Chapter I

INTRODUCTION

One characteristic feature of most underdeveloped countries is their foreign trade orientation. This orientation is mostly reflected in exports of primary products and imports of consumer goods and machinery. The export profile of these economies shows a concentration of one or two primary commodities accounting for a major part of their foreign exchange earnings. As a result, the export sector plays a vital role in determining the growth rate and structural pattern of these economies.

Yet it must be admitted that heavy dependence on exports of a few products is detrimental to these economies in more than one way. For one, the export products are highly susceptible to fluctuations in the international prices of the primary export commodities. For another, the economy becomes highly dependent on imports of consumer goods and even food products. The smooth functioning also to some extent, retarded thanks to heavy dependence on the export sector. The obvious long run outcome is the economy's weak export capacity relative to its strong import needs and a consequent strain on its balance of payments position. Under these circumstances any additional flow of foreign capital obviously becomes subservient to the most lucrative export sector and/or the related needs of infrastructure.

The classical dictum "Trade as an engine of growth", though very much confirmed
countries such as Canada, Australia, New Zealand and South Africa, do not necessarily offer similar rewarding effects for many underdeveloped economies. Mainly three factors seem to explain such a situation. One, the dualistic structure of the underdeveloped economy showing the co-existence of a well developed export sector and a primitive domestic sector. The economic history of countries like China, India and Malaya shows that the main reason why they did not benefit much from external trade was that foreign investments for developing export industries failed to get properly integrated in their economic structure. Further, circumstances that favoured the proper utilization of the opportunities presented by increased external trade in countries like Canada, Australia and New Zealand were not available in the other countries, and the opportunities were not seized upon and made proper use of in these countries.

Second, the distribution of gains from trade between the developed and underdeveloped economies is a much debated theme. Quite often, the flow of foreign capital moved into the most profitable export sectors and the resultant pattern of the economy of these countries was oriented to the needs of the developed economies and offered little scope for any technical progress or internal and external economies. The existence of underemployment and disguised unemployment and the tendency for labour to follow traditional occupations, coupled with the limited regional mobility of labour, helped to keep down the wage level in such underdeveloped economies when large foreign investments were made in some extractive industries. Thus the
income level by far remained stagnant, effective demand did not rise and markets did not expand. The foreign enterprises could produce the goods at a low cost of production and reaped the benefits of trade. Even when productivity in particular enterprises was large, the benefits in the form of large returns accrued primarily to the residents of developed countries.

Third is, given the existence of dualistic structure and unfavourable distribution of gains from trade for such economies, they do not help increase domestic capital accumulation. When the demand for export products increased and export earnings rose correspondingly, these countries found it irresistible to use the incomes for further expanding the primary goods industries rather than to divert the earnings for importing capital goods or for investing in major industries. In other words, "they failed to industrialise in a boom because things were as good as they were and failed to industrialise in a slump because things were as bad as they were." 1

Against this background an attempt is made in this introductory chapter to review critically the available economic literature to test the hypothesis of "export-led growth" strategy as applied to the underdeveloped countries, especially of those, the economic heritage of which fits into the preceding description.

Centre-Periphery Schema

Given the nature of an underdeveloped economy as it is, its dependence on a few primary export products involves price fluctuations, affects the flow of foreign investments and credits and finally, tends to link itself with a more advanced country. At this point, centre-periphery relations become evident. The developed industrial countries, exporting mainly manufactures and importing primary or semi-processed commodities are considered as the 'centre', while the less developed countries whose export and import patterns are the reverse of the centre's, are labelled the 'periphery'. A considerable volume of literature is available underlining the economic relations between the two types of economies, thanks to the pioneering efforts of Raul Prebisch and H.W. Singer and the subsequent scholarly writings on their theses.

The basic problem is one of distribution of gains from trade between the centre and periphery. To start with, Raul Prebisch challenges the classical view that trade tends to distribute the fruits of technical progress among all parties. He believes that the classical arguments are theoretically sound, but he seriously questions the validity of assumptions upon which they are based. Prebisch says: "According to this assumption, the benefits of technical progress tend to be distributed alike over the whole community, either by the lowering of prices or the corresponding raising of incomes." The basic themes of

the analysis revolve around the fact that there is a persistent deterioration in the periphery's terms of trade vis-a-vis the centre. To buttress his arguments, he stresses that the technical progress defined as the reduction of the value of inputs per unit of output is greater in the centre than in the periphery. Consequently, productivity increases at the centre tend to be fully absorbed by increased wages, because of the strong bargaining position of trade unions in economies with high employment, or by the increased profits of monopolistic supplies. Whereas, any increase in productivity tends to lower prices in the periphery because the labour market is very much competitive and displaced labour following technical progress exert further downward pressure on the wage rate. Thus the conclusion is obvious that there is a tendency for prices at the periphery to decline following the increase in productivity.

The nature of the export commodity/commodities from periphery to centre and vice-versa, contributes also to the declining terms of trade process. The centre's almost stagnant or reduced demand for food, excessive domestic protection to agriculture


4 Celso Furtado also supports Prebisch's analysis when he writes, "Depending on the price elasticity of an export item and the position of the country in the international market, the fruits of the increase in physical productivity of labour in the export sector may, through a decline in prices, be reaped abroad." For details, see, Celso Furtado, Development and Underdevelopment (Berkeley and Los Angeles, 1967), p. 66.
and constant fall in the use of raw materials thanks to substitutes such as synthetic products, make low price and income elasticities of demand for the import supplied by the periphery.

In other words, the prices of primary products are more prone to fluctuations than those of manufactures because of lower price elasticity of demand, frequent shifts in their supply schedule and the long gestation periods of investments. Undoubtedly, in a period of industrial recovery at the centre, the prices of primary products tend to increase more than those of manufactures, profits are transferred to the periphery. In a downswing in the centre, the reverse happens, with primary product prices declining more than those of manufactures. The result is obvious that the losses in terms of trade of primary producers in the downswing are greater than their gains in the upswings.

Available empirical evidences support Raul Prebisch and his analysis. In the historical relation between the more developed countries and underdeveloped countries, H.W. Singer's studies show two important effects of underdeveloped country's specialization on primary products; one, the mechanism of international trade-cum-investment was not sufficient for growth in the periphery, because such trade-cum-investment was related

5 A useful description and evaluation of this point is available in Werner Baer, "The Economics of Prebisch and ECLA", Economic Development and Cultural Change (Chicago), January 1962, pp. 169-82.
more to the industrial or investing country. Second, is diversion of the underdeveloped countries into types of activity offering less scope for technical progress. And a third, relates to terms of trade. As Singer says:

It is a matter of historical fact that ever since the seventies (1870s) the trend of prices has been heavily against sellers of food and raw materials and in favour of the sellers of manufactured articles. The statistics are open to doubt and to objection in detail, but the general story which they tell is unmistakable. (7)

Technical progress is desirable. But the obvious outcome of it has been the unequal distribution of gains arising out of it between primary producers and manufactured product producers. The gains are reflected either in the form of rising incomes to producers or in the form of falling prices to consumer. In case of developed countries, the producers have obtained higher incomes, while the food and raw material producers in underdeveloped countries have been confronted with lower prices. As Singer holds:

Generalising, we may say that technical progress in manufacturing industries showed in a rise in incomes, while technical progress in the production of food and raw materials in underdeveloped countries showed in a fall in prices. (8)

6 But his later piece of writing shows that the engine of growth might in fact be effective, but pull the car in an undesirable direction. See for details, H.W. Singer, n. 1, p. 60.

7 Ibid., p. 48.

8 Ibid., p. 49.
He holds the same view for the falling long term trend of prices of primary products as does Prebisch:

This lack of an automatic multiplication in demand (for food stuffs), coupled with the low price elasticity of demand for both raw materials and food, results in large price falls, not only cyclical but also structural. (9)

A Critique of Prebisch-Singer Thesis

The most serious criticism leveled against Prebisch thesis is regarding his empirical observations on the terms of trade trend of developing countries. The suggested trend is based not on the measurement of prices within the poor countries, but rather on inferences from the United Kingdom's commodity terms or the terms of trade between primary products and manufactured products. The primary products whose average prices for broad categories are used in the computations of the

9 Ibid., p. 50.

Gunnar Myrdal also supports the viewpoint of Prebisch, of course, leaving the actual historical trends of prices as a moot question, but believes that, "most of the underdeveloped countries are saddled with a basket of traditional export goods ... the prices of which have been lagging behind. According to his analysis, terms of trade between world agriculture and manufacturing shifted to the advantage of manufacturing because of monopolistic elements in their product and factor markets allowed industrial countries to keep the benefit of their technological progress in the form of rising factor incomes, whereas in primary producing countries, the gains in productivity have been disturbed in price reduction." Quoted in G.M. Meier, "International Trade and International Inequality", in James D. Theberge, Economics of Trade and Development (London, 1968), p. 258.
terms of trade are for the most part, averages so computed, not superior in quality, and in some cases are perhaps inferior to the corresponding commodities of earlier years. And within the broad category of primary products, it is unreasonable to believe that the prices of foodstuffs, raw materials, minerals and petroleum all moved together. Since the exports of primary products from poor countries are varied, generalization based on an aggregation of primary products is undoubtedly wide of the mark. Again, the prices used for computation are mostly the prices of manufactured exports and not agricultural commodities.

Further, no weight is given to the gain in utility from the new commodities which have become available, such as the automobile, the tractor, and pencillin. Manufactures, even though be the same, might have become incomparably superior in quality. "For example, it may perhaps take more pounds of coffee, or of cotton, to buy a lamp today than it did in 1900, but today's coffee and cotton are, I presume, not appreciably better in quality than those of 1900, whereas today's electric lamp is incomparably superior to the kerosene lamp of 1900."

Another point of criticism is regarding the simple commodity terms of trade totally unrelated to the entire export earnings from primary products. Even if it were true that an underdeveloped country experienced a secular deterioration in its commodity terms of trade, the question would still remain

whether this constituted a significant obstacle to their development. If the deterioration in the commodity terms is due to increased productivity in the export sector, the single factorial terms of trade can improve at the same time, which implies a greater quantity of imports per unit of factors embodied in its exports. A possibility also exists to improve income terms of trade at the same time as its commodity terms of trade deteriorate. When due weight is given to the increase in productivity in export production and the rise in export volume, it would appear that the single factorial terms of trade actually improved for many poor countries, not withstanding any possible deterioration in their commodity terms of trade.

Regarding the claim that there is more rapid technological progress in manufacturing than in agriculture, Jacob Viner suggests that such a tendency is a consequence— not a cause— of countries which are more advanced technologically being often more industrial than agricultural. He says: "There is not, as far as I know, any marked backwardness in technology of the agriculture of Denmark, of England, of Newzealand, or of Iowa."

P.T. Ellsworth suggests the decline in freight rates during 1876-1905 as one of the causes of decline in the British price of primary imports. When the fall in British export prices over this period is also taken into account, the terms

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11 G.M. Meier, n. 9, p. 511.
12 Jacob Viner, n. 10, p. 27.
of trade of primary exporters may well have improved. As he concludes:

A large proportion and perhaps all, of the decline in the British prices of primary products in the period between 1876 and 1905 can be attributed to the great decline in inward freight rates ... since the price of British manufacturing exports fell in this period by 15 percent the terms of trade of primary countries were f.o.b. prices used for their exports as well as for their imports, may well have moved in their favour. (13)

Another set of criticism is levelled against the choice of years for the study. Prebisch's demonstration of the low income elasticity of demand for imports into the centre relies heavily on the US import co-efficient between 1919 and 1948, a period too abnormal to establish any long term trend. This period would be expected to contain more years of declining than of rising imports as a share of national income. Since he speaks of only USA having a sheer size, diversity of economic regions and resource endowment - which has in general a low foreign trade component in national income. It is the marginal propensity to imports of raw material that matters rather than total imports. Another point which is adduced in the import structure of developing countries is that they tend to have a


built in stabiliser in the form of a high marginal propensity to import, which damps down the effect of fluctuation in incomes. On this similar reasoning, Flanders reformulated the basic Prebisch thesis as consisting of two components: (i) a balance of payments problem, with demand for imports in periphery tending to grow faster than import demand in centre, so that equilibrium can be achieved only if periphery grows more slowly than centre. This problem arises from centre's inelastic demand with respect to income; (ii) a real income problem, which is frequently stated as centre's price inelastic demand for imports from periphery, but more correctly should be attributed to periphery's monopolistic position in the world market which causes the demand for her exports to be less than infinitely elastic with respect to price. The result of this is that the free market responding to existing relative prices, misallocate resources in periphery between export industries and import competing industries, so that aggregate real income in the periphery is not maximised.

In order to control the wider fluctuations in primary commodity prices, international commodity agreements have been suggested as an alternative. As early as in 1920s such agreements were drawn up to stabilize rubber and tin prices which affected South-east Asia. In 1930 and later, Brazil dealt on its own with the coffee glut by withholding and destroying its stock. Nevertheless it is agreed at a point of time that these agreements are difficult to operate between the consuming and

15 Ibid., pp. 317-18.
producing countries as the world economy is susceptible to divergent rates of growth and disparate levels of industrialization and technical progress. Yet to treat the problem of stabilization of primary prices as part of the global development strategy, the importance of such agreements cannot be underestimated. As Victor Urquidi has suggested that the only way to achieve a relative stabilization of prices over the long run is to promote continuously reciprocal and co-ordinated adjustments between world exportable output and world demand for primary products.

In recent times joint actions have been formulated by producing countries in at least seven major commodities - oil, bauxite, phosphate, copper, tin, coffee and banana. Iron Ore Exporting Countries Association has come into existence recently and co-operative efforts are continuing in tropical timber, natural rubber, nickel, tungsten, cobalt, columbian, tantalum, pepper and quinine.

Much more recently, developing countries explained their commodity concerns and proposed a remedy at the fourth United Nations Conference on Trade and Development (UNCTAD). It is called an "integrated programme" and calls for a series of commodity arrangements for 18 agricultural and industrial raw

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17 For details see, C. Fred Bergsten, Towards a New International Economic Order: Selected Papers of C. Fred Bergsten, 1972-74 (London, 1975), Ch. 18, pp. 287-98.
materials which account for about 75 per cent of their commodity trade. For many of these commodities, UNCTAD proposes the establishment of international commodity agreements based on buffer stocks, augmented by export controls and production controls. The stock would be financed by a common fund. The theory behind the common fund is that fluctuations in commodity prices will not be synchronized; that is, the prices of some will be rising while the prices of others will be falling. Thus, a common fund supporting all of them will need less money than a series of individual and unco-ordinated buffer stock funds. UNCTAD estimates that such a fund could begin operation with £3000 million, of which £1000 million would be paid initially.

Import Substitution Industrialization Model

Based upon his early post-war writings, Prebisch's chief policy recommendations were that exports cannot be regarded as a major contributor to increasing the rate of economic growth

18 However, USA's approach has been to look at commodity problem on a case-by-case basis. At Nairobi, US Secretary of State, Dr Kissinger put forward a comprehensive approach to commodities which contained the following features: insure sufficient financing for resource development; improving the conditions of trade and investment in individual commodities and moderating excessive price fluctuation; stabilising the overall export earnings of developing countries; improving access to markets for the product of developing countries and international arrangements to assume reliability of supply. To achieve the desired ends the idea of International Resource Bank was mooted at this Conference. For details, see, Joseph A. Greenwald, on Commodities and the North South Dialogue, an address to the America Bar Association meeting in Atlanta, Georgia, August 1976.
in the periphery. Majority of developing countries rely on exports of relatively unprocessed primary commodities which on the whole face fluctuating markets.

Developing countries cannot expect to export manufactures or more highly processed primaries in significant quantities because of their own supply shortcomings and second, because of various kinds of barriers erected against their entry in importing countries. In a recent note, G.K. Helleiner has highlighted the manifold problems that confront the less developed countries in promoting export of manufactures. Important among these are: substantial degree of control exercised by multinational firms on marketing outlets for manufactured products in the developed countries; highly imperfect markets for the relevant technologies in LDCs; homogenous nature of exports from a number of LDCs towards developed countries; high tariff and non-tariff barriers against their manufactured exports in their major prospective markets; the absence of international conventions or rules to protect the LDCs against discriminatory treatment; the frequent practice of multinational corporations controlling the right to export from their subsidiaries and the right to sell technology; the weak administrative capacity and

political power of the host government in LDCs which render difficult the process of effective bargaining, monitoring and control with respect to foreign agreements and MNCs.

On the other hand, the demand of LDCs for imports of goods and services vital for accelerated development grows at a rate in excess of their exports. Transfers of income from developed countries in the form of private investment and economic aid will not necessarily fill the gap and in any case generate a reverse flow of debt service, dividends, royalties, etc. A development strategy recommended for such countries is import substitution of manufactures, to be achieved by effective protection of domestic infant industries.

M.J. Flanders believes that there are three types of benefits which Prebisch seems to expect from a policy of protectionism for the periphery - rationing effect, countervailance and allocative effect. The rationing effect is closely tied with the worldwide dollar shortage (only in 1950s) so that tariffs are one method of rationing limited supplies of US dollars.

Whereas countervailance has been suggested to prevent further deterioration in the terms of trade of the periphery, by allocative effect is meant that the resource allocation should respond to existing relative prices in a free market mechanism.


21 However, Flanders provides a critique of Prebisch's views on protectionism as a remedy to accelerate the process of

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H.W. Singer buttresses further the case for industrial import substitution by arguing that traditionally the export sector of primary producers has been to a great extent in the hands of foreign companies that form an enclave in the peripheral economy, providing little local benefit. He also stresses the indirect advantages of manufacturing industries to the host economy. As he says: "They provide the growing points for increased technical knowledge, urban education, and the dynamism and resilience that goes with urban civilization, as well as the direct Marshallian external economies."  

Thus in matters of policy prescription, he advocates "some method of income absorption", whereby the results of technical progress may be retained in the developing country. A greater proportion of profits should be kept by the primary producers. Progressive social legislation is necessary to economic development in peripheral countries. According to him, a tariff system designed to ration scarce foreign exchange, as Prebisch seemed to advocate, not to decrease the total demand for imports, cannot be expected to cause an improvement in the terms of trade. At best it might slow down future deterioration in the terms of trade. The policy of countervailance raises a number of highly complicated issues regarding what Prebisch is really assuring as to market structure, income distribution and wage rate determination in the periphery cannot be expected to cause a significant reduction in the prices of its imports. Further the effects of the tariff will be diffused among many industries in many countries of the centre and will thus be even less likely to influence the prices of industrial imports. M.J. Flanders, n. 14, pp. 299-303.

provide for increases in real wages in these countries.

Yet Singer's views have been questioned. His acceptance of the 'historical fact' of the declining terms of trade of primary producers appears to be based solely on the evidence of a 1949 United Nations report. His innovation of the 'enclave' sector is a warning to policy-makers in a number of less developed countries, but hardly an objective description of the primary producing sector in the majority of them.

Despite the obvious limitations pointed out time and again, Prebisch-Singer analysis seems to have attracted much attention among development economists in Latin America in the immediate post-war years. We may recall here the bitter experience of the world depression of 1930s in the context of peripheral countries and again the Second World War jeopardised the process of economic development of these countries. In this context, the immediate post-war years gave a ready audience to the writings of Prebisch and Singer. Thus the phase of import substitution industrialization model was set in. The adoption of such a strategy for many developing countries emerged as a result of the suggestions of Economic Commission for Latin America guided by Prebisch thesis; the economic obstacles to the export of manufactures to developed countries and lastly high rates of population growth.


Hirschman discusses four distinct origins of import substitution strategy for developing countries—wars, balance of payments difficulties, growth of the domestic market (as a result of export growth) and official development policy.

A noteworthy feature of this period has been the export 'lagging' type of development since 1945 (except Korean War boom) among the developing countries. A considerable volume of literature starting from the writings of Ragnar Nurkse and A.K. Cairncross is available on the possible causal influences at work in the apparent association between industrialization, the lag in the export sector of the economy and the slower rate of growth in export of these countries. The arguments centre round either on demand deficiency theory advocated by Ragnar Nurkse or supply deficiency theory put forth by A.K. Cairncross. Thus opinions may differ, to a degree alone, among the

25 A.O. Hirschman, "The Political Economy of Import-substituting industrialization in Latin America", in Hirschman, A Bias for Hope - Essays on Development and Latin America (London, 1971), pp. 89-91. While discussing the stimulus to Import Substitution Industrialization, Hirschman thinks that balance of payments difficulties and deliberate development policy are likely to produce bias in favour of non-essential industries. The first leads to a bias in favour of non-essential industries and the second is likely to produce exactly the opposite bias. The remaining two causes (wars and gradual growth of income) are neutral with respect to the luxury character of the industry. Ibid., p. 91.

authorities on economic development of underdeveloped countries in general and Latin America in particular, on the possible causes of import substitution. Nevertheless, the appropriate time for the writings of Raul Prebisch and available conditions in the context of these economies made import substitution strategy appear to be an appropriate policy as a step towards diversifying the economic structure of these countries.

Import substitution in the sense of replacement of imports by domestic production has various interpretations. One way to define and measure import substitution is the change in the proportion of imports in total supply (domestic production plus imports). Three causes of industrial growth can be seen in this way: (i) the substitution of domestic production for imports; (ii) growth in final use of industrial products and (iii) growth in intermediate demand stemming from (i) and (ii).

Hollis B. Chenery subscribes to this viewpoint that if domestic production rises faster than imports then import substitution is taking place. He attributes the growth of output to the growth of demand (intermediate and final, independently) holding the ratio of foreign to total supply constant. Then the residual change in output is attributed to the change in the supply ratio which he calls import substitution. His cross section analysis of 51 countries suggests that changes in supply conditions are more important in explaining the growth of industry than are changes in demand.

A second way to look at import substitution is in terms of its stages. Briefly, it is a two-stage phenomenon. The first stage is the take over of an existing market for consumption goods from the foreign supplier. The second and much more difficult stage, consists of extending production backward to intermediate goods, capital goods, raw materials and finally, breaking into the world market. This stage includes too many variables and does not reflect the real aim of import substitution. A third way to analyse import substitution is to refer to all arguments to the effect that developing countries cannot rely on exports as an engine of growth. In a narrow sense, it refers simply to the take over of an existing domestic market from the foreign producer by prohibiting his imports in one way or the other.

Whatever interpretation may be given to the term import substitution - it means generally the satisfaction of a greater proportion of a country's total demand for goods through its own domestic production. Domestic production which relates to the replacements of imports is quite obviously based upon easily identifiable investment opportunities. Thus, the domestic market is assured to the domestic producers either by way of curbing imports altogether or reducing them to a considerable extent.

In a period of balance of payments crisis, import substitution is introduced accompanied by import controls or high tariffs. During its first stage, domestic production of consumer goods grows very rapidly. This is made possible by relatively simple technology, less capital requirements and fairly
existing demand. This results into rapid growth in industrial output and employment accompanied by a significant decline in the share of imports in total demand for manufactures. But it is often pointed out that the goods are of doubtful quality, produced in factories of uneconomic size and sold at high prices in the protected domestic market. As an illustrative measure, Johnson finds that the cost of import substitution may greatly exceed that implied by the difference between protective tariff rates and the foreign price of the goods produced. The high cost of import substitution may progressively absorb the increment in real income, which should accrue to capital and technical improvements, so that in addition to the consumption lost there may occur a substantial capital accumulation without any growth in real income per capita.

In addition, the case of Pakistan analysed by Soligo and Stern reveals that investment in consumer goods industries has slowed the growth of real income "because, at world market prices, the marginal productivity of domestic capital and labour is below their opportunity cost and may even be negative. Factors remain inefficiently employed so long as the government continues to apply tariffs to non-essential consumer goods in an effort to correct their trade imbalance."

Rather, the first stage of import substitution should emphasize the use of domestic raw materials and intermediate

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28 Both the examples have been quoted in P.B. Clark, *Planning Import Substitution* (London, 1970), pp. 22-23.
products which are or could soon become, competitive by international standards. Self-sufficiency in consumer goods should not be the ultimate goal. As Hirschman stressed: "Thus the sequential or staged character of the process is responsible not only for the ease with which it can be brought under way, but also for the lack of training in technological innovation and for the resistance to both backward linkage investments to exporting that are being encountered."

The next stage in the import substitution process relates to the domestic production of consumer durables followed by intermediate and capital goods. A highly unequal distribution of income due to the initial pattern of capital ownership, a series of controls over the distribution of scarce inputs such as capital and foreign exchange because of government policies and a sheltered profitable market, combine to facilitate this process. Often this stage is characterized by slow industrial growth, a sharp decline in employment opportunities and little further reduction or even an increase in the import component of total demand for manufactures. The last aspect of the effect is due to strong resistances against backward linkage investment on the part of private industrialists and public authorities.

29 A.O. Hirschman, n. 25, p. 123

Hirschman puts it as follows: "The industrialist who has worked hitherto with imported materials will often be hostile to the establishment of domestic industries producing these materials. First, he fears, often with good reason that the domestic product will not be of as

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Further, as the countries move on to higher stages of manufacturing the governments retain the old economic policies that are no longer applicable to the new phase of import substitution. Moreover, a strong push across-the-board import substitution in all the sectors indiscriminately lead to the wastage of resources.

Thus the factors which tend to initiate import substitution in consumer goods industries are likely to perpetuate that trend. In the experience of many countries, import substitution has led to more import substitution and bigger controls. The first stage of import substitution goes easily, but industrial growth slows thereafter because the limit of the existing market has been reached. John H. Power points out that one or more of three other forms of demand should replace the already established consumption demand if growth is to continue. That is, (1) domestic markets for new consumer goods must be found, good and uniform quality as the imported one. Secondly he feels that he might become dependent on a single domestic supplier when he could previously shop around the world. Third, he is concerned about domestic competition becoming more active once the basic ingredients are produced within the country. Finally his location may be wrong once the source of supply of the materials he uses is thoroughly altered. For all these reasons, the interests of the converting, finishing and mixing industries are often opposed to the establishment of domestic sources of supply for the products that they convert, finish or mix.

In a similar way, the government policy on protection is also in a way responsible for resistance on the part of private entrepreneurs.... High tariff protection for the initial industry combined with low or zero tariffs or preferential exchange rate treatment for the industry's inputs. Ibid., pp. 106-7.

31 Datas-Panero, n. 24, p. 36.
manufactured goods must penetrate the export market or investments must move from finished consumer goods industries to capital goods production, intermediate goods or raw materials. More consumer goods output will inevitably be constrained unless supported by either (ii) or (iii).

**The Emergence of "Export-led Growth" Model**

However in the 1960s, the economic thinking in developing countries became increasingly critical of import substituting industrialization for countries at a certain stage of development. It had become difficult to transform import demand into demand for domestically manufactured products.

By this time, the votaries of import substitution - individuals and institutions alike - underwent a change in policy prescriptions for the process of development in Latin America. UNCTAD under the leadership of Raul Prebisch became the leading agent in exploring new export opportunities for developing countries in both primaries and manufactures and identifying the chief barriers in such exports. Celso Furtado had also become averse with the functioning of import substitution process.

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33 Hirschman points out the changed thinking in the views of Raul Prebisch and Celso Furtado.

Raul Prebisch wrote: "An industrial strategy virtually isolated from the outside world thus in our countries.... The criterion by which the pace was determined was based not on considerations of economic expediency, but on immediate feasibility, leading to the (Contd. on next page)
The 'Foreign Exchange Gap', for which import substitution industrialization was adopted gathered momentum as imports have continued to rise after the introduction of import substitution phase, although affecting the very composition of imports. The large initial imports of capital equipment and recurrent imports of components, spares, replacements, etc., coupled with increased outflows of foreign exchange for technical assistance payments, royalties and the servicing of direct foreign investments have usually risen. Imports are also bound to go up either through the multiplier effects of the increased investment or through permanent increase in real incomes that results as a consequence of import substitution. For example, in Nigeria the average propensity to import out of gross domestic product rose from 14.2 per cent in 1950 to 21.9 per cent in 1963, with a high of 26.1 per cent in 1960.

Cost of production ... tariffs have been carried to such a pitch that they are undoubtedly on an average - the highest in the world. It is not uncommon to find tariff duties of over 500 per cent. As is well known, the proliferation of industries of every kind in a closed market has deprived the Latin American countries of the advantages of specialization and economies of scale, and owing to the protection afforded by excessive tariff duties and restrictions, a healthy form of internal competition has failed to develop, to the detriment of efficient production."

Furtado wrote: "In Latin America ... there is a general consciousness of living through a period of decline.... The phase of "easy" development, through increasing exports of primary products or through import substitution has everywhere been exhausted."

Quoted in Hirschman, n. 25, pp. 87-8.

34 P.B. Clark, n. 28, p. 18.
Import substitution is subject to the law of diminishing return. To begin with, import substitution industries face a secure domestic demand for their product of a size equal to the import bill for that product. Their rates of growth in the first few years can be high, until they saturate the existing domestic market. Rates of growth tend to decline until the product can be cheapened or new export markets are conquered. Once the easy phase of import substitution is over, the firms face a rough weather. As a remedial measure, Hirschman suggests that firms should replace the lost dynamism by backward integration into supplying industries.

More recently, as a rebuff to the import substitution policy, "export-led growth" in the context of some countries - Hongkong, Taiwan, Thailand, Malaysia and South Korea notably has been suggested as an alternative strategy for the economic development of developing countries. They have all placed greater reliance on diversification of exports as the engine of growth. The policy of protection adopted by these countries has been moderate and selective. The growth of domestic industry has been less plagued by import constraint than has been the case of Latin America. The cost of export promotion has been more visible and explicit as compared to that of the phase of import substitution and consequently corrective mechanisms have been adopted. Further export oriented strategy uses indirect rather than direct intervention in the play of market forces. There is a constant need to reckon with competition in prices and quality abroad as against the provision of
sheltered market and encouragement of monopolistic situations in import substitution phase. Finally, economies of scale can be better realized in an export oriented strategy.

Thus, there has been a shift in emphasis in the later part of 1960s and early 1970s from import substitution industrialization to export promotion activities in the case of developing countries. Disillusion with the phase of import substitution and its attendant shortcomings, availability of unutilized and underutilized capacity, mass unemployed human resources and the severe pressure of balance of payments difficulties have pushed the strategy of export promotion to the fore in many developing countries. At the international level also, the efforts of successive UNCTAD have been most stimulating to the increase of LDCs exports mainly arising out of the consideration of two factors: first, the average annual rate of growth of real gross national product in these countries in both the late 1950s and the early 1960s was little below 5 per cent.

35 For example, Daniel M. Schydowsky provides an estimate of the size and the impact of unutilized/underutilized capacity in Argentina. According to his estimate, capacity utilization has fluctuated between 55 and 67 per cent from 1961 to 1965. Taking an average of 60 per cent utilization and considering a target of 90 per cent, Argentina could have had a 50 per cent higher industrial output. Since industry contributed 30 to 35 per cent of GNP, this implies that total (and per capita) national income could have been some 15 per cent higher each year. Thus, even excluding investment effects out of the higher income, excess capacity meant that Argentina lost one year's worth of GNP every six years. See for details, Daniel M. Schydowsky, "Latin American Trade Policies in the 1970s: A Prospective Appraisal", Quarterly Journal of Economics (Cambridge, Mass.), May 1972, pp. 261-89.
One of the possible explanations has been the stagnant export as a constraint on economic development in these countries and the remedial measure has been suggested as the increase in LDCs' export earnings to meet the necessary import requirements; second, the flow of foreign capital to LDCs has also been slowing in this period. In the presence of foreign exchange constraint as suggested by McKinnon, Chenery and Strout, where an extra dollar of exports has the same effect on development as an extra dollar of foreign capital, export promotion has been suggested as an alternative strategy.

Several other studies of the Economic Commission for Latin America and of World Bank have also shown a striking correlation between the expansion of exports from developing countries and their rates of overall economic growth. The examples of a fairly rapid growth of exports and of above average overall growth rates in post-war years of Mexico, Peru, Venezuela, Japan and Israel, the Philippines, Thailand, among others, are often cited; in contrast in several cases where income growth has been relatively slow so has been the growth of exports (for example,


Various models of export growth have been propounded at different periods of time showing the causal relationship between the expansion of exports and economic growth. Among the most important export models are (a) the foreign trade multiplier model, (b) the growth model, (c) the leading sector approach, (d) the staple model, (e) the export base approach and finally (f) the development stages (or location theory) approach. The salient feature of these models has been that on the whole these (exports) could not stimulate growth in developing countries when the same models were applied successfully in developed countries. The reasons often attributed are unequal distribution in the export sector; the non-responsive-ness of the non-export sector and the nature of export commodity in developing countries.

Further, each one of the models is too narrowly conceived to have the relevance to a particular case. And a necessary assumption about the synthesis of the models may have to be made.


40 One of the examples of synthesis may be provided by the combination of staple theory and leading sector strategy. As against leading sector strategy, the staple theorists such as Watkins say the product should be natural resource intensive and it must be an export sector. But Rostow - the proponent of leading sector strategy argues that the leading sector must be a manufacturing sector and it may, but need not, be an export industry. The

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Finally, each one of the models has its own shortcomings. For example, the foreign trade multiplier model provides short run explanation mainly concerned with the utilization of existing capacity and fails to explain how export trade influences the long-term growth potential of an economy. As far as the growth models are concerned, the objectives of the two types of countries are quite different. For the developing countries the creation of productive capacity is a critical problem and is simplified by an import surplus whereas for the advanced countries, the full utilization of productive capacity becomes the critical problem and may be remedied with an export surplus.

C.P. Kindleberger has aptly summarised efficacy of the models of export growth:

Expanding exports can stimulate economic growth or retard it. The same is true of increasing imports, and of tariffs which reduce imports. And a decline in the rate of growth of exports can slow down the rate of economic growth, or speed it up. (41)

Traditional trade theories of export models as applicable in the context of developed countries though may have limited applicability in developing countries of today, yet we can not dismiss that export promotion as a strategy is wholly untenable. The rationalization about export promotion stems from the fact

ideal synthesis of the two approach should be the export of soluble coffee, chocolate and aluminium instead of raw coffee, cocoa and bauxite from developing countries.

that export activity (a) reduces the uncertain risks of purely domestic activity, (b) serves as a catalyst of growth, (c) provides easy way out to meet the debt servicing charges of developing countries and (d) entails little additional cost to the economy in the face of unutilized/underutilized industrial capacity. A brief review of all these points of rationalization would be worthwhile here.

Investor (especially foreign investor) may be more willing to invest in directly productive activity in a poor country if he (foreign investor) can sell the product in his own (developed) market than if he were required to sell in the local (underdeveloped) market exclusively, primarily because the risks of selling in his own market may be fewer. On the other hand, we may say that export trade is more risky than purely domestic trade, implying that direct productive activities' investment may be safer (and thus more desirable) if the new output is to be sold where it is manufactured. The escape route lies in the analysis of market uncertainty. An unknown domestic market is certainly riskier than a familiar export market, especially if the owners of the industrial facilities are citizens of the country controlling the developed market. On the other hand, if the domestic market is known and attractive in a poor country one may consider that domestic market to be safer than any export market. The ideal solution may be to spread the risks by producing for both domestic and foreign market.

Donald B. Keesing, however, suggests that early promotion
of exports of manufactures, even on a small scale, itself teaches valuable industrial and commercial lessons. Exports in turn open the way to further exports, by learning effects both at home and abroad, and successful export performance contributes successful head to head competition on home ground. The technology and the skills of the local industry receives an acid test. If the outcome is a success, the morale boosting effect may cause local industries to redouble their efforts. After all, one key turning point in industrial development is the switch from a defensive to an aggressive attitude about local industrial abilities.

One of the possible rationale to adopt export promotion activity is to meet the debt and debt servicing charges of developing countries in a multilateral system of trade and payments agreements. Simply put, it envisages that the creditor-developed countries, instead of asking the debtor-developing countries to discharge their repayment commitments through achieving export surplus with themselves should allow these countries to do so through additional exports to other developing countries over and above the level of exports which would take place in normal circumstances. This implies that the developing countries which receive these exports would increase their liabilities to the creditor developed countries to the same extent as the debt liabilities of the developing countries which export these goods, are reduced. As far as the creditor-developed countries are

concerned, this proposal would mean that the repayment due to them for one debtor developing country or countries are re-
C lent almost simultaneously to another developing country/coun-
tries. This process continues until all the developing coun-
tries have built up their competitive industrial structure suffi-
ciently to enable them as a group to raise their exports to the developed creditor countries so as to discharge their debt obligations to them.

Further, exports provide a source of valuable foreign exchange earnings at no additional cost to the economy provided excess capacity and unemployment of labour exist. Thus the use of additional labour and some of the installed idle capacity to produce for exports does not require the economy to sacrifice much, if any other output. When full capacity utilization in all sectors of industry is reached, further export expansion, now entailing capacity expansion as well, should be directed to those sectors in which the economy has a comparative advan-
tage and away from the indiscriminate diversification of the industrial sector. While where excess capacity persists, all industrial output can be promoted in the short run. In the long run, however, considerable selectivity needs to be exer-
cised.

It is apparent from the preceding discussion that the developing countries should not only cling to the traditional

43 For a complete review of this model, see Deena R. Khat-
trade theory in its static aspect, yet try to assimilate the dynamic flow of benefits arising out of export activity by a proper analysis of expected demand and potential supply of their given resources. According to Joseph E. Haring: "Export promotion is simply the ascertaining of the shapes and locations of potential supply and demand curves and their producing and trading where the profits appear greatest." Export promotion may also be regarded as "a positive policy aimed at the acceleration of the development of exports."

However, there is no precise scope of export promotion and, for various people and institutions, it has different interpretations. Some of them tend to think that the scope of this term is limited to research, advertisement, trade missions, exhibitions and other elements related mainly to the demand side of the export activity and trade measures. Others think that export promotion encompasses simultaneously the supply and demand side of exports activity, trade and internal measures. It might seem that this discrepancy stems from different approaches to the need, scope and instruments of the state economic policy in general and particularly in exports. While developed economies not facing structural disequilibrium in external balance tend to limit pro-export policy to export marketing and foreign trade policies, yet the developing countries in a bid to accelerate

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economic development in the face of external imbalances, tend to promote exports by taking internal measures directed at increasing elasticity of export supply too.

Among the most important instruments to stimulate the exports in general and of manufacturing exports in particular, mention may be made of the low exchange rate, and a variety of familiar subsidy and tax measures. These may include tax holidays and liberal depreciation allowances for industry, low cost loans and industrial finance, government subsidized export credit and export promotion, external turnover taxes not applied to exports and the deliberate design of social overhead facilities, education and research expenses to aid export industries in the long run.

The development of exports can have both direct and indirect impact on the process of economic development of a developing country. The direct impact is reflected mainly in the enhanced level of imports through increased exports; stimulus to the efficient linkage industries and the competitive pressure through close communication with advanced countries to effect reduction in per unit cost. Among the indirect modes of impact, mention may be made of increased investment, consumption and the flow of technology.

An increasing level of exports generally means that the country has the necessary resources to step its level of imports. The country is enabled to take advantage of the international division of labour, procuring desired goods from abroad at considerable savings in terms of inputs of productive factors.
This helps increase the efficiency of industry which is a major factor in economic growth. An alternate but less well known schema runs through J.M. Keynes' view that larger exports unaccompanied by larger imports would increase foreign exchange reserves; in a country where the supply of money is directly connected to these reserves, the resulting increase in the money supply, would by the familiar Keynesian process - lower interest rates and thereby, stimulate domestic investment.

Export development provides stimulus to the most efficient sectors of the economy. The effect of exports on other related industries depends on two factors: the extent to which the export industries penetrate the rest of the economy and the rate of technological progress in the export industries relative to that of the remaining sectors. If exports are produced by industries that form an enclave in the economy and are barely related to other sectors (the oil industry), then even a very fast rate of export growth will hardly affect the other sectors. On the other hand, if exports do not manifest a higher rate of technological change (both purely technological change and economies of scale) then again there is no special advantage in developing exports rather than other industries. If export market is adequately cultivated, the high rate of technological change (especially the economies of scale) provides a cushion

46 Quoted in B.I. Cohen, n. 36, pp. 281-3.

against the small size of the market. Further, in the downswing of the business cycle, additional production through technical change can find access to the export market at competitive price without any sacrifice on the domestic market.

The necessity of remaining competitive in international markets tends to maintain pressure on the export industries to keep costs low and to constantly strive for efficient operations. The competitive pressure also tends to lead to improvement in the quality of the export product and in general, inhibits the establishment of inefficient export industries. Thus the value of competition and close tie up with advanced countries in view of dependence on technology enables a switch from a defensive into an aggressive attitude in local industry.

As a result, it "induces an entrepreneur to expand capacity and make use of known but previously unutilized techniques. This sub-model is particularly relevant to those general models of growth which emphasize the importance of technical change, as contrasted with capital expansion."  

Nevertheless, in addition to direct benefits of providing part of the wherewithal for economic development and stimulating more efficient use of resources, a dynamic export sector also produces substantial secondary benefits. These include increased investment, consumption and flow of technology.

Profitable export industries tend to stimulate additional investment, both domestic and foreign. When exports of a primary

product are profitable and expanding, there is a stimulus to domestic investment in the existing industries associated with the product in various stages of production. Expanding exports also encourage investments in ancillary industries set up to supply and service the operations of the main export industry. Such linkages may be either in a backward direction (the provision of inputs) or a forward one (processing of other uses of outputs). One may also conceive of final demand linkages which are the product of the demands exerted by the industry's local income recipients; these arise, however, from any income increasing development, their precise nature deriving from the size and distribution of the income increases. For example, the development of electronics industry enables the development of a whole network of small manufacturers supplying inputs to export oriented antennae, plugs and jacks, terminal boxes, coils, yokes and transformers.

In addition to stimulating domestic and foreign investment, a growing export sector also encourages the increased flow of technological innovations as well as managerial skills. Under the pressure of competition and desire to continue expanding foreign sales, foreign technologies and methods are imported to further improve productivity and quality. G.K. Helleiner demonstrates that there is likely to be a progression in the degree of sophistication of export-oriented manufacturing industry over a time, which must, to no small degree be attributable to the

49 G.K. Helleiner, n. 20, p. 249.
"learning phenomenon".

A growing export sector also serves as an indirect stimulus to increase consumption. As consumers become gradually aware of the foreign consumers product that they can obtain because of expanded export earnings, there is increased desire to acquire these products. Thus, there is a kind of 'demonstration effect' where individuals decide to increase their expenditure when they become aware of the existence of a large variety of goods or of superior goods. However, the impact of internal expansion and income growth attributable to export growth also depends upon the income elasticity of domestic demand for domestically produced goods and services. If, for example, the domestic demand for items presently exported is quite income elastic, internal growth may have an anti-trade bias and the export ratio is likely to fall. If, however, the demand for exportables is quite inelastic, growth will tend to have a pro-trade bias which is likely to contribute to a rise in the export co-efficient.

An Evaluation of Export Promotion Strategy

The success of the often cited "export-led growth" of developing countries has not been an unmixed blessing. Much of the export promotion activities have been undertaken with a heavy government subsidy; assumed a liberal import policy causing 51

50 Ibid., p. 251.

51 For details of this point see, Charles W. Hultman, n. 39, pp. 153-6.
a strain on the balance of payments, specially increasing the external vulnerability of the economy; mounting unemployment and aggravating income distribution pattern; negligence of agricultural exports to maximize output and employment opportunities; and finally causing distortions in the industrial structure. Each one of the factors need detailed discussion.

It is generally thought that the developing countries should specialize in labour intensive items for exports as they are easy to manufacture involving less sophisticated technology and absorbing surplus labour. This results into more benefits as compared to cost. However, this may not be the case. Manufactured exports frequently enjoy large number of fiscal incentives; subsidized provision of infrastructural facilities such as buildings, roads, water and power supplies, dock facilities, credit, etc. Not only this, these subsidies can be expected to increase with the relative international disadvantages of the exporting country with respect to labour cost, resource availabilities, distance, etc. To quote G.K. Helleiner: "A study conducted by Phillips for the UNCTAD indicated that the cost of producing their radio receivers for export from Africa would be 25 percent greater than it is from a Far East location."

The phase of "export-led growth" has assumed a liberal import policy and any quantitative regulation is considered inefficient. This is in itself not shocking except to counterprove the efficacy of 'linkage effects' to be generated in the industrialization process and the balance of payments.

difficulties in new garb. The theoretical validity of linkage effects when put to acid test evidences that larger export firms tend to be more import intensive in their purchase of inputs than smaller ones and that foreign-owned firms tend to be more so than local firms. Analyzing the Brazilian import structure during the period of 1967-70 and 1970-73, total imports increased around 20 per cent on an average during 1967-70 whereas for 1970-73, this average worked out, to 34.5 per cent. The salient features of this import growth has been the increase in import co-efficient from 4.7 per cent in 1967 to 11 per cent in 1973. Industrial imports accounted for 80 per cent of the total imports. No doubt, the increase in the import co-efficient was bound up with the expansion of the dynamic core of industry, but on the other hand, it constituted the vulnerable aspect of such growth, in that it imposed increasing rigidity on the pattern of imports, which could come to constitute a bottleneck in the future. And precisely out of this consideration, the Brazilian second National Development plan (1975-79) emphasized the indigenous development of capital goods sector.

Generally, a favourable aspect of manufactured exports is considered as the creation of employment opportunities in less developed countries. While the experience of small countries like South Korea, Taiwan and the Philippines suggest labour-intensive manufactured exports has been instrumental, directly

53 Ibid.
or indirectly, in achieving reductions in urban unemployment and subsequent wage rate increases, yet, however, William G. Tyler's sample findings prove contrary to the expected generality. According to Tyler:

For the larger countries in our sample, industrial export promotion offers little promise of eliminating unemployment and underdevelopment in the reasonably short run. This pessimistic finding is not mitigated by the fact that manufacturing exports may be growing very rapidly. It is paradoxical that Brazil, while enjoying one of the fastest rates of growth for manufacturing exports, has the furthest to go before such exports will contribute to alleviating its surplus labour problems. In the case of India, Ranadev Banerjee and Reddaway have convincingly argued that the expansion of Indian manufacturing exports does not constitute the easiest and necessarily the most desirable development strategy. While one might argue that large countries might benefit by changing their export composition to more labour intensive manufactured products, it should be noted that the three large countries Brazil, Mexico and India in our sample already possess the lowest estimate of the required manufactured exports per job generated. (56)

G.K. Helleiner puts two main arguments as to why for a large number of developing countries and especially in Latin America, employment opportunities through labour intensive manufacturing exports have failed to generate adequate job opportunities. Citing Brazilian and Colombian experiences, he says, large firms which are far more capital intensive in their production than the rest of the firms, are well entrenched in export

efforts. And it seems that many of the same companies which in the past benefitted and which still do from import intensive import substitution, now benefits from the newer export promotion policies. Secondly, relatively few firms are involved in export activities in these countries as far as manufactured exports are concerned. For example, full 62 per cent of (non sugar) industrial exports are accounted for by only 24 firms, of which 10 are foreign owned. In 1970, only 11 firms accounted for over half of all Brazilian manufactured exports. As a consequence of foreign dominated enterprises and market concentration, it naturally follows that these would employ capital intensive technologies, with large size of the plant and relatively modern equipment.

About the implication of income distribution in such economies, it seems that government policies have been responsible to suppress the wage rate and allow a higher return on capital and managerial skill. Brazil is obviously a case in point where, it is claimed that income distribution has aggravated during the period of military regime. It is only in 1975 the minimum wage rate was raised to 532 cruzeiros a month which is still insufficient to maintain a family of five members on subsistence level, given the high rate of inflation into the economy. Conditions are also not so good in the rest of Latin


58 A recent survey carried out by the (Brazilian) Institute of Agricultural Economics showed that an average family of two adults and three children needs 791 cruzeiros

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America, where income distribution implications are acute.

In a bid to industrialize these economies, the developing countries bias toward agriculture sector in no way seems to have been better than in the import substitution industrialization phase. Except for the boom conditions in early 1970s for a short period, the agricultural exports have not shown encouraging results. In a few major countries, agricultural export diversification in the face of boom conditions got a temporary bonanza, yet, however, there seems to have been a lack of proper policy of expanding agricultural exports. In the wake of oil crisis, tight international monetary situation and rising import bill on account of inelastic demand of raw materials and equipment to maintain the tempo of industrial activity in such economies, there seems to be a deliberate shift in emphasis on the export promotion of primary commodities. For example, Brazil has gone to rely heavily once again on coffee exports in 1975 and 1976 in order to meet its balance of payments crisis. However, it seems that supply constraints are still more effective in primary commodities exports rather than demand considerations.

Thus an objective evaluation of export promotion strategy suggests that the claims made by the proponents of this strategy just to purchase the indispensable minimum of food to ensure physical survival, Latin America (London), 25 July 1975, p. 229.

59 Coffee, which was hardly 12.5 per cent in export basket in 1974, regained its position in 1976 as one-quarter of total Brazilian exports, Latin America, 21 June 1974.
at the end of 1950s and early 1960s do not provide a viable option, if not for all types of developing countries, at least, surely for major developing countries such as India, Brazil, Mexico and Argentina. The basic question which this strategy poses remains unanswered. Can the developing countries afford to pursue liberal policies in the face of unavoidable and involuntary imports, leaving very little foreign exchange? Thus the policy options open to developing countries may not be a simple choice between import substitution and export promotion. The economic structure of such countries could contain industries of both types and a possible strategy would be to develop import substitution within sheltered markets and gradually to phase out the protection granted so that the industries could become export competitive. This is perhaps the conclusion which Stefan H. Robock comes to when he says:

An industrial sector characterized by efficiency, specialisation, and comparative advantage can be both an effective substitute for imports and a promising contributor to foreign exchange earnings through exports. The issue of strategy for industrialisation as a choice between import substitution or export expansion is indeed a false dichotomy. (60)

One of the weaknesses of the Prebisch-ECLA approach has been to view import substitution and export promotion as an either/or problem. Yet, more recent thinking stresses the importance of selectivity, and it is admitted that unfettered

60 Stefan H. Robock, "Industrialisation through Import Substitution or Export Industries: A False Dichotomy", in Markham and Papanek, eds., Industrial Organisation and Economic Development (Boston, 1970), p. 365.
comparative advantage cannot be the sole guide to the choice of activities. Import substitution and export promotion activities are not necessarily fully competitive but these can be of complementary nature.

A country can devote certain amount of resources on production of exportables which would enable the country to import a certain amount of goods from abroad that can not be produced at home. On the other hand, some amount of resource could be devoted to the production of goods at home or close substitutes which have been imported from abroad. A number of variables - size of the market, availability of its natural resources, technology, composition of exports, price and income elasticities of demand - would affect the optimal mix of the two activities.

The initial boost to traditional exports would generate additional income, output and employment. A part of this marginal rise in income will be spent on goods the country was never able to produce because of lack of market. The domestic or foreign entrepreneurs receives impetus to set up the industries at home producing goods which would have been imported. Import substitution industrialization (ISI) could also diversify the structure of the economy, generate the growth of skill and technology and develop the potential entrepreneurial talents.

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61 For this section, I am grateful to P.K. Mitra's article. For detailed analysis, see, P.K. Mitra, "Import Substitution and Export Promotion as Means to Industrialisation", Economia Internazionale, vol. 27, August-November 1974.
But ISI cannot go indefinitely. The limits to growth of above factors are reached. A rational choice of import substitution industries according to this criteria would give them a fighting chance of eventually becoming internationally competitive. Thus the simultaneous development of traditional exports and new exports as a result of ISI could be geared.

The process could continue in this way through promotion of exports and import substitution activities and again exports and so on.

A country could initially undertake a number of ISI activities the extent of which may vary from one country to another and then rely partly on exports for fuller utilization of the resources and so on.
If traditional exports are initially given a boost followed by import substitution activities, the development path could be A A', A' B, B B', B' C as indicated in the diagram. In case, import substitution activities are promoted initially and exports later, the development path could be AM, MB, BM' and M' C.

The actual path depends on (i) composition of exports, (ii) nature of import substitution activities. Israel has for long applied an interesting method for the optimal selection of export-oriented and import substituting activities. One of the inherent dangers in this type of mix is likely to be the growth of inefficient uncompetitive industries by means of high protective walls. A way out is to start with low levels of protection and to subject the industries to periodic examination for their efficiency and finally abolish import duties. Given a list of mixed exporting and import substituting industries, the policy maker can choose those with the lowest domestic cost per unit of foreign exchange.

However, it should be recognized that export success is conditioned by the size of a country and the structure of its existing exports. The continuous protectionist policies being pursued by developed countries in their import policies towards developing countries, need not be emphasized here.

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Besides a protective policy for agricultural products, developed countries realize that the stimulation of manufactured exports from developing countries can pose a threat to the livelihood of workers in the more backward areas and sectors of their countries. M.J. Sharpston holds:

The importation of labour-intensive goods tends to lessen the labour scarcity of high wage countries and, as a result, to depress labour's share of national income. In any case, what concerns organised labour most is almost certainly the effects on structural unemployment rather than effects on wages or income distribution as such. 63