CHAPTER II

LITERATURE SURVEY

Introduction

In the first Chapter a brief introduction on the evolution about the EPZ is presented. Since EPZs were established as instruments of foreign exchange earnings and they are involved in international trade some background information and knowledge about international trade theories will be of great use in analyzing and evaluating the working of EPZs. So an attempt is made in this Chapter in that direction.

Nations trade with each other because they benefit from it. Other motives may be involved of course, but the basic motivation for international trade is that of gain. The gain from international trade, like the gain from all trades, exists because specialisation increases productivity.

International Trade and Economic Development

It is generally believed that international trade promotes economic growth and development and thereby economic welfare of people. However, economists are not unanimous on

CHAPTER II

LITERATURE SURVEY

Introduction

In the first Chapter a brief introduction on the evolution about the EPZ is presented. Since EPZs were established as instruments of foreign exchange earnings and they are involved in international trade some background information and knowledge about international trade theories will be of great use in analysing and evaluating the working of EPZs. So an attempt is made in this Chapter in that direction.

Nations trade with each other because they benefit from it. Other motives may be involved, of course, but the basic motivation for international trade is that of gain. The gain from international trade, like the gain from all trades, exists because specialisation increases productivity.

International Trade and Economic Development

Classical Theory of International Trade

It is generally believed that international trade promotes economic growth and development and thereby economic welfare of people. However, economists are not unanimous on

this issue. For example, while Haberler, Cairncross and Robertson hold the view that foreign trade leads to economic growth and development, Myrdal, Prebisch and Singer hold the view that the benefits of international trade are largely biased and is in favour of developed countries.

Haberler enumerates the following benefits from trade.

i) Trade provides material means indispensable for economic development.

ii) Trade is the means and vehicle for dissemination of technological knowledge and the transmission of ideas.

iii) Trade is the vehicle for the international movement of capital.

iv) Free international trade is the best guarantee for free competition.

After seeing some of the benefits of international trade it is proposed to discuss in brief the different theories on international trade. First let us discuss the classical theory and then the refinements on classical theory and other theories.

Classical Theory of International Trade

In the opinion of Adam Smith, trade between two countries would be mutually advantageous if one country could

produce one commodity at an absolute advantage (over the other country) and the other country could, in turn, produce another commodity at an absolute advantage over the first. David Ricardo, in his book "Principles of Political Economy and Taxation", has propounded the comparative cost theory. This was later refined by J.S. Mill, Marshall and Taussig. The theory of comparative cost states that if trade is left free, each country, in the long run, tends to specialise in the production and export of those commodities in whose production it enjoys a comparative advantage in terms of real costs, and to obtain by importation those commodities which could be produced at home at a comparative disadvantage in terms of real costs, and that such specialisation is to the mutual advantage of the countries participating in it.3

Refinements in the Classical Theory

The theory of comparative cost was severely criticised for its wrong assumptions. But even under wrong assumptions the theory was found to be valid. So attempts were made to elaborate the theory with certain modifications by economists like J.S. Mill, Alfred Marshall and Taussig. As remarked by Haberler, in a modern economy ....

goods are not strictly exchanged with other goods but goods are bought with money. The flow of international trade is determined directly by absolute differences in money prices and not by comparative differences in labour cost."\(^4\)

The Ricardian theory assumes that no cost is involved for the transfer of goods between two countries. If the transfer cost is also taken into account the international division of labour will be considerably reduced. If the cost of transfer of a commodity is more than the difference in the costs of production between two countries, it will not be traded between them as there is no comparative advantage. The theory can also be applied when more than two commodities are exchanged. If two countries are exchanging a number of commodities between them, one country may be enjoying a comparative advantage over the other in all its exports. The theory is also applicable when more than two countries are involved in the trade. Under this situation each country will specialise in the commodities in the production of which it has comparative advantage over the others.

Ricardian theory assumed the situation of constant prices. But if variable costs are also taken into account the substance and spirit of the theory are not eroded. However, Goethe's...
production under increasing costs condition will certainly reduce the chance for international specialisation. The mere existence of "non-competing" groups does not influence the theory so long as the relative wages in each country is the same.

As pointed out by Taussig, considerable pressure is exerted by interest charges on international trade as long as different quantities of capital are involved in the production of different commodities. A country reaps comparative advantage for those goods which are produced with much capital but with less interest rate. However, high or low interest does not in itself act as an independent factor; it exercises an influence only so far as it enters to a greater degree in one commodity than in another\(^5\).

Opportunity Cost Theory

The major shortcoming of the comparative cost theory was its assumption that the price of a commodity was equal to the amount of labour time expended on the production of the commodity. Gottfried von Haberler tried to rectify this defect by restating the theory in terms of opportunity costs.

---

The opportunity cost of a commodity is the amount of a second commodity that must be given up in order to make available the required factors of production, in order to enable the production of one additional unit of the first commodity. According to the opportunity cost theory, a nation with a lower opportunity cost for a commodity has a comparative advantage in that commodity and a comparative disadvantage in the other commodity. The theory has an additional merit and hence superior to the classical theory as it recognises the existence of various factors of production other than labour.

The Prebisch-Singer Paradigm

The Prebisch-Singer hypothesis adds a new dimension to the classical theory. It foresees a declining trend for the exporters of primary commodities and an improving trend for exporters of manufactures. The hypothesis revealed a tendency towards worsening terms of trade for developing countries with international trade, thus contributing to a widening gap between the rich and the poor countries and with the benefits of international trade being very unequally distributed between the two groups of countries. The assumptions of the hypothesis are:

i) It is a "two country World" with the centre and periphery.

ii) The centre exports industrial goods and the periphery exports raw materials only.

iii) Higher level of production (is generally found) in the centre.

iv) The periphery does not consume its own products and there is no change in the real income with the fall in the prices of primary goods.

v) Periphery has price inelastic demand facing it.

vi) In the centre there is no distinct exporting sector and the manufactures produce both for domestic consumption and export.

vii) The centre's pricing decisions are affected by the wage levels in both markets.

viii) The diverse market structures (exist) in the centre and periphery - the centre has oligopolistic market and in periphery perfect competition.

ix) In the periphery there is well defined 'export sector', where prices are decided by world markets. As the prices rise in the upswing, the incomes are increased, but as prices fall in the downswing, incomes remain rigid.

So, the theory states that development has been unequal and that the backward areas' technical progress is usually penetrated, where it was needed to produce foodstuffs and raw materials at low cost for delivery to the great industrial centers'. Prebisch and Singer have also questioned the mutual profitability of international division of labour for the periphery when trade is guided by comparative costs.

From Ricardo to Keynes, the conventional wisdom for more than a century was that abstracting from 'cyclical' ups and downs, the terms of trade of primary products vis-a-vis
manufactures would be subject to an improving tendency. Given a niggardly nature, as population expanded and/or consumption per head increased, agricultural production and mineral extraction would show diminishing returns and, in a market economy, this decline will be reflected in rising relative prices for primary goods. Prebisch and Singer challenged this view. Their firm belief was that the commodity prices could show decline in the long run. Since 19th century, Britain was the 'centre' country, the centre was visualised as buying primary goods from the periphery and also selling them manufactures.

Criticising the Prebisch-Singer theory, Kindleberger observes that there is no long-run tendency for the terms of trade to move against primary products in favour of manufactures. He also points out that if allowance is made for the improvement in quality of manufactures, "the terms of trade may have turned against manufactures and in favour of raw materials per unit of equal quality." So the difficulties in shifting resources should not be related with primary production as such but with the economic backwardness. "As a

---

7 Ibid. p.155.
8 Ibid.
country really becomes adult, it develops the capacity to innovate".\textsuperscript{10}

According to Hans Singer\textsuperscript{11}, the specialisation of less developed countries (LDCs) on exports of food and raw materials to industrialised countries, largely as a result of investments by the latter, has been unfortunate for the LDCs:

a) because it removes most of the secondary and cumulative effects of investments from the country in which the investment took place to the investing country.

b) because it diverts the LDCs to activities having less technical progress

c) because it reduces the benefits of LDCs of foreign trade cum-investment based on export specialisation.

Kindlerberger\textsuperscript{12} reiterated: if, however, the response to an equal increase in productivity in two countries is a shift out of exports in the developed, but no comparable shift in the LDCs, due to inelasticity of supply with respect to price decrease, the terms of trade would turn against the latter.

W.A. Lewis, Colin Clark, Atallah and Michaely contributed much for the interpretation of the Prebisch-Singer theory. While we do not survive by gains of trade alone it is certain that the terms of trade affect in a big way the share

\textsuperscript{10} Ibid.


\textsuperscript{12} Kindleberger, C., op.cit.
of world income going to the periphery. 13 This phenomenon in a big way results long period transfers of income from periphery to the 'centre' countries. All the efforts of the periphery to improve productivity of primary goods export industries are self-defeating, as some of the points of technical progress will usually be transferred to the outer world in the form of lower prices of primary goods exports. 14

Raul Prebisch held that the conventional theories continue to disregard systematically the social structure. 15

"we allowed ourselves to be mesmerized by prosperity of the centres....we gave up a policy that was producing results viz., import substitution not confined narrowly to individual countries but extended where possible to inter-regional trade. The great prosperity of the centres spread quickly to Latin American countries. Something fundamental to the economic development has been missed because of the wastage of capital accumulation potential caused by more and more research, fritted away on the privileged forms of consumption which have taken root in Latin America periphery. In conclusion I recognise that market forces have great

13 Ramesh Tandon, op.cit., p.216.
14 Ibid.
importance but they do not solve basic problems for us

These forces must be combined with state
intervention. .... a new nationalism must be sought but
one based on dominant interests. It is not a question
simply of a new international economic order but a new
internal, ethical and social economic order." 16

**Modern Theories of International Trade**

Here an attempt is made to briefly explain the
modern theories of international trade.

**Factor Endowment Theory**

The Factor Endowment theory propounded by E.H.
Heckscher and Bertil Ohlin was refined further by Paul
Samuelson and Wolfgang Stolper. The theory consists of the
Hockscher-Ohlin theorem and the factor price equalisation
theorem. The Hockscher-Ohlin Theory states that a country
will specialise in the production and export of goods whose
production requires a relatively large amount of the factor
with which the country is relatively well endowed. The
Factor Price equalisation theorem states that free
international trade equalises factor prices between countries
relatively and absolutely and this serves as a substitute for

16 Ibid p 4.
international factor mobility. International trade increases the demand for abundant factors and decreases the demand for scarce factors because when nations trade, specialisation takes place on the basis of factor endowments. International trade tends to equalise the prices of internationally traded goods in all the regions of the world as the movement of goods from areas where they are abundant to the areas where they are scarce under the influence of trade. International trade will expand up to that point at which prices of the commodities are found to be equal in all regions. International trade also tends to equalise factor prices all over the world.

Leontief Paradox

Wassily W. Leontief made an exhaustive study on the Heckscher-Ohlin theory. According to the factor proportions theory, the US should have been exporting capital intensive goods and importing labour intensive goods. This hypothesis was disproved in Leontief's test and showed that the US was actually exporting labour intensive goods and importing capital intensive commodities. This paradox was popularly called as "Leontief paradox". Leontief in his test, proved that the ratio of capital to labour was higher in the import substitution industries than that in export industries in the US. He substantiated that the country resorted to foreign

trade in order to economise its capital and dispose of its surplus labour. In his explanation, Leontief has stated that though labour was numerically small in relation to the capital stock in the US, the effective supply of labour was relatively greater on account of the superior quality of the US labour force. He also pointed out that the productivity of an American worker is almost three times higher than that of a foreign worker. So Sodersten rightly observed: If production functions are identical between countries, if factor reversals are ruled out and if factors of production are homogeneous and identical between countries except for a multiplication constant, Leontief’s explanation might be valid. P.T. Ellsworth has showed an important shortcoming in Leontief’s analysis. He stated that the capital intensity of US import replacement industries is irrelevant to the comparison as production functions are not similar and identical between countries. According to W.P. Travis, factor endowment cannot be expected to influence trade pattern in a tariff-ridden world.

The Heckscher-Ohlin theory is not commenting on the intra-industry trade on products which are similar but not necessarily identical in nature. A large volume of such trade is taking place between industrialised countries. The analysis of

German trade done by Stopler and Roskamp\textsuperscript{20} pointed out that exports are capital intensive while imports are labour intensive. The study made by Tatemoto and Ichimura\textsuperscript{21} on Japanese international trade indicated that the trade pattern is more or less in accordance with the Heckscher-Ohlin theory. Due to the divergent opinions and circumstantial support received from various quarters no conclusion could be finally arrived at regarding the applicability of the Heckscher-Ohlin theory.

Consumer tastes and preferences and demand pattern are likely to change. The demand for fuel-efficient small cars has increased considerably on account of oil crisis. The demand for the same has also moved to other segments.\textsuperscript{22}

Complementary Trade Theories

The Heckscher-Ohlin theory failed in explaining a substantial portion of the international trade. The important theories which are extending the Heckscher-Ohlin trade model are summarised below:

Intra-Industry Trade

The Heckscher-Ohlin theory is not commenting on the intra-industry trade on products which are similar but not completely identical in nature. A large volume of such trade is taking place between industrialised countries. On the intra-industry trade, producers cater to the 'majority tastes' within each country leaving the 'minority tastes' to be

\textsuperscript{20} Ibid.
\textsuperscript{21} Ibid.
satisfied by imports. Such minor market segments called 'niche' often throw open the opportunity for entering the market by new/small players. In this connection it may be remembered that the Japanese companies have successfully employed the niche marketing strategy for capturing markets for their products. Different strategies are needed in foreign markets primarily because those markets exist in different sets of environments. 22

Consumer tastes and preferences and demand pattern are likely to change over a period of time. The demand for fuel-efficient small cars has increased considerably on account of the increase in the price of oil. After consolidating their position in a market segment with the strength of reputation they have built in, the Japanese companies systematically moved to other segments.

Technology, skill and management may also be included under the definition of factor endowments. In that case the Heckscher-Ohlin theory can be extended to the inter-industry trade provided the recognition of a number of segments within an industry.

Economies of Scale

The Heckscher-Ohlin model depends on the assumption of constant returns to scale. In times of increasing return to scale mutually beneficial trade can be made even when two nations are identical in every respect. If one country is specialising in the production of one commodity and another country is specialising in the production of another commodity the cost of production can be reduced if the production is subject to increasing returns to scale.

Even if production capacities remain the same for two or more countries when tastes differ, mutually beneficial international trade can take place.

Technological Gaps and Product Cycles

According to the technological gap model enunciated by Posner, technological innovations form the basis of trade. Companies having monopoly of patents and copyrights of technological innovations can export these products to other countries. Due to certain favourable factors like low labour cost the foreign producers may acquire the technology and their products may be more competitive than the innovator. Unless the level of technology is frequently upgraded by the advanced countries they may be forced to import from the countries which have acquired the technology.
According to the product cycle model developed by Vernon, an innovative product is often introduced in developed countries. The product is then exported to other developed countries. As the market in these countries are expanded more production facilities are established through subsidiaries. The developing countries, which have production facilities would start exporting to the developed countries. Companies are generally pursuing new product strategies that are less costly and risky than developing completely new brands.23

Availability and Non-availability of Goods

This approach to the theory of international trade indicates the pattern of trade in terms of domestic availability and non-availability of goods. According to the availability approach, a nation would tend to import those commodities which are not readily available domestically and export those whose domestic supply can be easily expanded beyond the quantity needed to satisfy the domestic demand. Natural resources, technological progress and product differentiation tend to increase the volume of international trade. According to Kravis,24 the absence of free competition tends to limit trade to goods that cannot be manufactured by the importing nation. Thus the availability approach is

24 Francis Cherunilam, op.cit., p.52.
adding new meritorious dimension in the exploration on the pattern of trade.

**Export Processing Zones**

Having discussed the different theories about international trade it is proposed to deal with EPZs in a little detail.

In order to earn more and more foreign exchange, many developing countries were trying to stimulate exports of nontraditional manufactures since the middle of the 1960s. The establishment of EPZs was one of the measures taken in this direction. EPZs are special enclaves, outside a nation's normal customs barriers. The majority of firms inside them are mostly foreign and enjoy favoured treatment with respect to imports of intermediate goods, taxation and infrastructure. The product decision must be made on the basis of careful analysis and review. 25

Inspite of various studies on EPZs the economic and welfare effects of these were not given proper attention. Mr. Peter G. Warr 26 tries, in his article, to clarify the issues and to draw out the general relationship between the benefits

---

and costs of establishing EPZs, and the overall trading regime of the host country.

Electronic assembly, garment production, assembly of light electrical goods and similar labour intensive light manufacturing processes are undertaken in common by many of the EPZ units. According to Peter G. Warr a notable feature of the firms in these Zones is their international mobility. Firms leaving an EPZ in one country often migrate to an EPZ in another in which conditions are more favourable.

The 'footloose' character of EPZ firms was not given any attention in the early theoretical works. While the classical Heckscher-Ohlin model treats capital as being internationally mobile, it fails to identify the international mobility of capital goods. Empirical work on EPZs has also often overlooked the footloose character of EPZ firm. Most of the empirical work includes detailed time series of exports, imports, employment, use of utilities, infrastructure and administrative costs. 'What the empirical studies have lacked has been an analytical framework, so that the benefits and the costs of EPZs can be identified conceptually and quantified empirically.

Under standard conditions, the international trade theory treats the factors of production viz. land, labour and capital as mobile domestically but immobile internationally.
Commodities are mobile internationally. The footloose EPZ firms exploit the international mobility of capital goods with the use of domestic labour. The EPZ firms move their capital equipment to countries in which they can earn the highest rate of return.

The international mobility of capital is represented by the models developed by Jones in 1980 and taken by Caves and Jones in 1985. In his article Peter G. Warr has brought out an amended version of the Caves and Jones model for revealing the essential features of EPZs. The inputs of processing activity in an EPZ are traded intermediate goods, capital goods and labour. The prices of these goods, the wages paid and the return to the capital goods used are formally related by

\[ p_j = \sum a_{ij} p_i + a_{kj} r_j + a_{lj} w_j \]

where,
- \( p_j \) = the price of the final goods \( j \)
- \( p_i \) = the price of the intermediate input \( i \)
- \( a_{ij}, a_{kj}, a_{lj} \) are the amounts of intermediate good \( i \), capital goods and labour respectively, required to produce a unit of good \( j \) and


28 Ibid.
These variables determine $R_j$, the rate of return to capital goods resulting from the production of good $j$ in an EPZ. The value added per unit of production of good $j$, $V_j$ by

$$V_j = P_j - \sum_i a_{ij} P_i$$

and now (1) can be rearranged

$$V_j = a_k R_j + a_L j W$$

Figure 2.1 represents equation (3) [value added] for two countries named 'poor' and 'rich'. In the poor country unit labour costs, $a_L j W$ are lower than that in a rich country. But unit requirements of capital goods $a_k j$ are lower in a rich country. The rich country's schedule thus has a higher vertical intercept (unit labour costs) - that is point B lies above point C - and has lower slope (unit capital good requirement) than that of the poor country. "A footloose manufacturer moves to the country where the highest value of $R_j$ can be realised". This is shown by the shaded surface in the diagram. "When unit value added is high, implying high returns to the capital goods specific to commodity $j$, the rich country is able to attract the processing activity". The rich country uses the scarce capital more efficiently. But if unit value added falls indicating reduction in the rate of

28 The World Bank Research Observer, op cit, p.68.
29 Ibid.
return, unit labour cost becomes more important. So below point A, the processing activity moves to the poor country.

Fig. 2.1
Migration of MNC manufacturers from EPZs

Under the Indian conditions the foot-locks of the industrial units in EPZs "is not found to be very rich. Though the mortality has occurred to a large extent due to migration to the other countries. Moreover, the industrial units involving bulk-breaking, repacking and assembly of semi-knocked-down products have not given approval for their operation by Indian Free Trade Zones. According to an American business man in Seoul Free Trade Zones are like Hilton Hotels..."
The analysis is consistent with the "product cycle" process identified by Vernon\(^{30}\) in 1966. It supports a gradual migration of newly developed manufactured processes from rich countries (where scarce capital goods are used more efficiently) to poor countries (where unit labour costs are lower) as international competition forces down the unit value added generated by these processes.

**Indian Conditions**

Under the Indian conditions the foot-loose character of the industrial units in EPZs is not found to be very relevant. Though the mortality has occurred to a few units none of them were due to migration to the EPZs in other countries. Moreover, the industrial units involving bulk-breaking, repacking, labelling and assembly of semi-knocked-down products are not given approval for their operations by Indian EPZs.

**Free Trade Zones**

According to an American business man in Seoul

"Free Trade Zones are like Hilton Hotels. When you are inside one, you don't know what country you are in, and..."


the hassels of the country don't touch you. It is a businessman's dream. And the workers are polite and obedient and almost look alike - sometimes you wonder if, they are Mexican, Philipinos, Malays or Arabs" 31.

The Zone is treated as a separate country: the Zone Administration is the Government 32. According to a Japanese industrialist "The Free Trade Zone is a new form of foreign settlement adopted to the new (post classical colonialism) situation".

FTZs overcome the problem of geographical distances by cheaper but faster transportation method and computerised telecommunication network. Production centres are established in third world countries by devising new technologies which were able to take advantage of the comparatively cheap unskilled and semiskilled labour. Fast changing consumer tastes and production methods have resulted in heavy investments that can be assembled by cheap labour at different end points. According to the U.S. Tariff Commission 33 "The combined use of semi-conductor production and manual processing is important to the producers who supply a rapidly increasing market, characterised by new technology, product

33 Ibid.
innovation and swift obsolescence of the products". The combined effect of all these trends was the dawn of EPZs with global assembly line owned by Multinational Corporations (MNCs).

Mr. Rodricks\textsuperscript{34} accuses that the FTZs "are in fact the brain children of the Transnational Corporations (TNCs), a new colonial device incubated in corporate board rooms and economic think-tanks, an outgrowth of 'their export-oriented industrialisation thesis' inculcated into the economic policy planners and technocrats of the third world. ..... As artificially inseminated industrial clones, they have now mushroomed in various countries of the third world."

But UNIDO, international financial institutions, foreign investors, local industrialists and host Governments consider FTZs and EPZs as a panacea for third world industrialisation problems. These agencies are of the firm view that these Zones will boost export earnings, ease trade deficits and ends balance of payments problems and over reliance on export of a few primary products. So third world countries are found to be competing with each other in

\textsuperscript{34} Ibid p. 128.
inviting the MNCs for making massive investments in their countries.

The People's Republic of China, even though it is under a totalitarian regime, has established four Special Economic Zones (SEZs) under the inspiration from the utterances of its premier, Deng Xiaoping. He said "If we can increase production, it doesn't matter whether operations are run privately — if a cat catches mice, it doesn't matter whether it is white or black".35

The Counter view

A number of international agencies like ESCAP, UNCTAD, ILO, World Federation of the Trade Unions and Women's and Labour — rights groups criticised the Zones. According to an UNCTAD study, the contribution of the Zones to the economic development of the third world has been disappointing if their economic impact is measured against rather ambitious objectives laid down by the developing countries in establishing such Zones. Besides, they have not led to any major transfer of technology. The report also states that foreign investors locate or relocate production activities in the third world countries because of the availability of hard working labour and easily trained manpower whose wages are low compared to those paid in capitalist countries.

ILO criticised on the ground that in some of the Zones the enterprises are exempted from stipulations of so many labour laws and that key issues either remain unregulated or left to the individual contract of employment. The Geneva based International Union of Food and Allied Workers Association attacked against the no-union, no-strike guarantees as investment incentives in the Zones.

Criticism against the Zones in India

Rangnekar and Bhaduri, two eminent economists and members of the Tandon committee which was appointed to report on the opening of EPZs in the country, deplored the facilities extended to FTZs on the plea that they subserve only the interests of free enterprise and multinationals. They warned against an attendant danger of freeing the most powerful sectors and industrial superstructure - the MRTP and the FERA companies - from all restrictions in the name of exports; to the extent that exports are given top priority in respect of licensing, credit facilities, raw material supplies, budgetary support and tax exemption. This, in turn, will give them vastly increased leverage and lobbying power for bending domestic policy in other areas to their liking.

36 Ibid, p.23.
37 Ibid.
They were also of the view that the concept of balanced development and self-reliance is undermined. Even the policy of regional dispersal of industry and protection of small industry were to be scrapped on the recommendation of the Tandon Committee. They warned that free access to technology and wide-ranging concessions will have the effect of defeating the purpose of protecting the society from being subject to monopolies and multinationals and prevent the country from reaching the goal of technological and economic self-reliance.

United Nations Economic and Social Commission for Asia and Pacific (ESCAP) in its report states that the benefits from EPZs to national economies are minimal when compared to the huge investments of public funds required to set up the infrastructure of the Zones and provide subsidised services and a host of tax incentives. So it characterised the Zones as costly public expenditure in support of private enterprise. The report also reveals that the tax related incentive schemes of the Zones in introducing new investment were either slight or unknown. If the revenue forgone were invested it would have provided more value added goods and created more employment opportunities.

38 Ibid, p.25.
Employment Generation

The Zones are started as a means to generate employment. But instead of creating more job opportunities the Zones lead to widespread unemployment in times of recession. It was estimated that a total of 15000 workers were laid off by the units working in Singapore alone. In 1980 according to a survey conducted by Hong Kong Electronics Workers' Union, half the workers in electronics industry were either retrenched or underemployed in 1981 owing to slight recession and the decision of MNCs to commence operation in lower labour-cost countries.

Another point that is highlighted is that the employment structure in export production is also marked by a profound imbalance as largely women in the younger age groups are employed in this sector.

Minimum Foreign Exchange Inflow

The EPZs were started with a view to earn maximum foreign exchange. But many of the Zone units failed in this aspect. This is largely because of the fact that many of the MNCs can adjust prices on their intra-company sales according to a deliberate plan, so that shipment to high-tax countries are priced high, while products shipped to low-tax countries are priced low. As a result of this the profit generated
becomes nil or minimal. Transfer-pricing practices within TNCs produce profits abroad rather than in the exporting country. Again the profits in the branch plants located in third world countries are not allowed for further investment in the country concerned but are sent back to corporate headquarters. Thus, whilst the host country does earn foreign currency it results in an escalating import bill, loss of potential revenue through exemption from taxes and customs duties and through repatriation of profits, paying for amortization and debt servicing. Some of the production units of KFTZ are found to import goods and components from the GCA and export to RPA thus providing for steady draining of the foreign exchange of the country.

Mechanics of Economic Imperialism

In his book, "FTZ: Cat's paw and Beachheads of Imperialism" L.M. Rodricks\(^{39}\) alleges that neocolonialism is practised by the former colonial powers in the newly independent third world countries. This is practised through a type of dependent capitalism — through bank loans, manipulations of the terms of trade, increased exploitation of irreplaceable natural resources and militarisation of the economies. This strategy got wide support from development ideologists from capitalist countries.

\(^{39}\) Ibid. p. 102.
Because of neocolonialism the newly independent third world countries were dragged into the world trade. They were compelled to earn foreign exchange through the export of their traditional primary products, while their terms of trade began to show steady deterioration. The imperialist countries began to dump their agricultural produce at very low prices in third world countries. The third world countries were experiencing high prices for their industrial imports and low prices for their primary exports. Moreover, the shipping, banking and insurance companies of the developed countries were exploiting the LDCs by charging high rates for their services. So it is estimated that the terms of trade of third world countries deteriorated by 20 per cent between 1954 and 1963. The MNCs were able to earn enormous profits by their trade with the third world countries.

Import Substitution Industrialisation

The ever widening gap of imports and exports compelled the newly industrialised countries to adopt a new strategy or model for their international trade called "import substitution industrialisation. This strategy was propounded by Raul Prebisch, based on his experience in Latin America during 1950s. This strategy got wide support from development ideologists from capitalist countries.
It was found that as the import substitution proceeds to the areas not traditional to the existing local production patterns, the import of raw materials from advanced capitalist countries increases. It was experienced that the import of raw materials and capital goods has resulted in foreign currency costs as high and sometimes in excess of the savings made on the imports of finished goods. The actual experience was found to be contrary to the expectations that the foreign exchange gap will be reduced considerably. So the countries which adopted this strategy were more dependent on foreign capital than what was the position earlier. While inducting foreign investment, the TNCs moved behind tariff barrier to produce locally what they had imported earlier. Thus, this strategy solved no problems connected with foreign exchange earnings, but only increased the contradictions inherent in what was known as the centre periphery relationships.

Export-Oriented Industrialisation

As the foreign exchange position began to reduce considerably many countries were forced to shift their strategy from import substitution industrialisation to export-oriented industrialisation. The new strategy was part of the process of globalisation and reorganisation of industrial production by the TNCs. The additional exports are expected to be generated by changed conditions of capital
expansion. The strategy was a step towards independence between the rich and the poor countries and the increasing co-operation between the MNCs and developing countries for mutual benefits. Under the changed system the capital expansion is providing for using the supply of unemployed cheap labour in the third world. So the availability of cheap labour and the suitable technology provided for relocation of industries and production began to be less dependent on geographic distances. Another determinant of relocation is the development and refinement of technology which makes it possible to decompose complex production processes into elementary units, so that unskilled workers can be easily trained to perform otherwise complex operations. The large movement of capital expansion coupled with unlimited supply of cheap labour and the development of transport, communication, organisation and new technologies have provided for large scale industrialisation in the third world. Thus the developing countries can absorb the latest technology and compete with the advanced industrialised countries. The protectionist policies are to be abandoned and the third world economies are to be integrated with the global situations with the help of foreign capital, technology and managerial skill.

In order to invite foreign investments and to produce for meeting the demands of the world markets new laws and systems were made by the developing countries. The FTZs, SEZs and EPZs were formed in the above background in many developing
countries. Thus FTZs/EPZs/SEZs are essentially the product of export-oriented industrialisation thesis.

According to L.M. Rodricks, institutions like UNIDO, Asian Productivity Organisation, Asian Development Bank and the ICRIER were implanting the idea of FTZs in Asian countries. UNIDO, established in 1967 by a UN General Assembly resolution, promoted industrialisation in developing countries. It provided assistance for the formation of FTZs in the form of survey and feasibility studies.

L.M. Rodricks thinks that many of the FTZs are yet to achieve the objectives for which they are established. He further states that the TNCs, monopolies and local capitalists are exploiting the concessions given to them by suppressing the rights of workers. He pinpoints the experience of Srilanka where 3500 workers are left with no job in 1984 when 10 FTZ units in Colombo owned by foreign firms were closed down. He points out the following three major defects with respect FTZs:

1. International sub contracting
2. Repatriation of a large portion of income by way of dividend, interest, royalties and a system of transfer pricing.
3. The concept of 'corporate borders' provides for the shipping of products from one factory to another
belonging to the same owner but within two countries without payment of duties, and many of the products are not entered in the international markets for actual consumption.

L.M. Rodricks alleges that Rajiv Kumar, in his study entitled "Export Processing Zones in India: An Evaluation", has cleverly and convincingly skirted an analysis of the most sensitive issues concerning the role and performance of FTZs in India. The study has revealed that the KFTZ and SEEPZ have contributed only marginally to foreign exchange earnings and in generating employment. However, L.M. Rodricks admits that Rajiv Kumar has made a number of suggestions for the improvement in the functioning of FTZs/EPZs.