POLICY

Statement by Daniel Bitran

Comments on Recent Policy

One month after the completion of the study under review (August 1976) the Mexican government enacted a series of key measures -- significant among which was the floating of the peso, which has meant an actual devaluation of 100% -- modifying, at least initially, basic aspects of the export promotion policy.

This policy was characterized by maintenance of the rate of exchange for more than 20 years, and by the application of a set of instruments and actions, noteworthy among which were tax and tariff reimbursements, credit subsidies, the liberal granting of import permits for inputs and capital goods, and technical assistance to exporters in trade matters. The incidence of these incentives increased over time, to the extent that the overvaluation of the peso increasingly affected the foreign competitive position of Mexican manufacturing production.

However, beginning in 1970, when mounting domestic inflationary pressures caused the rate of exchange of the Mexican peso to differ more sharply from its real parity with the dollar, the increase in exports of manufactures rose further from its already high rate (from an annual rate of 20% between 1965 and 1970 to 24% between 1970 and 1974). There was a slowdown in 1975 due to the effects of the recession in the United States. In my opinion this performance is indicative of a policy that made it possible to more than offset the exchange rate disadvantage, through increasing liberality in the granting of incentives, but also thanks to a redoubling of promotion efforts through the Mexican Foreign Trade Institute (IMCE) established in 1970.

Nonetheless, it appears that the striking magnitude of the current account deficit of the balance of payments (over US$3.7 billion in 1975, exceeding the value of commodity exports by one fifth) led the government to take action in August 1976, without even waiting for the change of government which was to take place in December of that year.

The mounting deficit on the current account balance, despite the steady increase in foreign sales, is explained by the following factors: (a) the increasing propensity of the Mexican economy to import, linked to the pattern of industrial development of recent years, which is unquestionably the most important factor; (b) an import substitution policy that gave liberal treatment to the importation of inputs, machinery and equipment in order to meet the needs of ever more complex fields of industry and to correct the major deficiencies in the supply of certain basic inputs to the industrial sector and to overcome a relative backwardness in the development of the capital goods sector; and (c) an export promotion policy that also provided broad facilities for the incorporation of components and capital goods from abroad.

Moreover, the growing importance of payments to external factors, which was coupled in the first six months of this year with a heightened capital flight that reached very high figures (because investors believed that devaluation was imminent), had the same type of effect. Finally, the measurable contraction in the inflow of tourists also affected the current account balance. Tourism represents a net inflow of US$500 million for Mexico (almost 20% of the value of exports). Its performance was adversely affected by the relative rise -- in dollar terms -- in prices of accommodations and other expenditures of foreign visitors in Mexico, as well as by non-economic factors related to the position on Zionism taken by the government in international forms.

The floating of the peso was explained to the Mexican people as a measure aimed basically at restoring the competitiveness of exports. Nevertheless, in the first six months of the year manufactured exports had recovered their growth after the contraction of 1975, and it had been possible to stabilize inputs, so that the Mexican trade deficit was reduced by US$1 billion. Judging by the results of an exhibition of Mexican products in San Antonio, Texas immediately after the devaluation, and according to statements made by IMCE officials, at the new exchange rate Mexico could sell almost anything in the United States market.

In the short term, however, the purpose of the measure was frustrated by the effects of the following factors:

- A stepup in inflation due to the rise of over 60% in the price of imports which -- depiste the reduction in tariffs decreed for raw materials and capital goods -- led to a general upward adjustment of 23% in salaries and wages;

- Immediate abolition of all CEDIs (tax rebate certificates), the use of which had represented an estimated reduction of 11 to 15% of the cost of exports; and

- Application of a new tax on exports (rate 8%) with a surtax intended to offset the foreign exchange gain.

A simple arithmetic calculation shows that as a result of these factors the inducement to export represented by the rise in the exchange rate of the peso from 12.50 to 20 per US dollar (60%) was cancelled out almost immediately. The awareness of this fact, as well as the open pressure from business sectors, must have had a determining influence on the new level of about 26 pesos per dollar at which the exchange rate was situated during the last week of october, once the authorities again decided to float the peso.

Together with the new level for the peso, the government announced the cancellation of the tax on exports, recently established, and the restoration of the CEDIs, but on a discretionary basis depending on the cost and competitiveness of each exportable product. The latter measures brought something of a return to the previous situation, although the exchange rate is now more realistic; thus, it should clearly encourage exports and tourism.

Maintenance of the desired external competitiveness will depend greatly on success in controlling domestic inflationary pressures, which have been aggravated by the effects of the successive devaluations.

Performance of Exports of Manufactures within the Economy

The growth rate of exports of manufactures (excluding the activity of in-bond industries) has been highly dynamic, reaching 20 to 25% per year in the last decade. In 1975 it declined by 30%, and in 1976 (before the devaluation) a recovery of 22% was expected.

In 1974 manufactures accounted for 51% of exports of goods. The proportion was 12% in 1960 and 21% in 1965 (27% if the classification of manufactures used by UNCTAD is applied). The absolute amounts were US$1,400 million and US$720 million, respectively. Because industry expanded at an annual rate of 8% between 1960 and 1975, the share represented by exports of manufactures in industrial gross domestic product rose from 3.9% in 1960 to 4.5% in 1970 and 10.0% in 1974. 1/ Their structure was as follows: intermediate industries 47%, metalworking industries 31% and traditional industries 22% in 1974 (in 1965 the share held by traditional industries was 18%, but that of intermediate industries was 74% and that of metalworking industries 7%). This structure is much more "advanced" than that of industrial gross domestic product, inasmuch as the metalworking industries represented 20% in 1975.

The significant gain made by metalworking exports -- an annual rate of 38% in 1965 -- is explained by several factors: (a) industrial development itself, which rapidly incorporated this branch into the industrial plant over the past decade; (b) the economic integration process; (c) the forging of links with other countries through transnational firms; and (d) the greater dynamism of metalworking manufactures in the international market. Furthermore, Mexico began metalworking production late in comparison with Argentina and Brazil, and this took place during a new and decisive phase of export policy. Possibly for these reasons, the metalworking industry showed efficiency levels close to those of the buyer industrialized countries. It should be noted further that these items have a low level of protection in comparison with the levels in Argentina and Brazil.

There has been a growing diversification of markets of destination of exports of manufactures from Mexico, but the United States continued to be the principal market in 1965-74, absorbing 47% of exports of manufactures. Europe increased its share from 13 to 19%; that of Latin America declined from 26 to 19%, owing to the relative decrease in sales to the CACM, as LAFTA remained at 15%.

The principal markets for the Mexican metalworking industry in 1974 were the United States, with 53%; LAFTA, with 23% -- more than half represented by the Andean Group -- and the EEC, with 9%. Of the purchases made by LAFTA from Mexico, 71% are metalworking products.

1/ The proportion falls to 6.5% if the base used is value added rather than gross value of exports.

Among sales to the United States metalworking products are particularly important (50%) -- owing to a certain degree of interindustrial integration between the two countries and the action of the transnational firms -- as are textiles. In any case, the U.S. provided the largest and most diversified demand for Mexican exports. It is a natural market for Mexico because of its proximity, size and complementation through the transnational firms. For example, of 87 items with sales exceeding US$400,000 to any country in 1974, the United States purchased 73. Sales to LAFTA also are quite diversified. Among them, naturally, traditional products are much less important. In sales to Europe, products of the intermediate and traditional industries are most important, with very little participation by metalworking products, except in transactions with the Federal Republic of Germany (Automotriz Volkswagen). The Mexican products sold to the largest number of countries are textiles, hormones, glass, and automobile products, in that order.

The Export of Manufactures and Import Substitution

Over the past ten years industrialization has been influenced by an export promotion policy which provides broad facilities, low tariffs for the entry of inputs and liberal treatment in the importation of capital goods, and by a substitution process embracing items of greater complexity with a higher imported component, under an industrial policy that does not give due attention to the technological linkages of production processes. This "model" has resulted in increasing import requirements, which far exceed both the growth of exports and the requirements of substitution in its earlier stages. Despite the rapid growth of exports, the negative balance in the trade of manufactures swelled from US$90 million to US$3,800 million between 1960 and 1974. As a result, imports of manufactures -- which accounted for 41% of industrial gross domestic product in 1960 and had decreased to 27% in 1970, again rose to 34% in 1974.

This situation also was heavily influenced by bottlenecks in the basic infrastructure (transportation), in strategic inputs (steel and petrochemicals) and in some raw materials (fertilizers, chemical fibers, metal products, electrolytic copper, aluminum). Another determining factor has been the backwardness in the production of capital goods: in 1974 imports of machinery and equipment had a value three times greater than the Mexican production of those goods. Moreover, the development of the metalworking sector requires a much larger proportion of machinery and equipment than the traditional sector. To the extent that metalworking has shown the greatest growth over the past decade (although it continues to lag), its impact on the volume of imports has been great.

Metalworking exports of Mexico increased in value from US$84 million in 1970 to US$305 million in 1974, but imports rose from US$1,300 million to US$2,400 million, which explains the 70% deficit in the balance of trade.

Thirty-four percent of exports of manufactures (US$350 million) were made by transnational firms in 1973. However, imports by those companies generated a deficit of US$600 million (one third of the national deficit), because they produce mainly for the domestic market. The export coefficient

of these firms with respect to their total production was less than 3% in 1970, i.e., not much different from the average for domestic firms (2.5%).

Mexico's Trade with LAFTA

Mexican trade with LAFTA -- including trade in manufactures -- has expanded more rapidly than its trade with the rest of the world. In 1974 the LAFTA market accounted for 15% of Mexican sales of such products. The dynamic performance is attributable almost entirely to trade with Brazil. Especially important are the interindustry linkages with Argentina and Brazil (one third of the sales to those countries are spare parts for machinery, radios, television sets and automobiles). Eighty percent of Mexico's exports to Argentina and Brazil are products in which economies of scale are important; besides the categories already mentioned, chemical and metal products are also noteworthy.

The concessions and complementation agreements cover the great majority of the products that have increased the flow of trade between Mexico and LAFTA over the last ten years. The exports that have increased most are those of industries in which the transnational firms predominate (chemical and pharmaceutical products, machinery and equipment, electrical equipment and transport equipment). Overall, exports of manufactures rose from 40% of the total in 1965 to 55% in 1974. In these categories the share of the transnational firms ranges from 50% to 70% of total production.

Main Features of the Mexican Experience

Because the study under review makes detailed reference to the instruments of Mexican policy on exports of manufactures, I shall limit myself here to mentioning some of the features that distinguish the Mexican experience from that discussed at this meeting in relation to other Latin American countries.

One of these features is the continued attention to the objective of substitution in industrial policy, which can be seen in analysis of the incentives granted by various government departments for industrial development aimed at import substitution. More recently, with the growing awareness of the relative stagnation in the production of capital goods, Nacional Financiera S.A. has been carrying on an ambitious program for the development of a set of projects whose technical and economic feasibility has been demonstrated.

A second feature concerns the proximity of Mexico to the principal world market for manufactures. The existence of a common border of over 3,000 km generates a vast spectrum of business, technological, tourist and subcontracting relations, which have a pronounced impact on the type of export development directed toward the second "natural market" of Mexican industry. Basically because of the activities of United States firms established in Mexico, whether or not associated with local interest, we even find that the range of Mexican exports to that country is more "advanced" than what might be expected from the actual level of economic and industrial development reached by the country.

A final distinctive feature that I would like to mention is the existence of an important in-bond sector in Mexico, whose production is destined for the United States market and whose value added is now quite close to the value added by all exports of manufactures to which I have already referred. Because of the special impact of this activity on the matter with which we are concerned here, I shall now discuss it specifically.

In-Bond Industries

This activity is based on the temporary importation of inputs and components which, once incorporated in the final product, are re-exported almost entirely to the United States market. The contribution of this sector is assessed in terms of value added, the concept being broadened to include domestic inputs.

In 1964 the United States bracero program was abolished, leaving 200,000 Mexicans unemployed. This, together with the continuing migration from rural areas to border cities (Tijuana, Mexicali, Nuevo Laredo, Ciudad Juarez), led the government, in 1965, to draw up a program for industrialization of the northern border region. In 1972, the program was extended to the entire country. Its operation also is based on certain provisions of the United States tariff code, under which American firms can re-import, tax-free, certain articles assembled in their plants abroad.

This program has clear advantages for United States firms: political stability, geographical proximity and considerable savings in transportation costs. These factors offset the relatively higher level of wages in Mexico with respect to other developing countries that provide facilities for this activity. In any case, there is a great difference in wages between Mexico and the United States: 4 to 5 dollars in the former, against 25 dollars in the latter in 1975. The difference is extremely important, in that the cost of labor represents 50 to 90% of all inputs used in this type of activity. The establishment of in-bond industries in Mexico caused a significant increase in the profits of United States firms. In the case of integrated electrical circuits it even led to a perceptible reduction in the world price of the product.

Despite the standstill of 1975, the dollar value added of in-bond industries increased by an average of 42% a year from 1970 to 1975, reaching US$450 million.

The relationship between the value added of in-bond industries and total exports of goods by Mexico increased from 6% to 16% between 1970 and 1975; with respect to exports of manufactures, it rose from 32% to 39%. (It is likely that this proportion would increase to 100% if exports of manufactures were also considered in terms of their value added.)

The number of in-bond plants rose from 120 to 455 between 1970 and 1975; the number of jobs generated increased from 20,000 to 80,000. It is believed that the productivity of the Mexican worker is higher than that of the U.S. worker in similar occupations.

The value added by branches is as follows: electrical and electronic equipment, 65%; footwear and clothing, 15%. The rest comprises a variety of other products.

The value added in the exportation of in-bond electrical and electronic firms (US$218 million) is five times greater than the value of exports of this type of product made by non-in-bond firms.

The decade of operation of the in-bond industries coincided with a definite spurt in domestic manufacturing industry. This key fact, coupled with the lack of diffusion of the effects of this activity and its unstable contribution to employment, is causing the Mexican authorities to consider the adoption of new policy measures to reorder its functioning. One of the basic objectives of the new approach is gradually to substitute the present in-bond activity with industries that incorporate a larger share of domestic inputs, now possible thanks to the progress of domestic industry.

THE EXPORT OF MANUFACTURES IN MEXICO AND ITS PROMOTION POLICY 1/

Comment by Bela Balassa

The study under review provides a useful description of recent changes in the system of export incentives and in the structure of manufactured exports in Mexico. However, it lacks analytical content; it does not provide estimates on the value of export incentives, nor does it investigate their effects on export performance. Also, the recommendations made in the paper are open to question. These questions will be taken up in turn.

Export Incentives

Mexico encountered increasing difficulties in continued import substitution in the confines of the domestic market during the sixties. These difficulties led the Mexican authorities to introduce a far-reaching export incentive scheme in March, 1971. 2/

In order to examine the possible effects of this scheme on Mexico's manufactured exports, one needs first to provide numerical estimates on the magnitude of the incentives granted. Such estimates have been made by the present writer in an advisory report to the Mexican Government. 3/ This report is referred to in the CEPAL study (p. 113) without, however, citing its numerical results.

Prior to 1971, manufactured exports received few incentives in Mexico, amounting to less than 2% of export value. In turn, the tax rebates provided under the CEDI scheme introduced in March, 1971 came to 8.5 percent of the value of manufactured exports. Additional incentives expressed in relation to export value, include the subsidy equivalent of preferential export credit (1.5%) and the duty-free importation of some inputs (2.0%), bringing the total to 12%. 4/

1/ CEPAL/MEX/76/10/Rev.1.

2/ Cf. Bela Balassa, "La politica comercial de Mexico: analisis y proposiciones," Comercio Exterior, November 1970, pp. 922-30. Reprinted in Wionczek, Miguel (ed)., La sociedad mexicana: presente y futuro, Mexico, Editorial ERA, July 1971; in its second edition published in 1974, pp. 33-55; and in La economia mexicana I. analisis por sectores e distribution (Leopoldo Solis, ed.) Mexico, Fondo de Cultura Economica, 1973 pp. 416-38.

3/ Bela Balassa, "Foreign Trade and Industrial Policy in Mexico," prepared under the auspices of UNIDO, March 1974.

4/ Balassa, Foreign Trade and Industrial Policy in Mexico, op. cit., pp. 4-5.

As to the effects of export incentives on Mexico's export performance, the CEPAL study notes that "according to the calculations made in the above-mentioned UNIDO study, the virtual subsidies (CEDIS) in force from 1971 are estimated to have a considerable impact". 1/ At the same time, it is claimed that "the decisive influence of these incentives does not, however, appear wholly convincing if consideration is given to another statement contained in the same study to the effect that the bias against exports compared with sales on the domestic market continues to be substantial." 2/

This statement is misleading because with unchanged import protection, the export incentives provided in Mexico in effect reduced the bias against exports. Thus, this question needs to be answered: what impact did the increased incentives have on export performance? Following the advisory report cited earlier, these effects may be evaluated in a variety of ways.

Incentives and Export Peformance 3/

As a first alternative, the Gerardo Bueno's estimate of the elasticity of export supply in Mexico may be used. 4/ Relating this elasticity, estimated at 3, to the 10% increase in export incentives as a proportion of export value, the introduction of the export incentive scheme in March, 1971 would seem to account for nearly one-third of Mexican exports of manufactured goods.

Alternatively, we may assume that the trend in manufactured exports observed between 1965 and 1970 (i.e., average annual increases of 11.5%) would have remained unchanged in the absence of the introduction of the export incentive scheme. We then find that actual exports of $500 million in 1972 and $740 million in 1973 (excluding processed food) exceed the predicted trend-values of $380 million and $440 million, respectively, by a considerable margin. The difference between the actual and the predicted figures remains substantial even if we adjust for the rapid price increases occurring in 1973.

The impact of the incentives scheme introduced in March 1971 is also shown by increases in Mexico's share in the world exports of manufactured

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1/ CEPAL, La exportacion de manufacturas en Mexico y la politica de promocion (CEPAL/MEX/76/10), p. 161.

2/ Ibid.

3/ The following discussion and data are limited to "domestic" manufactured exports and exclude the so-called maquila exports from border areas that will be considered subsequently. Manufactured exports have been defined to include SITC classes 5 to 8 less unwrought non-ferrous metals.

4/ Gerardo Bueno. "Mexico," in Bela Balassa and Associates, The Structure of Protection in Developing Countries, Baltimore, Md., Johns Hopkins University Press, 1971, p. 158.

goods, excluding intra-EEC trade. This share was between 0.20 and 0.21% in the 1965-70 period; it reached 0.23% in 1971, 0.25% in 1972, and 0.28% in 1973. Mexico's larger share in the world market thus represents an increase in manufactured exports by approximately two-fifths as compared to the situation in the absence of the introduction of the incentive scheme. 1/ This trend continued in 1974 when Mexico's exports of manufactured goods rose by 50%, exceeding by a considerable margin increases of world trade in manufactures.

Thus, available evidence indicates that the export incentive scheme contributed to the expansion of Mexico's exports of manufactured goods to a considerable extent. In the advisory report it was noted, however, that the deterioration of Mexico's competitive position, consequent on the rate of inflation in Mexico exceeding that in its main trading partners, and especially the United States, is bound to have adverse repercussions for its exports. 2/ Since 1973, Mexico's competitive position has deteriorated to a considerable extent, with wholesale prices rising by 63% between the first quarters of 1973 and 1976 as compared to 41% in the United States. This may explain why in 1975 Mexican manufactured exports declined while world trade in manufactured goods continued to increase, albeit at a reduced rate, and the manufactured exports of the developing countries rose by 23%.

Policy Recommendations

As suggested in the advisory report, 3/ in order to remedy the deterioration of Mexico's competitive position it would be necessary to increase export subsidies on an across-the-board basis or devalue the peso. By contrast, the CEPAL study calls for greater selectivity of incentives and for the programming of manufactured exports as "part of overall industrial planning" 4/ to bolster exports. These recommendations are open to serious objections.

To begin with the question of industrial planning, experience indicates that countries which have not planned have had a much better economic performance than those that have relied on planning methods. Countries that have planned include Taiwan, Korea, Israel, as well as Brazil; India has not planned. Whereas the first group of countries reached rapid rates of economic growth relying largely on private initiative, in India investment, production, and import controls applied in the process of planning, have constrained not only the growth of the private sector but also the growth of the entire national economy.

1/ Balassa, Foreign Trade and Industry Policy in Mexico, op. cit., pp. 5-6.

2/ Ibid., p. 8.

3/ Ibid.

4/ CEPAL, op. cit., pp. 148-150.

Planning and programming are particularly inappropriate in regard to manufactured exports. For one thing, private firms are better able to discover export opportunities than the government bureaucracy; for another, the responsibility for exports cannot be divided because firms have to take the risks involved in exporting and reap the rewards.

Instead of planning, improved export performance would require reducing the bias against exports in the system of incentives in Mexico. At the same time, rather than greater selectivity, one should aim at providing across-the-board incentives to exports. This amounts to the application of the "market principle" that ensures efficient export expansion in response to the incentives provided.

By contrast, efforts aimed "at greater selectivity, taking into account the different conditions which may obtain in competitive prices, domestic demand, available supply, etc.," 1/ are bound to have adverse consequences. For one thing, they would burden the government apparatus beyond its capabilities and lead to falsifications and bribery by the interested parties; for another, selectivity encourages high-cost, and discourages low-cost, exports by providing greater incentives to the former than to the latter. At the same time, high profits by low-cost exporters should not give cause for concern because they lead to greater expansion by channeling resources into industries in which Mexico has a competitive advantage.

Maquila Exports

We have examined so far Mexico's "domestic" manufactured exports, excluding maquila exports which involve the re-export of imported materials in processed form, mainly to the United States. The ECLA study devotes a chapter to these exports; their relative importance in Mexican exports and future potential, however, would also need to be considered.

Following the granting of free trade status to maquila exports in the late sixties, these exports were rising at a rapid rate. They came to account for 73% of domestic manufactured exports in 1970 and surpassed these exports by 1974. Also, preliminary figures indicate that maquila exports remained practically unchanged between 1974 and 1975; domestic manufactured exports declined by 14%.

At the same time, the value-added content of maquila export (i.e., net foreign exchange earnings) increased steadily from 37% in 1970 to 44% in 1972 and to 46% in 1975. Taking account of the use of exportable materials and inefficiencies in processing activities, the share of net foreign exchange earnings in domestic exports might not have been much higher, if at all.

The value-added content of maquila exports could be increased further by backward integration, i.e., by expanding the domestic production of parts

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1/ CEPAL/MEX/76/10/Rev. 1, p. 180.

and components. In this connection, preferential tariff treatment would continue to apply under Items 806.30 and 807.00 of the U.S. tariff schedule as long as some components originate in the United States.

To further integrate maquila industries in the domestic economy and to increase the volume of their exports, it would further be desirable to establish export-oriented industrial complexes in Mexico. 1/ Apart from increasing exports, the creation of these complexes could also contribute to increased industrial efficiency and decentralization. 2/

Conclusion

It has been shown that the introduction of the export incentive scheme in early 1971 contributed to the rapid expansion of the exports of manufactured goods by domestic firms in Mexico. Subsequently, however, with prices rising more rapidly than in its trading partners, Mexico's competitive position has deteriorated, leading to a decline in its manufactured exports in 1975 as against increases elsewhere.

Corrective measures have been taken with devaluations of September and October 1976 that would however need to be accompanied by appropriate monetary and fiscal measures. At the same time, one should avoid attempts at programming the export sector, and manufacturing industries in general, as well as introducing selectivity in the system of export incentives, which are likely to have adverse effects.

Maquila exports that have been given free trade treatment have rapidly expanded. To accelerate the trend toward higher domestic content, the increased production of parts and components entering these exports would be desirable. Exports would further be encouraged, and efficient industrialization in a decentralized framework furthered, through the establishment of export-oriented industrial complexes.

1/ Such a proposal was first made in Manual Uribe, "Estrategia de Infraestructura para el desarrollo del sector externo," Pensiamento Politico, December 1973, pp. 473-86.

2/ Balassa, Foreign Trade and Industrial Policy in Mexico, op. cit., pp. 14-15.

IV. Studies of Non-Latin American Countries

KOREA'S EXPERIENCE WITH EXPORT-LED INDUSTRIAL DEVELOPMENT 1/

by Larry E. Westphal

Economic activity in South Korea was dominated until approximately 1955 by adjustments first to the partition and then to the dislocations caused by the Korean War. In 1955, manufacturing accounted for only 8% of GNP; nearly half of GNP originated in the primary sectors. Because of the disruption and aftermath of the Korean War, exports were but 1.4% of GNP; manufactured exports were virtually nil.

Korea's industrial strategy during the last half of the 1950s was predominantly one of import substitution. Protection was afforded by a complicated system of multiple exchange rates, complemented by widespread quantitative restrictions on imports as well as tariffs. The discrimination against exports was not, however, as great as might appear, for export earnings were convertible in a free market and commanded a sizeable premium; there were also direct cash subsidies to exporters. Partly in response to these incentives, but also as a return to the situation prevailing before the Korean War, exports grew at an average annual rate of 16% between 1955 and 1960. In real terms, exports in 1960 were roughly 16% greater than 1950, just prior to the Korean War.

Fueled by import substitution for non-durable consumer goods, the growth of industrial output was quite rapid (12% per annum) during the latter half of the 1950s. However, as opportunities for "easy" import substitution diminished rapidly in the early sixties, industrial growth began to falter. At the same time, political and social instability resulted in several changes of government. Starting in 1961, with the temporary establishment of a unified exchange rate, a number of attempts were made at policy reform and economic liberalization. These culminated in 1964/65, during which a number of reforms were successfully implemented. Among these were fiscal and monetary reforms which aimed at increasing both public and private savings, through respectively expanding direct tax revenues and raising the real interest rate in commercial banks to roughly 10%. As a result, domestic savings increased from less than 8% of GNP in 1965 to an average of more than 17% in the period 1970 to 1975.

Policy makers came firmly to accept that rapid economic development depended upon an export-oriented industrialization strategy. This view was predicated on the relatively small size of the domestic market, which meant that extending import substitution further into new lines would involve increasing inefficiency if carried out immediately, and on Korea's very poor natural resource base. A major associated policy change was the lasting establishment of a uniform exchange rate in 1964. The gradual adoption of a

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1/ The full text is given in World Bank Staff Working Paper No. 249 (February, 1977).

complete set of explicit export incentives had started earlier, in 1959. By 1966 exporters operated under a virtual free trade regime, receiving indirect tax and tariff exemptions, free access to imported inputs, reduced charges on overhead inputs, and interest rate and direct tax preferences. Estimates for 1968, for example, indicate that value added on the given volume of exports was about the same as under a free trade regime, with interest rate and direct tax preferences approximately compensating for the modest overvaluation (roughly 9%) of the domestic currency. In turn, the overall effect of incentive policies was to favor exporting over production for sale on the domestic market to a slight degree.

To offset inflation at higher rates than experienced in Korea's export markets, frequent devaluations and changes in export incentive rates between devaluations have been required to maintain the real effective exchange rate for exports at a relatively constant level since 1961. Furthermore, the rate for exports has been kept nearly equal to that for imports, while quantitative import restrictions have been gradually relaxed. In turn, a variety of evidence indicates that export and import effective exchange rates were very close to the optimal, growth maximizing free trade exchange rate. Also important has been the relative uniformity of export incentives in their total impact on value added across industries; this has led to the expansion of exports more or less in line with Korea's comparative advantage and has avoided undue stimulus to inefficient exports. At the same time, protection on the domestic market has been quite low by international standards, and has offered few opportunities for profitable investment in inefficient import substituting activities.

The export incentive policies adopted in the first half of the 1960s undoubtedly resulted in some increase in the overall inducement to export; however, their main thrust was to replace a complicated, largely ad hoc system based on multiple exchange rates and direct cash subsidies and requiring frequent adjustments with a simplified and more stable system. In fact, exports had increased rapidly between 1960 and 1965, at an annual compound rate of 24%. The export policy reforms are therefore most properly credited with having laid the foundations for continued rapid growth once a larger base had been established. In response, export growth accelerated for several years and has continued to be very rapid in spite of a continually expanding base. Thus, in constant prices, the annual compound growth rate of exports between 1965 and 1975 was 31%.

Manufactured exports, which accounted for only 14% of commodity exports in 1960, rose by 1975 to 82% of the total. In addition, manufactured exports have become increasingly more diversified, so that in 1975 Korea was a major exporter of electrical machinery and applicances, transport equipment, various manufactures of metal and nometallic minerals, and footwear, in addition to textiles, clothing, and plywood, which had led the initial growth of exports. In turn, the concentration of exports by destination has become less: in 1975, Japan and the U.S. were the market for 56% of Korea's exports, while Japan alone had received 63% of the total in 1960. There is little evidence to suggest that Korea's special relationship with Japan and the U.S. has been responsible for this phenomenal performance. In particular, direct

foreign investment has played a very small part in Korea's industrial growth: thus, direct foreign investment accounted for less than 5% of the capital stock in the manufacturing sector in 1970.

Largely because of the growth of manufactured exports, Korea has experienced atypically rapid industrialization. Since 1960, manufaturing output has grown at an annual rate of 19%, while manufacturing value added has increased at 17% per annum. With real GNP rising at 9% annually, the share of manufacturing in GNP has risen from 11% in 1960 to 32% in 1975. Real per capita income over this period increased at 6.6% per annum, so that in 1975 Korea's population of over 34 million enjoyed a per capita income in excess of $400.

The growth of manufactured exports over the past 15 years has contributed to Korea's industrial development in various ways. Including the backward linkage to domestically produced intermediate inputs, export expansion has been responsible for more than one quarter of the growth of manufactured output and for an even more sizable fraction of the growth in manufacturing employment. In turn, the manufacturing sector has directly accounted for nearly 40% of GNP growth and 38% of employment growth. But these figures understate the contribution of export growth, for they do not reflect the multiplier effect due to increased consumption and investment out of the additional income earned or the increase in economic efficiency that results when the resource cost of exports is less than the value of the foreign exchange earned.

All of the available evidence points to increased factor utilization and allocative efficiency as a reuslt of export growth. One indicator, albeit crude, is the fall in the open unemployment rate from 8.3% in 1962 to its current level of 4.1%. Another is the increase in the aggregate capacity utilization rate within manufacturing, which by one set of estimates increased by more than 7% per annum between 1962 and 1971. In turn, to the degree that Korea's comparative advantage may be said to lie in labor-intensive as opposed to capital-intensive activities, several studies demonstrate that Korea's industrial growth has exploited its comparative advantage: over the 1960's, for which the evidence has been most carefully analyzed, manufactured exports were more labor-intensive than manufactured imports, and they became increasingly more labor-intensive over time even as shifts in the composition of output caused manufacturing production for the domestic market to become somewhat more capital intensive. Overall, the labor-capital ratio in the manufacturing sector actually increased between 1960 and 1973; at the same time, total factor productivity about doubled.

In the Korean case, resource allocation along the lines of comparative advantage has meant not only that labor-intensive exports pay for capital-intensive imports but also, due to a very poor natural resources endowment, that there be an increase in the share of trade in total economic activity. As a result, import substitution has contributed very little in the aggregate to the growth of manufacturing, though it has been very important in particular sectors at different times. Among the sectors in which import substitution, often fostered by government promotion, has played an

important role since 1960 are cement, fertilizer, chemicals, metals, and, more recently, machinery. Korea's industrial structure can thus not be characterized as overly concentrated in the light manufacturing sectors; the heavy industrial sectors are relatively large and expanding rapidly. The important point is that selective import substitution has permitted the concentration of scarce investment resources in one or few sectors at a time and thereby enabled greater exploitation of scale economies and of linkages among closely related activities.

To summarize: Korea's overall development performance since the policy reforms in 1964/65 has indeed been striking. The role of monetary (especially interest rate) and fiscal policy in increasing public and private savings has been a key factor. But also, exports have proven to be a powerful engine of growth and, due to their labor intensity, they have contributed greatly to the rapid expansion of productive employment, which in turn has doubtless been a major factor in maintaining a relatively even distribution of income. The most important lessons from Korea's experience appear to be that exports respond to incentives while efficiency in resource allocation can be assured by operating close to a free trade regime.

The changes in export incentive policies during the first half of the 1960s provided assurance of stable profits on exports and were the concomitant of the government's decision to adopt a strategy of export expansion. At the same time, the government began to provide assistance in marketing and established annual export targets broken down in considerable detail by commodity, market, and domestic exporter. However, it would be naive to conclude from the latter that targets independently set by the government determine actual export levels via a command-type system, for the targets were set jointly by the government and the exporting enterprises and were often exceeded. Rather the targets complemented incentives to exporters, without which rapid export growth would not have been possible. Perhaps the most important function filled by the export targeting system and its trappings was to publicize the importance attached by the government to exports: export incentives were well advertised and access to them was immediate. But there remains some question whether exports would have grown as rapidly without the additional impetus provided by the targeting system.

In other ways, policy reforms affecting prices, though quite certainly a necessary condition, should not be interpreted simply as the sufficient condition leading to Korea's remarkable performance, particularly as regards to the level of the growth rate or the relatively even distribution of the fruits of growth. Korea has been the recipient of relatively large foreign capital inflows over the past 20 years, and only in the past five to ten years could these be considered as a synergistic response to its performance. In turn, events predating 1955 led to a relatively egalitarian distribution of assets and a social and political structure lacking an aristocratic or oligarchic class. Equally, atypically large, mostly privately financed expenditures on education have not only permitted the formation of a highly skilled labor force but have also made it possible for the mass of the labor force to participate in jobs of increasing productivity. Nonetheless, though the evidence is presumptive, and not conclusive, there is little doubt that government policies affecting prices have contributed greatly to Korea's development performance, and in particular to the rapid growth of its exports.

KOREA'S EXPERIENCE WITH EXPORT-LED INDUSTRIAL DEVELOPMENT

Comment by Frederick E. Berger

The Korean case, as analyzed in Larry Westphal's paper, gives comfort neither to the orthodox partisans of free trade nor to the pessimists concerned with elasticity.

First of all, the Korean economy seems to be strongly influenced by state intervention in the form of protection for import substitution, abundant subsidies, and preferences for export activity. Professor Westphal believes that this microeconomic action of the state has been highly effective in facilitating export growth, and that the net impact of all the incentives has been to foster a comparatively efficient pattern of resource allocation, judged in the cold light of world prices.

At the same time, and considering only the facts, there seems to be no justification for pessimism about the elasticity of the domestic supply of Korean products, nor about the external demand for those products. In the period from 1960 to 1975, total exports grew at a more or less sustained rate of about 40% per year. 1/ The highest rates of sustained growth in Latin America have been about 25% in Brazil, 15% or 16% in Colombia, and 12% to 15% in Mexico.

To be sure, it might be better to make the comparison between specific categories such as manufactured products, inasmuch as Latin American exporters -- unlike their Korean counterparts -- generally started from comparatively high levels of export of raw materials, which distorts the comparison of the totals. In any case, and although there might be some pessimism in the Latin American context, this would be difficult to justify in the Korean case, all the more if it is kept in mind that Korea has a weak natural resource base.

This discussion will move from these initial impressions to an attempt to draw some conclusions from Westphal's study for a trade policy in Latin America. In doing so, it is well to evaluate the importance of the Korean experience for Latin America, but it is also useful, for our purposes, to situate the analysis in the framework of the argument between the advocates of free trade and the pessimists who are concerned with elasticity, which puts us at some distance from institutional, cultural or casuistic considerations. Some comments on Westphal's approach and its possible weakpoints will follow.

According to Westphal, Korea's success cannot be ascribed to any special relationship with Japan or with the United States, contrary to an erroneous opinion frequently heard. He argues that even in the Japanese and United States markets Korea received no preferences that were not granted

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1/ In nominal terms.

to other developing countries as well, except during the Vietnam war between 1967 and 1973, when allied military purchases accounted for only 3.4% of Korea's total exports.

In the second place, it certainly does not appear that exports have been developed in an enclave with few links to the rest of the economy. On the contrary, Westphal presents evidence that exports have been diversified broadly, as regards both their composition by-products and their penetration into various markets; that they have had a major and a favorable impact on income distribution and employment; and that they have brought about more rapid and broader industrialization than usually occurs in countries at a similar stage of overall development.

Third, transnational firms and direct foreign investment have played a very secondary role in the export boom in Korea. There has apparently not even been special access to foreign markets through the transnational firms, as in some Latin American countries.

Professor Westphal points out that the Korean case may not be relevant to Latin America, inasmuch as Korea has a very strong government which is willing to carry out frequent devaluations, to control the labor unions, and to maintain competitive domestic wage levels, high rates of public saving and stable incentives, and which, moreover, is able to put all these measures into effect. One might ask to what extent this description diminishes the relevance of the Korean case, considered in the general contemporary framework of Latin America.

Westphal also seems to believe that the large inflow of foreign capital in Korea may be one of the "special factors which probably does not apply in other countries." This seems puzzling. In the first place, official bilateral assistance for development during the 1950's and the early 1960's--which probably had a significant concessional element--could not have been very different from what existed in the Latin American case. What unquestionably is not typical is the continuing inflow of foreign capital investment during the period from 1960 to 1975. This does not seem to be a specific feature of the Korean case, but rather a basic consequence of the dynamic and sustained export effort. Indeed, Korea seems to confirm the theory that an effective mobilization of domestic resources, within the financial framework of the modern world, depends to a decisive extent on the growth and diversification of exports. In any case, it seems that he would not agree that the inflow of capital following the early 1960's in Korea was an exogenous feature or one found only in the Korean case, and that the same thing would be unlikely to occur in other countries.

In this connection, we need consider only the external financial experience of Mexico, which several years ago was the first Latin American country after 1930 to publicly place long-term bonds in international capital markets; and that of Brazil, which has mobilized unprecedented volumes of external financial resources for about the last ten years. In both cases the inflow of capital has been clearly linked to a good export performance. In a related financial aspect of trade expansion, it would be interesting to apply

some of Mr. Westphal's observations to the strengthening of domestic capital markets that occurred in Korea from 1960 to 1975.

It is undoubtedly true that the experience of each country has some features that would be difficult to duplicate elsewhere; Korea is no exception. Westphal points out that Korea began its industrialization with several favorable "initial conditions." The Japanese colonial occupation had destroyed the landowning aristocracy; the United States occupation government had begun a major agrarian reform; the upheavals caused by two wars and the consequent end of foreign domination made it possible to free efforts for a return to "normality." Furthermore, the country has achieved one of the highest literacy rates in the world, with a massive formation of human capital.

In summary, there seems to be no strong a priori justification for arguing that the Korean case is so special that it is not relevant to Latin America. The initial conditions may have freed Korea of the burden of an unequal distribution of wealth and income, which may or may not have favored policies aimed at redistributing wealth and equalizing the possibilities of earning income elsewhere. The main advantage of the abundant human capital in Korea--to the extent that it explains the success of trade and industrialization efforts--confirms a well-known fact: investment in human resources in Latin America has a high social return. Moreover, for purposes of the comparison, Korea's advantage in human capital should be measured in terms of the exceptionally low natural resource base of that country vis-a-vis most of the Latin American countries.

Implications for Latin American Trade Policy

Let us consider more fully the implications of the Korean case for the problems of Latin American trade and development policy. I believe that the crux of the Korean example is that the active interventionist attitude of the State has been aimed at applying moderate incentives which are very close to the relative prices of products and factors that would prevail in a situation of free trade. Using Professor Michaely's terminology, it is as though the government were "simulating" a free market.

In fundamental opposition to the "simulation" approach adopted by Korea and Israel, government intervention in Latin America has tended to bring about a wide divergence from free market relative prices. The history of the trade policy of some Latin American nations is one of conflicting reformist efforts, going from the extreme of total liberalization to waves of severe repression of the external sector. This frustrating experience has tended to polarize professional and public opinion about the effectiveness and efficiency of state intervention as opposed to something that is very close to laissez-faire. According to one group, history demonstrates the ineffectiveness of markets and general policy instruments; the other holds that governments are essentially irrational in their intervention in markets. Study of the Korean case may be productive for both groups, in that it suggests that there is not necessarily a clear dichotomy between the two extremes.

In the Korean case, Professor Westphal concludes that "exports respond to incentives, and efficiency may be ensured by operating very close to a free trade system." The key to achieving this seems to lie in having very low levels of protection and subsidies. Westphal observes that during the pilot year of 1968 the set of all incentives gave an effective export subsidy rate of 12%. The average nominal tariff rate on all products was 49%, but only 13% if the tariff is deflated. The effective rate of protection for total production of manufactures was approximately zero (-0.9%, to be exact), and all of this meant a subsidy for primary producers, especially farmers.

This should be compared with the typical Latin American case, in which tariffs are high and variable, exports and the primary sectors receive negative protection, and the effective rate of protection for manufactures may reach 200 or 300% or even more.

The structure of Korean policy gives the results predicted by conventional trade theory. Exports are intensive in resources that are abundant in the economy; this brings about a rapid increase in employment, and with it a comparatively equal distribution of income. Moreover, the steady growth and diversification of exports give the economy a decisive flexibility (or elasticity) and greater debt service capacity, so that external savings can be mobilized and used efficiently. There is no evidence whatever of bottlenecks in the external sector or of inelasticity of foreign demand. Unfortunately, Westphal does not present data on the evolution of the terms of trade or on the balance of payments. Reading between the lines, however, one can see that the blance-of-payments trend must have been highly favorable, considering both the phenomenal growth of exports and the inflow of foreign capital.

Let us look again at the contrasting case of some typical experiences in Latin America. Relative prices differ widely from world prices, and generally favor capital-intensive processes rather than labor-intensive ones. The result is "structural" unemployment, in which the problem lies in the structure of policy and not in the structure of behavior, whether of markets or technology. The inefficient use of factors leads to a lack of competitiveness in foreign markets and to the need for even greater protection of sales in the narrow domestic markets. It also leads to a chronic underuse of installed capacity because of the high rates of protection of capital in domestic markets, which do not permit economies of scale. And in the midst of all this, the transnational firms must be given favorable conditions in order to compensate them for the internal distortions. There is also the entire range of macroeconomic and balance-of-payments problems found in trade systems that depart considerably from world prices. Exports decline and there develops a dependence on a few primary exports whose comparative advantages are sufficient to overcome all the policy disadvantages. But these exports suffer from price instability, and for long periods also from the deterioration in the terms of trade. As dependency on imports grows, exports remain unstable and stagnated.

The result is a further structural problem, of instability in the balance of payments and a growing external resource gap. Nonetheless, the root of this problem lies, once again, in the structure of policies, and not in the basic structure of national economies nor of the world economy.

The syndrome of bottlenecks in the external sector leads to debt service problems -- put another way, to a lack of solvency in world financial markets. This experience seems also to corroborate the pessimism regarding elasticity, particularly as concerns the effectiveness of general policy instruments as opposed to direct administrative controls and higher import tariffs. However, it should not be surprising that, having allocated resources improperly for a period of several years, the country cannot suddenly hope to achieve trade efficiency and a highly elastic response to unified rates of exchange, a general fiscal policy and the nondiscriminatory control of money and credit.

In the transition to a reformed external sector it is possible to attempt to compensate for all existing distortions, whether they be true external effects or market deficiencies, or rather--which is equally probable--effects of policies. What seems evident, however, in light of the Korean experience, is that the less the distortion caused by policies of effective protection and administrative controls, the less costly and more efficient will be a policy of compensation. The high rates of protection and the extended use of direct controls are so far removed from relative prices in world trade that compensation proves to be technically difficult, and financially very costly. Moreover, as Balassa and Sharpston suggest, the more indirect the distortions that must be compensated for, the greater the probability of reprisals by the trading partners.

Planning and Prices in Latin American Export Promotion: Arguments Favoring a System of Optimum Intervention

In conclusion, it appears that an effective long-term strategy for export promotion in Latin America may depend on a prior reduction and rationalization of import tariffs and direct controls. Nonetheless, the Korean experience underscores the fact that under these circumstances the State can play a useful and efficient role in the development and strengthening of exports during the initial phases of opening and reforming the external sector.

As Latin America leaves the "easy phase" of export promotion based on compensation for distortions of product prices, Korea can offer some other long-term lessons on the basic distortions of factor and market prices.

We have heard, at this conference and elsewhere, a long list of complaints about the high costs and inefficiency of some of the new Latin American export development schemes. Some have even suggested that these efforts may be as socially expensive as the unchecked import substitution of past years.

David Morawetz laments that export development sometimes fails completely in its attempt to bring about investment in more labor-intensive undertakings, so that we end by having export enclaves that have no effect on the unemployed or underemployed masses. Danny Sydlowsky deplores the fact that installed capacity is drastically underused. In analyzing the Brazilian

experience, we hear complaints about the growing complexity of incentive schemes, the lack of consistency and the problems of managing the system. Indeed, it has been said that the Brazilian Government itself wishes to restructure and rationalize the incentives. Furthermore, the Brazilians, Colombians and others are facing the problem of excessive costs and reprisals by foreign countries.

To some extent, these are the understandable consequences of protecting sales rather than factors of production. Finally, all of the traditional arguments in favor of protection can be reduced to supposed imperfections in the factor market. Thus, the "dynamic comparative advantage," as an argument in favor of protection, is in reality another way of saying that the capital market has failed, and that the need to protect sales of labor-intensive products is an indirect and technically complex way of granting subsidies for the use of labor.

The arguments against optimum intervention when domestic distortions are present normally refer to the lack of political feasibility and to the high fiscal costs of direct subsidies to factors. Nonetheless, as governments face the many problems of microeconomic intervention in product markets, they may become more favorable to a more direct attack on the basic causes of trade failure; i.e., the distortion of factor prices and sometimes the repression--caused by policies--of factor markets.

If governments are strong enough to generate public savings, to control the real wage level and to adjust foreign exchange rates continually, are they not strong enough to implement neutral fiscal policies, reforms of labor and of the capital market and direct subsidies to factors if necessary? This would not only be optimum in the theoretical sense, but would also have a number of practical advantages. For instance, there might be some saving if the microeconomic presence of the state were reduced, and the danger of reprisals by trading partners could be avoided.

Perhaps the most effective means of promoting exports in Latin America would be a reform of social security, replacing a tax on the use of labor with a tax on the income of the firm; or a value-added tax, rather than a turnover tax; or the elimination of implicit or direct taxes on domestic savings in the form of monetary and financial assets.

Coupled with these reforms of the factor market, it would be possible to begin dismantling the network of controls and subsidies for products and taxes, and to simplify the administration of trade and balance-of-payments policies.

I would like to close by congratulating Dr. Westphal on his thorough study of the complex Korean experience. I believe that my comments made clear what I regard as extremely relevant, and of great help in the formulation of a trade policy in Latin America.

INDIAN EXPORTS

by Martin Wolf

India's economy appears to be free from major dependence on exports, since the ratio of gross exports to GNP has usually not exceeded about 5%. Furthermore, although the growth of exports has exceeded that of GNP over the last decade, its contribution to GNP growth has been small. However, the importance of exports should not be underestimated. The pattern of import substitution has ensured that the bulk of imports are crucial items like food, oil, fertilizers, industrial raw materials, and those capital goods whose substitutes are not produced within India. The slow growth and low level of exports has entailed a succession of balance of payments crises and a chronic foreign exchange shortage, which have led to curbs on essential imports and, consequently, hindered growth and created still greater difficulties for exports. In the future, exports can also play a role in adding dynamism to an economy constrained by low and erratic growth of agriculture, and the virtual exhaustion of opportunities for import substitution.

India's export growth in real terms has slowly improved since Independence and reached a rate of about 6% per annum during the '70s. While between 1955/56 and 1967/68 the most striking feature was the growth of barter trade with Eastern European countries, since 1967/68 the growth in barter trade and in earnings of convertible currency has been about equal, and the share of exports to Eastern Europe has stabilized at about 20%. In very recent years, there has been a dramatic growth in exports to Middle Eastern OPEC countries. Exports to all OPEC countries have risen from 6% of the total in 1973 to 20% in 1975.

India's generally poor overall export performance is to be explained in part by the initial dominance of subsequently stagnant categories like jute manufactures, cotton textiles, and tea. The subsequent improvement in performance reflects the increasing weight of more dynamic categories like engineering goods. However, India's share in world trade has fallen steadily, and the same applies to all major categories.

The major problems affecting India's exports have been the consequence of India's trade and industrialization strategy which has heavily favored import substitution, and consequently penalized exports. While good and reliable information on the relative profitability of domestic and export production of the same goods is not available -- most analyses being on far too aggregate a level -- it is easy to relate many examples of industries penalized in foreign markets by the high cost and low quality of domestically produced raw materials. Important examples occur in the case of garments, electronics, and other engineering goods. Equally inhibiting in the past have been de jure and de facto restrictions on the expansion of successful firms in the domestic market for whom the uncertainty of export profitability in the Indian context has reduced the attractiveness of a highly export oriented expansion. Export taxes may have also been a significant inhibiting factor for major commodity exports.

In order to increase the level of exports the Government has employed a number of incentives. Some are designed to increase the attractiveness of exports, while others are mainly intended to make exports possible through mitigation of the negative effects of quantitative import controls. The most general action taken to encourage exports was the devaluation of the rupee in June, 1966. However, because of compensating reductions in export subsidies and introduction of taxes, the net devaluation was substantially less than the gross, and the devaluation on the export side was significantly less than that for imports. Following the summer of 1971, a significant devaluation of the nominal exchange rate has occurred because of the link with the pound sterling, which was ended only in September, 1975.

The most important specific incentive is cash assistance which was introduced in 1966. However, the basis has never been entirely clear. Officially, it is usually claimed to compensate for those taxes and imposts, which do not come within the purview of the duty drawback system. At other times, it has been said to offset the difference between the domestic shortrun marginal cost of production and the f.o.b. realization. To the extent that the latter is indeed the basis, the incentive will probably be concentrated on industries with the least comparative advantage, and there is some evidence that this is indeed the case. Cash assistance has tended to be largely focussed on engineering goods and chemicals, which are certainly not the only high potential categories. An equally significant problem is that the assistance has usually been seen as essentially short-run in nature, indicating a failure to recognize the penalization of exports implicit in the Indian policy system. Corresponding to this view cash assistance used until recently to be announced for less than a year at a time, which made export planning extremely difficult.

Import replenishment licenses to exporters have been the most important device to circumvent the effects of a restrictive import policy. They also act as an incentive since the imports have generally commanded a scarcity premium, and the license is officially transferable. Again, there has been a certain confusion of purpose, since the main aim has been to provide the imports necesary for export production, and, consequently, the license is restricted in terms of what can be imported and to whom it can be transferred. Nevertheless, it is also recognized to have an incentive value. However, because of the restrictions, as well as the unpredictability of the premium, the value of the incentive varies in an arbitrary manner between industries and over time. Furthermore, it tends, of course, to provide the greatest incentive to the most import-intensive activities.

Other means of assisting exports include duty drawbacks, the provision of some raw materials, usually chemicals, at international prices, favorable terms on export credit, and a number of minor schemes. The full quantification of the effect of all these is immensely difficult. However, the evidence seems to indicate little relation to economic efficiency, and a strong tendency to concentrate overall assistance on relatively capital-intensive industries like engineering goods and chemicals.

A measure taken by the Government to offset the attractiveness of the domestic market has been the imposition of general and specific export obligations. However, it appears that there is some unwillingness on the part of firms to accept very high export obligations when profitability is neither high nor secure.

Until recently the bureaucratic delays associated with licenses and incentives was an appreciable problem for exporters. Within a controlled economy, such problems are inevitable, but highly significant improvements have been made during the last two years through devices like automatic licensing and prepayment of incentives in advance of detailed scrutiny of documents. The result has been much more effective administration of the export promotion system.

To sum up: India's export promotion drive, especially for manufactures, has been hindered by: 1) inadequate profitability, which is largely the result of the strategy of import substitution; 2) lack of access to imported inputs, which is a consequence of the import control regime; 3) the poor quality of much production, which results from an inadequately competitive environment; and 4) instability of the policy environment and vulnerability to ad hoc decision making.

Over the past three years the Government has greatly increased its emphasis on export performance, and, while not abandoning the basic features of the policy system, has granted a number of significant concessions. Constraints on capacity utilization and on expansion have been relaxed; cash assistance has been extended to more products and guaranteed for longer periods; it has been made significantly easier to obtain imported capital goods and raw materials, even when the product is domestically produced; replenishment license rates have been increased, and they have been made more flexible and granted to a wider range of industries; and an exchange rate policy has been followed, that has allowed a significant real depreciation of the rupee. Taken together with the administrative improvements already mentioned, the result seems to be a significant change for the better in the policy environment.

On the basis of these various changes in policies and procedures it seems likely that some improvement in medium term export performance will occur. Over the long term India's prospects depend largely on such categories as engineering goods, apparel, gems, handicrafts, marine products, and finished leather and leather goods. In order to achieve the potential various hurdles will have to be overcome including market restrictions overseas and organizational problems at home. However, the most important factor will, undoubtedly, prove to be India's own policy framework. The continued and improved provision of adequate incentives, more in line with comparative advantage and on a stable and assured basis, will prove the crucial precondition for a performance markedly superior to that of the past.

EXPORT PROMOTION POLICIES IN ISARAEL

by Michael Michaely

Israel has always had a large import surplus. In the first few years after its establishment, the ratio of Israel's exports to its imports was extremely low: in 1949 and 1950 exports of goods and services were only about 15% as large as imports. This ratio increased gradually, particularly during the 1950s, with many fluctuations along the upward trend. By the late 1950s or early 1960s the ratio of exports to imports was roughly 50%; and by the end of the 1960s it was fluctuating around 60%. The increase of this ratio kept pace, however, with the increase in total imports; and the absolute size of the import surplus thus kept rising, although not monotonically. The annual import surplus (of both goods and services) was about $300 million in the late 1940s and early 1950s and, with fluctuations, remained around this level until 1960. During the 1960s, in contrast, the import surplus rose substantially, especially with the increase in imports of military goods following the Six-Day War of 1967: in the mid-1960s the import surplus fluctuated around $500 milion, and in the early 1970s it was about $1,200 million. In the last few years the import surplus increased again very substantially, as a combined result of the increase in demand for military imports following the war of October 1973, the increase in world prices, and the worsening of the country's terms of trade in the process (particularly owing to the increase in the price of oil). In 1975, the import surplus amounted to approximately $4 billion.

The ratio of value added in exports to the economy's total value added, its gross national product, is a rough indication of the share of the country's productive resources involved in production for exports. This ratio, valued in 1955 prices, was at first negligible: in the first half of the 1950s, it fluctuated around 5%. From then on, a rising trend is clearly visible: in the early 1960s the ratio was about 10%, and by the early 1970s it approached 15%. With time, then, a significant share of the national economy was accounted for by exports, although even in recent years that share has been less important than in other small economies.

The growth of exports was accompanied by a considerable change in their structure. In the early 1950s almost half of total exports of goods consisted of citrus fruits (mainly oranges). This category had a predominant share indeed of total exports when measured in terms of value added (the share of value added in total value of citrus fruits is particularly high--about 70 to 75%). Of the rest, mostly industrial exports, about half were polished diamonds, in which the value added is only about 20% of total value. Thus, all other industries accounted for only about one-quarter of total exports of goods (slightly less in terms of value added). Exports of services were at that time negligible. Since then, a few strong trends appear in the development of exports. The share of citrus fruits has fallen sharply, amounting in recent years to only about 12% of the gross value of exports of goods or about one-fifth of value added. The share of polished diamonds has been roughly maintained, amounting to about a quarter of the gross value of exports of goods but less than 10% of value added. In recent years, two-thirds of

exports (in both gross and value-added terms), compared with a mere one-quarter in the early 1950s, have consisted of an assortment of industrial goods and some agricultural products other than citrus fruits, chief among the former being textile products, chemicals, and metal products.

Except in the very early years, Israel's trade and payments policy has developed progressively from restriction to liberalization.

As a means of changing the effective exchange rate for exports (as well as for imports), changes in the formal rate of exchange have always constituted a major element of the system.

Schemes of export promotion may be classified as, first, those which in one way or another are related to the size of exports and which may, in principle at least, be quantified by the exporter (as well as by others); and, second, those which are related in a more vague way to export activity, and which may be expected to contribute to export expansion but to an indeterminate extent. The discussion will center mainly on the better-defined schemes of the first category, making only cursory remarks about the rest. The former category of export-expansion instruments may again be subdivided into four groups: subsidies to output; subsidies to inputs; subsidies to exports through import-entitlement programs; and "branch funds," which combine elements of the three other measures.

In the present discussion, "export policy" will be represented by the single index of the effective exchange rate for exports. The question to be discussed will be, hence: to what extent have changes in the effective rate been influential on export performance?

This question may be subdivided into two. First, we may inquire to what extent have changes in the effective rate led to parallel changes in the relative price of exports. Only inasmuch as changes in the exchange rate lead to a relative increase in the price of exports, in comparison with domestic prices in the economy, could they be expected to promote exports at the expense of other sectors in the economy. Second, assuming that a change in the relative price of exports does take place, we may inquire to what extent such a change does indeed have an impact on export performance.

It is interesting to investigate the extent to which the country's economic performance--at least partly due to export-promotion policies and the foreign-exchange regime in general--has been biased toward exports versus import substitution. In Israel's case, where the economy started out with an extremely large import surplus, a most appropriate means of answering this question would be to determine how much of the reduction of the import surplus was achieved by reducing imports and how much by increasing exports. This would provide an indication of whether the country's growth process was biased toward or against foreign trade.

YUGOSLAVIA: COMMODITY EXPORTS AND EXPORT POLICIES

by Vinod Dubey

Yugoslavia has managed to combine rapid economic growth with fundamental structural institutional and social change during the last two decades. The annual growth of real GNP has averaged about 6% with constant-price value added in manufacturing and mining increasing at around 10% per year.

The Yugoslav growth experience cannot be fully appreciated or understood without viewing it in the context of the development of the unique Yugoslav economic system characterized by workers' self-management and increased decentralization of decision making. Unfortunately this fascinating evolution from a centrally administered orthodox communist system and its implications cannot be discussed here--only its relevance is indicated.

Any discussion of export experience and export promotion in Yugoslavia should, ideally, discuss development strategy, general trade and balance of payments policies and particularly the relation of imports and exports. This task is not attempted in this paper which concentrates mainly on exports of manufactures. Only incidental remarks on the broader and related issues are made where necessary.

Yugoslavia's merchandise trade has grown rapidly during the last two decades, with an acceleration in the rate of growth in current values during the recent years of high international inflation. The growth of imports has exceeded that of exports and the ratio of the value of exports to that of imports has declined sharply after 1965. The rapidly increasing merchandise trade gap has been met partly by workers' remittances and tourism receipts (which were growing rapidly until the recent world recession and amounted to $2.2 billion in 1974). During 1954-65 the growth of exports (and imports) was largely the result of an increase in volumes. During the last decade the increase in export volume has declined sharply.

The rapid growth of foreign trade shows that Yugoslavia is a relatively open economy. The ratio of merchandise trade to GDP was around 35% in 1965, 33% in 1970 and 45% in 1974. The reliance on trade is high relative to the country's size and per capita income.

The rapid growth of merchandise exports has been accompanied by changes in the commodity composition in line with the development of the economy. The importance of agricultural goods has declined and the relative share of manufactures (SITC 5-8) in total exports has more than doubled. Within manufactures the increase in the share of machinery and equipment (SITC 7) is particularly noteworthy.

The export orientation of industry coexists with a high import intensity of industrial production, particularly of the export industries. All the export industries except wood manufactures had an import content of over 20% in 1970. For a number of the industries the import content of

exports (in both gross and value-added terms), compared with a mere one-quarter in the early 1950s, have consisted of an assortment of industrial goods and some agricultural products other than citrus fruits, chief among the former production has been rising. The net foreign exchange contribution of the exports of these industries is therefore considerably less than the value of their exports. 1/

It is difficult to classify Yugoslav development strategy into the import substitution-export promotion dichotomy. Import substitution and export promotion do not appear to have been seen as alternatives but were followed in different sectors at different times. Thus in the early postwar period of inward-looking development, industries were protected but their exports were subsidized. At the same time the producers of basic raw materials and agricultural goods were not protected but their exports were taxed. In the later stage of outward orientation of growth import substituting investments and export promoting efforts were carried on simultaneously.

Yugoslavia has sustained a fairly successful record of economic growth and structural change for a long period of time. It has followed a pragmatic but broadly outward oriented development strategy. Again broadly, and with short-term reversals to the trend, it has been following a policy of greater import liberalization and lower protection with the object of developing a more competitive industrial base. While there has also been the objective of reorienting trade to the convertible currency areas and the developing countries Yugoslavia has had limited success in penetrating these markets. Particularly during the last two years there has been a sharp return to the traditional pattern with the bulk of the exports going to the Comecon countries. Yugoslavia has used and still uses most of the traditional export promotion techniques. It is difficult to quantify the export subsidy equivalent of these measures. It would appear that the retention quota and the availability of credit for export production on concessionary terms are the major promotional devices. However, more important than these in determining future export growth would appear to be the continuation of the acceleration in growth of the developed countries and success in multinational trade negotiations for increased access to these markets including reduction in nontariff restrictions.

1/ In the case of all the export industries except shipbuilding the value of exports is exceeded by the direct and indirect import content of production. The net impact of the sector on the balance of payments is negative. This is one reason for the recent pressures for greater import substitution in raw materials and intermediate goods production.

YUGOSLAVIA: COMMODITY EXPORTS AND EXPORT POLICIES

Comment by Ernesto Tironi

Congratulations are in order to the organizers of this conference for including on the agenda the case of Yugoslavia. Several lessons of interest to Latin America can be drawn from the Yugoslav experience, and one of the merits of Mr. Dubey's paper is that it allows us to do so readily.

In general, the Yugoslav case is noteworthy as a successful effort to improve economic efficiency through opening of the economy to the rest of the world, within a democratic institutional framework in which the agents in the process have been the great masses of the population, workers acting through various channels, and not merely a limited group--ordinarily the capitalist elite who owns the large companies. It therefore stands in sharp contrast to the cases most frequently cited as successes in the application of externally-oriented development strategies: Brazil, South Korea, Taiwan, and others. However, the Yugoslav experience shows that openness to the rest of the world is not tantamount to a lack of concern with internal development, nor does it imply reactionary policies. In Latin America this example would seem to be relevant for Peru.

Taking up points that are more specifically related to economic aspects, and not to political economy. One of the most interesting facets of Mr. Dubey's paper is his attempt to show Yugoslavia's performance in area of export promotion by comparing it with that of similar countries, in this case the OECD members. He also suggests several interesting methods for realistically assessing the performance of the countries, considering in particular the composition of exports by products and by markets of destination.

In this connection, an interesting point in the Yugoslav experience is that the success of its promotion policy goes considerably beyond what is shown by rates of export growth alone, because the increase has been achieved from a larger base. In 1954 the Yugoslavian economy was already quite open to the rest of the world, with substantial exports of manufactures (about 40% of total exports). Naturally, it is much more difficult to make great advances when a country is at a higher level of trade development. This was not the case of countries such as South Korea and Brazil, which began to expand their manufacturing exports from a very small base. Consequently, the comparative success of Yugoslavia is greater when properly measured in relation to its starting point.

In the paper we are discussing five specific lessons which seem to be of interest to Latin America. First, the rejection of the dichotomy between import substitution and export promotion. Throughout its development over the past two or three decades, Yugoslavia has shown that these two processes can take place successively for the same commodity over time, or rather that they can occur simultaneously in the same productive sector, considered in a more disaggregated form.

The second interesting lesson is unquestionably the recognition of the interrelationship between foreign exchange and tariff policies. The most eloquent example of this appeared in the reform of 1965, when there was a monetary devaluation coupled with a reduction of tariffs. As in almost all countries, however, it was difficult to put into practice the idea of continuing to make small but scheduled devaluations in order to adjust at least to the domestic inflation.

The third noteworthy aspect of the Yugoslav experience concerns practical ways of compensating for the discrimination suffered by exports with imported inputs. The Yugoslavs use a system of tax rebates on the value of exports; the rebate is determined by sectors in accordance with the use of imported inputs, direct as well as indirect, and with the tariffs applied to those inputs. The system is quite simple; there are only four or five categories of tax rebates, ranging from zero to a maximum of 4%. This system implies a reconciliation of export promotion and import substitution. In fact, it can be seen that the imported component of Yugoslav manufactured exports is much lower than in other countries in a stage of export expansion (about 30% on average, compared to almost 50% in the Korean case, for example).

A fourth interesting mechanism is that by which exported firms are given the right to retain a percentage of the foreign exchange they obtain from their sales abroad in order to import. There is at least one reason this interesting mechanism should be explored more thoroughly: it probably discourages the underinvoicing of exports. This is a significant problem in the Latin American countries, especially at times of profound structural transformations. To the extent that firms have the right to retain a percentage of their foreign exchange, they will be less inclined to show amounts lower than what they actually receive.

Finally, it is interesting to note that in the Yugoslav case the expansion of industrial exports has been achieved mainly through the efforts of national or mixed companies (foreign firms associated with Yugoslav firms). This also contrasts with the experience of Brazil, South Korea and even Colombia.

In conclusion, Yugoslavia seems to have successfully opened its economy to the rest of the world; more important, this has been done without a high social cost, particularly at the outset. The available information shows no decline in the purchasing power of workers, as has occurred in Brazil, for example.

There seems to be little doubt that the notable success of Yugoslavia is because its opening to the rest of the world has been programmed and guided by the State through simple and effective policies, rather than through a naive expectation that the market will solve everything. This is the most significant overall lesson that Latin America can draw from the Yugoslav experience.

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