Deceleration in World Economic Growth and Industrial Development in the Third World

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Introduction

This brief essay has two main objects. The first is to examine how well the central *economic* tenets with respect to industrialisation, trade and economic growth which have guided UNCTAD's work since its inception have stood the test of time. Its second main purpose is to enquire what modifications are required in intellectual outlook and emphases to best meet the organisation's basic goal of rapid economic and industrial progress in the Third World in the changed circumstances of the world economy.

Industrial Growth in the Third World

The main theses of Dr Prebisch, the intellectual founding father of UNCTAD,[1] with respect to the interrelationship between trade, industry and development may be rationalised and summarised as follows.[2] Owing to the low income elasticity of demand for primary products in the developed countries and other factors, there was a long run tendency for the terms of trade of developing countries to deteriorate over time [see Prebisch 1957; Bacha 1978]. In the structural approach to economic growth which Prebisch espoused, manufacturing was the engine of growth and industrialisation was the key to economic development [see Singh 1981]. However, in view of the fact that income elasticity of demand for the import of manufactures in less developed countries is very high (and much greater than the world income elasticity of demand for developing countries' exports of commodities), an increase in the tempo of growth in the developing countries would inevitably lead to balance-of-payments disequilibria. To forestall such disequilibria, it was essential that the developed countries should be willing to accept manufactured exports from the developing countries on a non-reciprocal basis as well as provide aid and other capital flows.[3]

[1] The other leading economists who made major contributions to this intellectual approach were Hans Singer, W. Arthur Lewis and the late Ragner Nurkse.

[2] See also Abrahamian's [1984] excellent discussion of this subject.

The economic history of the last few decades suggests that at a very important level, this approach to economic development has stood the test of time remarkably well. As Table 1 indicates, the developing countries made rapid industrial progress during the period 1960-80. Their share of world manufacturing production, though still very small, increased by nearly 50 per cent, from 6.9 per cent in 1960 to 10.2 per cent in 1980. Disaggregated data for individual industry branches shows that Third World industrialisation during these two decades has also been widely based: the Third World countries significantly increased their share of world production both in light industries and in heavy industry. As a result of this industrialisation (and that of the socialist countries, also shown in Table 1), there have not only been far-reaching changes in the location and structure of world industry, but also a major transformation of the economic structure of the developing countries themselves. The share of manufacturing industry in GDP in these countries rose from an average of 13.4 per cent in 1960 to 19.7 per cent in 1980.

These developments were accompanied by similar changes both in the structure of world trade and the exports of the developing countries. The latter's share in the world exports of manufactures increased from less than four per cent in 1960 to nine per cent in 1980. In the 1960s, in the developed market economies, imports of manufactures from the Third World increased at much the same rate as the former's imports from the rest of the world (chiefly their intra-trade). However, during the 1970s imports from the Third World rose at about twice the rate of the latter, leading to concern about 'de-industrialisation' of industrial countries on account of cheap labour imports from the Third World.

[3] Papers in this *Bulletin* by members of UNCTAD's Secretariat describe the organisation's operational work in implementing the policy conclusions from these theses. Colin Greenhill's paper outlines the history of UNCTAD's involvement in attempts to obtain greater access to developed country markets for Third World manufactures.

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Table 1

Structural changes in the world industrial economy: 1960-80

manufacturing output (value added) for major economic groups

	1960	*1970*	*1980*
Value added (US dollars bn at 1975 prices)			
developing countries	49	101	218
DMEC[1]	533	942	1358
socialist countries	119	283	572
total	701	1326	2150
Contribution to GDP (per cent)			
developing countries	13.4	15.7	19.7
DMEC[1]	24.3	26.5	27.8
socialist countries	24.6	30.7	36.7
total	23.1	25.9	28.4
Share in world manufacturing output (per cent)			
developing countries	6.9	7.6	10.2
DMEC[1]	76.0	71.1	63.2
socialist countries	17.1	21.3	26.6
total	100.0	100.0	100.0

	1960-1970	*1970-1980*
Average annual growth (per cent)		
developing countries	7.6	8.0
DMEC[1]	5.9	3.7
socialist countries	9.0	7.3
total	6.6	4.9

[1]developed market-economy countries
Source: UNCTAD 1981

The favourable picture outlined above refers of course to the 'average' (in the statistical sense) developing country. Economic and industrial progress in the Third World has by no means been equally distributed among countries — it would not be expected to in view of the wide diversity in the levels of economic, social and political development in these nations at the beginning of the period being examined. Nevertheless, it is important to remember that the industrially most successful Third World nations have included countries like India, China,[4] Mexico and Brazil where the bulk of the Third World's population lives.

If we now turn from an examination of long-term trends over the time span 1960-80 to the most recent period, there are pressing reasons for disquiet. As Table 2 shows, since the second oil crisis of 1979, there has been a sharp decline in the rate of economic growth of the Third World countries. Although China, India and other Asian countries have continued to grow at their previous trend rates, for the Third World countries as a whole, there was no increase in *per capita* GDP in 1981 and 1982. Economic performance in 1983 was worse still; preliminary data suggest that *per capita* GDP in the developing countries declined by one per cent last year [World Bank 1984]. Similarly, Third World manufacturing production has been hard hit by the world economic crisis. Industrial production and capacity have continued to expand in India, China and other East Asian economies, but in Africa and Latin America industrial production has fallen sharply and in many countries there is evidence of a massive de-industrialisation. For example, in Tanzania, which is fairly typical of low-income sub-Saharan African countries, manufacturing production has fallen by 25 per cent in each of the last two years and industry is currently working at only 20 per cent of its capacity. Similarly in Latin America, even in the industrially most advanced countries of Brazil and Mexico, production, employment and capacity utilisation in industry have decreased significantly during the last two years.

Is the recent adverse economic experience of the Third World countries simply a short-term aberration? Will these countries soon automatically climb back to their long-term trend rates of growth or will it be necessary for them to follow rather different economic strategies and policies than they did in the past? Can the Prebisch theses outlined earlier satisfactorily explain these recent developments? Will the operational and policy conclusions which UNCTAD has drawn from the Prebisch approach remain valid in the foreseeable future? These urgent questions will be examined in the following sections.

The Slowdown in the World Economy

It is certainly an arguable proposition that the economic retrogression of the developing countries during the last four years is entirely due to the world economic crisis. The most important channels through which the slowdown in world economic

[4] The argument remains valid even if China is excluded from the analysis. UNIDO [1979] indicates that between 1966 and 1975 10 countries accounted for nearly three quarters of the total growth of manufacturing production in the Third World (other than China and other Asian socialist countries): Brazil, Mexico, Argentina, South Korea, India, Turkey, Iran, Indonesia, Hong Kong, and Thailand. 60 per cent of the Third World's population lived in these countries in 1975.

Table 2

Growth of GDP, 1960-82 major economic groups

country group	*1980 GDP (billions of dollars)*	*average annual percentage growth*				
		1960-73	*1973-79*	*1980*	*1981*	*1982*[1]
all developing countries	2,231	6.0	5.1	3.0	2.0	1.9
low-income	544	4.5	5.1	6.1	3.7	3.7
Asia	492	4.6	5.6	6.6	4.1	3.9
China	283	5.5	6.3	6.8	3.0	4.0
India	159	3.6	4.4	6.6	5.6	2.8
Africa	52	3.5	1.5	1.2	0.1	0.8
middle-income oil importers[2]	920	6.3	5.5	4.2	1.1	1.1
East Asia and Pacific	204	8.2	8.5	3.6	6.9	4.2
Middle East and North Africa	28	5.2	2.9	4.7	0.1	2.7
sub-Saharan Africa[2]	43	5.5	3.7	4.0	3.7	4.0
Southern Europe	201	6.7	5.0	1.5	2.4	2.2
Latin America and Caribbean	444	5.6	4.9	5.7	—2.4	—1.2
middle-income oil exporters	687	7.0	4.8	—1.3	1.5	1.9
high-income oil exporters	221	10.7	7.5	7.5	—1.8	—11.7
industrial countries	7,395	5.0	2.8	1.3	1.0	—0.2

[1] estimated
[2] does not include South Africa
Source: World Bank 1983

activity since 1979 has affected industrial and economic development in the Third World are the following: a) a reduction in the demand for Third World products, particularly commodity and mineral exports; b) as a consequence of a), a fall in commodity prices and hence adverse movements in the terms of trade; c) an increase in the real burden of interest and debt service payments partly due to a) and b) and partly due to an enormous increase in interest rates; d) a reduction in the quantum of aid and other capital flows.

During 1981-82, commodity prices fell by 25 per cent in US dollar terms, the largest continuous decline in more than three decades. In real terms, ie deflated by the price index of manufactures exported by the developing countries, the fall was 20 per cent, and brought commodity prices to their lowest level since the Great Depression. Although prices have improved during 1983, they still remain very low in historical perspective [IMF 1983]. With respect to interest rates the real eurodollar rate — using developing countries' export prices as a deflator — increased from about -5 per cent in 1976-79 to +20 per cent in 1981, and about +18 per cent in 1982 [World Bank 1983, Figure 2.3, p 9].

The three factors a), b) and c) above have played havoc with the balance of payments situation of the non-oil developing countries. Their combined current account deficit rose to $108 bn in 1981 and to $87 bn in 1982, about twice the average annual level during 1977-80. However, as the IMF's *Annual Report* of 1983 points out, 'For the oil importing developing countries, the entire deterioration of the combined current account balance from 1978 to 1981 can be ascribed essentially to these three adverse factors' [as reported in IMF 1983a].

Both from an analytical and policy point of view the following aspects of the world economic crisis in relation to the developing countries seem to me to deserve special attention.

First, the deterioration in the balance of payments position of the developing countries, which as seen above is due mainly to external factors, has far-reaching consequences for all spheres of the economy, real as well as financial. The external payments constraint can become so binding that the country has to curtail not only the imports of luxuries or other consumer goods, but also the essential imports

required for maintaining the existing levels of domestic production.

It is because the necessary complementary inputs in the form of industrial raw materials, spare parts, etc can no longer be imported into countries like Tanzania, Mexico or Brazil, that the level of industrial capacity utilisation has become so low and industrial production has declined. The dollar value of Mexico's imports fell by almost 40 per cent in 1982 and by 70 per cent from the first quarter of 1982 to first quarter of 1983. The fall in the dollar value of Brazil's imports was 12 per cent and 23 per cent in the corresponding periods, on top of an earlier fall in 1982 [World Bank 1984]. Similarly in Tanzania, it is estimated that the level of imports today is 25 per cent below its 1970 volume.

Reduced industrial production has adverse effects on other parts of the economy. Thus agricultural production becomes handicapped directly as well as indirectly by the non-availability of foreign and domestic industrial inputs (eg fertilisers), transportation or incentive goods for farmers (which again are mainly industrial). These disequilibria in agricultural and industrial production in turn generate inflation and disequilibrium in government finances. In many developing countries, sales and excise taxes on industrial production and import duties are a major source of government revenue, so that the balance of payments constraint is directly and indirectly responsible for the enormous increases in budget deficits or the public sector borrowing requirements which these countries are experiencing.[5] Again taking the Tanzanian example, it has been estimated that if industry were operating at a normal level of capacity utilisation instead of its present low level, sales and excise tax revenues would be doubled, which would not only elimate the current fiscal deficit, but also make a sizeable contribution to the capital account [see JASPA/ILO 1982].

The second important point concerning the present world economic crisis is that it is not some random event, but has been caused by the structural features of the world trade and payments system and the economic policies of the advanced countries. The highly restrictive policies of 'monetary restraint' followed in the US, UK and other advanced countries since 1979 have been directly responsible for the extraordinary economic slump the world has witnessed in the last few years. It is also significant that the main cause of the slump is not protection, but what I have called elsewhere a system of beggar-my-neighbour competitive deflation. Under the present trading and financial regime, even without creating any trade barriers, when each country attempts to achieve a balance on its payments or reduce inflation by deflating its economy, it pushes other countries into deficit and the net outcome is a vicious circle of deflation. This is what the world economy is suffering from today rather than beggar-my-neighbour protection. Instead of trade barriers, it is precisely the lack of such barriers in the movements of capital in the advanced countries, particularly the short term capital movements across the exchanges, which have played a major role in this process of competitive deflation.

Thirdly, an implication of the earlier analysis is that if the world economy were to revive, the developing countries would in general gain through exactly the same channels by which they are presently disadvantaged, ie through increased commodity prices, increased export demand and, hopefully, through increased aid and capital flows. However, the initiative and ability to undertake measures for such a recovery lie entirely with the US and other advanced countries. There is little the developing countries (because of their small share of world economic activity) can do to increase world economic growth.

It is fashionable these days to stress the two-way interdependence between the Third World countries and the industrial countries. At one level this is certainly correct since in 1982 the developing countries accounted for 27 per cent of the total OECD exports and for about 40 per cent of US exports. In the second half of the 1970s, the South provided a net stimulus to the OECD economies by its faster rate of growth of production and hence its rapid expansion of demand for OECD imports, financed largely by foreign borrowings. However, in 1982, with a contraction of imports by many developing countries, the South's net contribution to OECD economic activity was most likely negative. But, as noted before, the developing countries were forced to reduce their imports by the lack of foreign exchange earnings which was largely due to economic policies followed earlier by the leading OECD countries. There is a fundamental asymmetry in the interrelationship between the developing and the developed countries which derives from the former's need for imports of capital goods and technology and therefore for hard currency earnings. These are essentially determined by the rate of growth of the OECD economies, which in turn is mainly governed by economic policies and interactions amongst these countries alone. As the OECD economists Larsen, Llewellyn and Potter [1983] rightly observe: 'In the short term, non-OECD markets can occasionally grow buoyantly and somewhat independently of general world conditions.

[5] This is the familiar distinction between a 'cyclical' and a 'structural' budget deficit which is often made with respect to budget deficits in the US and in other advanced countries. Unfortunately, the IMF invariably ignores such distinctions in relation to the developing countries.

[However], over a run of years, non-OECD imports are constrained by their export proceeds. The latter are determined in substantial part by the growth of the value of the relevant imports of OECD countries, largely primary commodities'.[6]

The fourth aspect of the present world economic crisis which deserves attention is that the events of the last few years may not simply be a temporary phenomenon, but instead herald a *long-term* deceleration in the expansion of world economic activity. This would have extremely serious implications for long-term industrial and economic policies in the developing countries as well as for UNCTAD's policy programme.

UNCTAD's Future Programme

UNCTAD was born in the middle of a golden age for the Western industrial economies, and in many ways for the world economy as a whole. This golden age spanned the quarter century before the collapse of the Bretton Woods system and the oil price rise of the early 1970s. The average annual growth rate of GNP in the OECD countries from 1950 to 1973 was 4.9 per cent, compared with 1.9 per cent between 1913-50 and 2.5 per cent during 1870-1913 [Reynolds 1983]. For more than two decades, until 1973, countries like France, West Germany and Britain maintained virtually full employment, an unusual phenomenon for capitalist economies. In fact, these countries were not only able to employ their own available labour forces, but also to give jobs to a significant number of workers from abroad. In the 1960s in West Germany and France, immigrant workers constituted something like 10 per cent of the employed labour force. In this golden age, as noted earlier, a number of Third World nations also made major industrial strides.

The historically high long-term rates of growth of output, consumption, and employment achieved by the advanced countries in the 1950s and 1960s were accompanied by an enormous increase in world trade. World exports of manufactures grew at an unprecedented long-term rate of over 10 per cent per annum — an expansion in which again a number of Third World countries also participated.

However, over the last decade, the rate of expansion of both world trade and of world economic activity has halved or less than halved. In the formulation of economic and industrial policy for Third World countries a major parameter to be determined is: what is likely to be the future long term rate of growth of the world economy? Is it likely to go back to its previous trend-rate of 1950-73, or is it more likely that the much reduced rate experienced during the past decade will continue (which incidentally is much more in line with the long historical record over 1850 to 1950)? Although obviously no firm answers can be provided to this question, there are a number of extremely important factors which suggest that the world economy may grow much more slowly than it did in the golden age [see for example Reynolds 1983; Kindleberger 1982]. Thus, the Third World countries have to contend with the probability that the rate of growth of the world economy during the next decade may not be significantly greater than it has been between 1973 and 1983.

The crucial consequence for the Third World of the expected long-term deceleration in world economic growth is that world trade will expand much more slowly than in the 'golden age'. However, the Third World countries continue to require an annual rate of economic growth of 6 to 7 per cent and of industrial growth of about 10 per cent for compelling economic and social reasons: to reduce absolute poverty and to expand employment opportunities for a growing and increasingly urban population [ILO 1976; Singh 1979; UNCTAD 1981]. These two factors seem to me to necessitate a re-examination of the traditional UNCTAD approach to the relationship between trade and development. For if overall trade increased very slowly, then even if there were no tariff or non-tariff barriers in advanced countries to imports of Third World manufactures, the latter would still probably only be able to grow at a pace unable to generate the socially required rates of economic expansion in the developing countries. Furthermore, the slower growth of world economy activity may mean that the adverse movements in the terms of trade which the developing countries have experienced during the last decade may not be reversed.

The policy conclusion which follows from this analysis is that in the coming decade the countries of the South will have to rely much more on their internal dynamics, on the growth of internal demand, rather than on world market forces to generate economic expansion. They will need greater import substitution, more internal technological development and more economic and technological cooperation among themselves.

It must be recognised that such a programme is easier for the large semi-industrial countries like Mexico, Brazil or India to implement than for the smaller or less developed economies. This is for two reasons. First, the 'large' size of the former means that they are *in principle* much more capable of insulating themselves from the impulses of the world economy; foreign trade normally accounts for a relatively smaller proportion of their GDP as they usually have

[6] On this point, see also Professor Sir Arthur Lewis's Nobel lecture, [1980] and Taylor's excellent paper [1982].

large enough internal markets to reap economies of scale. In principle, the rate of growth of such economies is therefore much less dependent on the growth of the world economy. Secondly, the semi-industrial economies already possess fairly diversified industrial sectors with trained manpower, managerial and organisation skills, so that on the supply side, they have possibilities of self-sustained internal growth to a degree much less open to economies at lower levels of industrialisation.

It should, however, be stressed that the policy emphasis on internal growth in large developing countries does not mean that export opportunities or the export effort should be neglected. For example many semi-industrial countries have an enormous export potential in the Middle Eastern markets (in contention with the industrial countries) as well as in other developing economies. Some of them (eg India, China, Korea) also have opportunities for increasing their foreign exchange earnings by 'export' of labour to the Middle Eastern oil producers. In view of the external financial gap which many semi-industrial countries will face for a long time to come (not least because of previous debt accumulations), it is clearly necessary for them to make full use of such opportunities to the mutual benefit of themselves as well as of the Middle East oil producers. Similarly, they should seek to extend their exports to the advanced countries to the extent that is possible. The main burden of the analysis presented here is that in order for the NICs to continue to achieve fast growth in a slow-growing world economy, the essential dynamic will have to be provided increasingly by internal factors rather than by the external economy.

The problems which small countries face in such a situation are far more difficult and some of them may even be intractable. Small countries must necessarily rely on trade and specialisation in order to achieve industrial development. There have therefore been a number of schemes for the establishment of common markets of contiguous countries to promote these aims. However, these integration schemes in the developing economies have to date not been conspicuously successful. The main reason is the large differences in the levels of development of the various countries; in a free trade situation, the more developed regions or countries have a tendency to develop even further without commensurate development in the less developed regions [Kaldor 1970]. For example, it is certainly arguable that industrial development in a country like Tanzania was aided by that country's withdrawal from the East African common market and thus from competition with the more advanced Kenyan manufacturing industry. Nevertheless, industrialisation in smaller developing countries does require much more intra-developing country trade; the latter is more likely to increase and to aid the development of all participating countries if it is *planned* rather than free trade. Despite all the difficulties and disappointments, in the period of slow growth of world activity and trade, it would be all the more essential for UNCTAD to continue and strengthen its role in this area by helping to create and implement such arrangements.

Contrasting Experiences of Industrialising Economies

In the context of the above discussion it is interesting to reflect on the contrasting experiences during the present world economic slowdown of India and China on the one hand and of Mexico and Brazil on the other. It was noted in section 1 (see Table 1) that the world's two leading poor economies, India and China, have done relatively very well in the recent period, despite the world economic crisis. The main reason for their success lies in the fact that since their independence, these two countries have deliberately followed policies of 'self-reliance', based on import-substitution, and 'inward looking' industrial strategies. Over the last 30 years, they have established their own technical and scientific infrastructures, and developed a range of capital goods and defence industries.[7] The result is that today the rate of economic growth of either India or China is more or less independent of world economic growth. The indigenous factors — eg the weather and the growth of agriculture — are far more important in determining the expansion of these economies than the world economic situation. It is an irony of the structure of the world economy today that in this particular respect, these two poor countries are far better placed than a rich industrial country like France. France has had among the highest long-term rates of industrial growth in Western Europe during the last two decades; it also has huge gold reserves; it has a socialist President committed to expansion of employment and production. Yet France's economic growth is almost entirely determined by the economic policies of Chancellor Kohl and President Reagan.

It may be argued that India and China have been successful in creating self-reliant economies because of their large size. There is some truth in that, but not the whole truth. France is also a large country. So are Brazil and Mexico, each of which is also much richer than either India or China. However, Brazil and Mexico are today in deep economic crisis, and unless the world economy has a spectacular revival, or other arrangements between the borrowers and lenders can be negotiated, these two countries are likely to be condemned to negative or very low economic growth for much of this decade. The essential reason for these

[7] Among the Third World countries, India has in fact emerged as the leading exporter of technology [Lall 1984].

economic differences between Brazil and Mexico on the one hand, and India and China on the other is, that during the last 15 years the former chose to follow export oriented, outward looking industrial strategies based on multinational investment and foreign debt. As a consequence Mexico and Brazil developed highly import-dependent industrial structures. During the golden age, these countries benefited from their greater integration with the world economy in much the way orthodox economics extols the virtues of increased trade and specialisation. However, their industrial structures which were suitable for the golden age, also left them vulnerable to prolonged economic disruption when the world economy ceased to expand.[8]

Conclusion

The foregoing discussion indicates that the central economic theses of Dr Prebisch remain valid in the changed circumstances of the world economy; if anything they are even more applicable in a slow growing world economy. In conditions of reduced long-term world economic growth, even if the terms of trade of the commodity producing countries do not deteriorate further, they are unlikely to revert to their previous peaks. For this reason, and more importantly to achieve the socially necessary rates of economic growth, the developing countries have no choice but to continue with their attempts to change the structure of their economies by industrialisation. The lesson which many of the African and Latin American countries have to learn from the recent set-backs to their industry is not that their objective of industrial development was incorrect, but that the industries which they established, although they may have been appropriate for the golden age, have turned out to be unsuitable in a period of slow growth of world production and trade. The diversification of these economies from producing mineral or agricultural commodities to the production of manufactures did not, as envisaged, reduce their degree of dependence on the world economy; instead the latter appreciably increased as the industries which were established were highly import-intensive.

In the short-term, those developing countries constrained by their balance of payments, whether Brazil, Mexico or Tanzania, have no choice but a) to reduce their *propensity* to import and b) to enhance their import capacity to the extent that this is possible. However, in a slow growing world economy, even in the long-term, the creation of viable industrial structures requires strategic attention to be focused on both a) and b), particularly the former. In view of its origins in the golden age, UNCTAD as an organisation, in its operations and policy programme, has traditionally been much more concerned with b) than with a). This balance urgently needs to be redressed.

[8] It does not of course follow from the experience of Mexico and Brazil that all countries which have in the past, or which continue at present to pursue 'outward oriented' economic policies are bound to fail during a period of slow growth of the world economy and world trade. For even if world trade shrinks, any single country (or a small group of countries) following a strategy of export-led growth can certainly be successful in increasing its share of trade and achieving a relatively fast expansion of the economy. However, such a solution is not feasible for the Third World as a whole, particularly for the larger countries. For a further discussion of this issue see Singh [1984].

[9] Reducing the propensity to import will require a reconsideration of economic policies on the demand as well as the supply side. This raises a wide range of issues which are more fully discussed in Singh [1984], from which I have borrowed passages for this paper.

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