2.1 Introduction:

Considering the fact that in the last four decades since 1970’s, export led growth strategy has got a wide consensus among the economists as an effective alternative to the import substitution policy for attaining the high economic growth (Shrinivasan, 1998), there is an imperative need to find out answers to certain questions that are being raised in relation with this policy. What is the meaning of the term export led growth and what is the rationale behind this strategy? Is there any theoretical ground on which the export led growth strategy can be analyzed? Is there any empirical evidence proving the interrelationship between export and GNP growth? And lastly what are the ways in which the export growth and GNP growth are interrelated? This chapter aims at finding out answers to these questions.

2.2 The Meaning and the Rationale:

There are different ways in which one can interpret the concept of Export Led Growth. Firstly, it implies that an increase in the rate of growth of exports leads to an increase in the rate of growth of an economy (Krueger Anne, 1978). Secondly, it means that exports and growth are interrelated in a circular and cumulative process and therefore exports can play a very important role in the overall growth process (Verdoom, 1949). Thirdly, the empirical studies show that there is a high correlation between export growth and economic growth which can be considered as another interpretation of export led growth (Herberger, 2006). In the export led growth strategy, exports and export policies are regarded as crucial growth stimulators. In the words of Thirlwall: “the growth of exports plays a major part in the growth process by stimulating demand and encouraging savings and capital accumulation, and, because exports increase the supply potential of the economy, by raising the capacity to import” (Thirlwall, 2000).

Thus, the basic idea is that the increase in exports exerts a favorable effect on the growth process of an economy. But the question is how the export growth will induce the overall growth process in an economy? What is the path or process through
which the exports can positively influence the economic growth? Beckerman (1962) and Lamfalussy (1963) tried to establish the linkages between exports and economic growth through their pioneering models (Giancarlo Gandolfo, 2001).

Lamfalussy model assumes that “the investment ratio depends on the ratio of exports to income and the rate of expansion of exports higher than that of the other components of National Income causes an increase in the desired investment rate, because the sectors producing exportable are the most innovative sectors as they are exposed to international competition” (Lamfalussy, 1963).

The Beckerman model is different from Lamfalussy model by more directly focusing on the relation between exports and productivity, prices and wages. A simple version of the model implies that a high rate of increase of manufacturing exports is accompanied by improvements in productivity, which contributes, to decreases in labor costs under the assumption that wages rise at a rate lower than the growth of productivity. The lowering of labor costs, in turn, leads to further increases in exports through a decline in prices relative to those of other economies (Beckerman, 1962). Thus, these two models argue that the sectors which are producing exportable are generally the most innovative and those in which the productivity increases are the largest; a rapid growth in these sectors has beneficial effects on the productivity of the whole economic system leading to high growth. This view of growth process points to “divergence” theory, in the sense that inter-country differences in growth rates, once established, would tend to be perpetuated (Bela Balassa, 1963).

A well formulated version of the above models can be observed in three growth models developed after 1970's, which discuss the linkages between export growth and economic growth from three different angles. The first model is the neoclassical supply-side model; the second one is the balance-of-payments-constrained growth model; and the third model is the virtuous circle model. (Thirlwall, 2006).

The neoclassical supply side model of relation between exports and growth assumes that the export sector confers externalities on non-export sector because of its exposure to foreign competition and it has a high level of productivity than the non-export sector (Feder, 1983). Thus the share of exports in GNP, and the growth of exports, matters for overall growth performance. The model assumes that the output
of export sector is a function of the labor and capital in the sector while the output of non-export sector is a function of labor, capital; and the output of export sector to capture externalities. The model shows that export sector confers externalities on the non-exporting sector that are associated with the transmission and diffusion of new ideas from abroad relating to both production techniques and efficient management practices. Esfasani (1991) argues that from the supply side the export growth may raise output growth through externalities, but also faster export growth permits faster import growth. If countries are short of foreign exchange, and domestic and foreign exchange resources are not fully substitutable, more imports permit a fuller use of domestic resources. In particular, more foreign exchange allows the greater import of capital goods that may not be produced domestically but are crucial for economic growth (Thirlwall, 2006).

The balance of payment constrained growth model provides the simplest of all explanations of the relationship between the export growth and the economic growth (McCombie, 1985). This model argues that in most developing countries, the major constraint on the growth of demand is the current balance of payments and the shortage of foreign exchange. Export growth relaxes balance of payments constraint on demand and allows all other components of demand (consumption, investment and government expenditure) to grow faster without running into balance of payments difficulties. Exports are unique as a growth inducing force from the demand side because it is the only component of demand that provides foreign exchange to pay for the import requirements for growth. Thus, it allows all other components of demand to grow faster in a way that consumption led growth and investment led growth do not (Thirlwall, 2006).

The third model relates the exports and growth in a cumulative process. It also raises the question of causality and provides an explanation of why growth through exports is concentrated in particular areas of the world while other regions and countries have been left behind. A simple cumulative growth model can be outlined as follows: output growth is a function of export growth; export growth is a function of price competitiveness and foreign income growth; price competitiveness is a function of wage growth and productivity growth, and productivity growth is a function of output growth. It is known as Verdoorn effect who suggested it in 1949. Thus, this model provides various reasons for why exports may be a more potent growth
inducing force than other elements of demand (such as investment, consumption, etc). Firstly, it shows that exports allow regional specialization, which may bring dynamic as well as static gains. Secondly, exports permit imports, and imports may be important in developing countries that lack capacity to produce development goods themselves. Thirdly, if the exchange of information and technical knowledge is linked to trade, exporting facilitates the flow of technical knowledge, which can improve the area’s supply capacity (Dixon and Thirlwall, 1975).

Thus, the open economy growth theories provide the rationale for the export led growth strategy that can be concluded as follows:

First, export growth represents an increase in demand for country’s output and thus causes an increase in the real GNP (Balassa, 1978).

Second, an increase in the exports leads to specialization in export production that increases the productivity levels in the export sector. It may reallocate resources from the relatively inefficient non-trade sector to the highly productive export sector (Giles and Cara, 2000).

Third, the export oriented trade policy may also give access to advanced technologies, learning by doing gains and better management practices (e.g. Hart, 1983, Ben-David and Loewy, 1998) that may result in further efficiency gains.

Fourth, an increase in exports may reduce a foreign exchange constraint (Chenery and Strout, 1966) that makes the country easier to import inputs to meet the domestic demand, and so enable output expansion.

2.3 Is there any alternative strategy?

It should be noted that the support for export led growth strategy is not universal. The critics point at various issues involved in the replication of export led growth strategy in other developing countries as the experiences in the East and Southeast economies are considered to be unique in many ways (Buffie, 1992). Thomas Palley (2002) has argued that after several decades of being presented as the optimal growth strategy, export led growth strategy that the East Asian countries followed have ultimately harmed the growth prospects of developing countries. Blecker (2000) also argues that the adoption of a development strategy that relied on high growth rates of manufactures exports is the root cause of the problems in many
developing countries as it led to growing excess capacity, intensified competitive pressures and disappointing growth performance, at least for a couple of years. Other researchers question whether the reliance on exports to lead the economy will result in sustained long term growth in developing countries due to volatility and unpredictability in the world markets (Jaffee, 1985). Kaplinsky (2000) and Ertuk (2001-02) suggest the possibility of Immiserizing growth as a result of the creation of excess capacity in export oriented manufacturing industries. Adelman (1984) points at the issue regarding the size of the markets in developed countries for the exports from developing countries, and even the issue regarding the trade barriers that may impede the route of development through exports.

The scholars like Prebisch (1950), and Singer (1950) favor the counter strategy of import substitution and protectionism for development. Import substitution involves the use of protectionist measures (such as tariffs, quotas and subsidies) to substitute domestic output for imports; it can be implemented without any external influences or independently, and the benefits of the strategy for increasing the output are immediate (Giles and Cara, 2000). Promotion of import substitution industries may also help to develop a variety of industries while export promotion may only result in a select number of industries (Palley, 2002). Some argue (e.g., Corden, 1987) that financing development via import substitution may be politically attractive as tariffs, quotas, etc, may raise taxes in a hidden fashion. Even the issue of domestic demand led growth as an alternative strategy has also been discussed widely by researchers such as Palley (2002).

2.4 The benefits associated with export led growth in comparison with import substitution:

There is no doubt that the above criticism has raised very important issues regarding the export led growth strategy. However, Meier (1995) points out some potential benefits associated with the export led growth strategy with respect to import substitution policy which can be discussed as follow:

1. The domestic resource cost of earning a unit of foreign exchange through export promotion tends to be less than the domestic resource cost of saving a unit of foreign exchange through import substitution;
2. As the export led growth rests on the exogenous world demand, a developing country can overcome diseconomies of small size.

3. For being exposed to world competition, firms in the country can increase X-efficiency (i.e., the forces that intensify motivation that result in lower cost curves for the firm).

4. Export led growth strategy can attract foreign direct investment while import substitution policy is mostly hostile towards foreign investments;

5. Export led growth contributes more than does the import substitution to employment generation and improvement in the distribution of income (Edwards, 1993).

2.4 The Rationale behind export led growth strategy

Even the empirical studies by different scholars have also brought about very important justifications in line with the above-mentioned benefits for the export led growth strategy for the developing countries like India.

1. Felipe (2003) shows that participating in trade, especially export production and promotion, exposes a country to the latest and most advanced production and marketing techniques, and the “learning by doing” process brings about dynamic innovation and technological diffusion into the economy. It also drives the economy to a higher production and economies of scale, which lead to increasing returns.

2. Many researchers use the “two-gap or three-gap” models of Chenery (1969), Bacha (1990) or Tayler (1993) to justify the need to earn foreign exchange via exports. According to these models, the investment- savings gap and the foreign exchange gap are the major obstacles to the growth and development of many developing countries. As countries need precious foreign exchange for their development needs (capital goods, industrial raw materials, oil and food), export earnings are more efficient means to finance these needs than foreign debt since the latter is vulnerable to adverse exogenous shocks and currency risks that may lead to debt defaults (Bajpayee and Sachs, 1998).

3. A similar argument (MaCombie and Thirwall, 1994) claims that large balance of payment deficits, spurred by large import propensities or elasticities, may
be a hindrance to growth for many developing countries. Thus, moderate trade
deficits or trade surpluses are more desired. This, obviously implies that
export growth should be in pace, or should outpace import growth.

4. It is argued that export led growth strategy allows an expansion of aggregate
demand without much inflationary pressure and without the danger of wage-
price spiral, compared to strong domestic demand injections. This is partly due
to the resulting real appreciation of the currency as a result of large export
earnings, which tame inflation and allow real wages to rise (Meier, 1995).

It is mainly in view of these considerations that many countries around the
world have abandoned the import substitution policies in favor of export promotion
strategies.iv (Bajpai and Sachs, 1998). The inward looking import substitution strategy
adopted by many countries like Brazil, China and India was based on the idea that a
large country could develop its own capital goods and intermediate goods sectors so
that it would not have to rely on world markets for imports of capital and intermediate
products if they want to achieve higher growth. But this strategy failed miserably (Nirupam Bajpai and Jeffrey Sachs, 1998). Various reasons can be cited for the failure
of the import substitution strategy in these countries. Firstly, these countries had to
import the capital goods, intermediate products and new technology, which could not
be produced or developed domestically due to resource constraint. Secondly, even a
large domestic market was not enough to spur strong internal competition in the
absence of vigorous competition from abroad. Thus, the strategy of inward looking
development, in which exports would be unimportant because imports would be held
to a minimum, proved to be ineffective in developing countries including India,
China, Brazil and former Soviet Union. On the other hand, it has been proved
empirically that the East Asian countries such as South Korea and Taiwan and some
South East Asian Countries such as Malaysia, Hong Kong, Indonesia and Singapore
which adopted the export led growth strategy experienced very high rates of economic
growth and were lauded as the “Asian tigers” or “growth miracles”.

2.6 Conclusions:

This chapter attempts to find out the meaning and implications of the export
led growth strategy and what are the linkages between the export growth and the
economic growth. It also tries to analyze what is the rationale for the export led growth strategy on the theoretical basis. It can be said that the export led growth strategy has definitely got some advantages over the import substitution policy in the form of large scale of production, technological advancement, expansion of aggregate demand and reducing the foreign exchange constraint.

As it has been pointed out by Giles and Williams (2000), however, the effectiveness of export led growth strategy is ultimately an empirical issue and over the last twenty years from 1980's many empirical studies have been undertaken by researchers to investigate the export-economic growth relationship. The next chapter provides a summary of the empirical literature on the export led growth across nations. In this chapter the study concentrates on the studies that are explicitly interested in export – growth relationship.

\footnote{In contrast to the Convergence theory that argues that economies with different initial levels of output generally grow to equal standards of living, the divergence theory states that the inert-country differences will be widened due to differences in the growth rates of different countries (Barro, 1991).}

\footnote{Verdoorn P.G. was one the first economists to discuss the empirical relationship between productivity and output growth form a simultaneous equation model.}

\footnote{The case of Immiserizing growth has been discussed by Bhagvati J. (1958), reflects that an unfavorable terms of trade effect, when, overwhelms even a favorable wealth effect, it leads decline in nations welfare.}

\footnote{Some researchers distinguish between a strategy of export led growth and strategy of export promotion (e.g. Bhagwati, 1986). The former is one that gives primary emphasis to exports as opposed to production for domestic market. Export promotion, on the other hand, is defined as a developments strategy of eliminating biases against exports. This study recognizes the validity of such separation but it is a distinction that may be difficult to separate at macro level as we are studying empirically. Consequently this study does not distinguish between export led growth and export promotion strategy.}