Book Reviews

II. Do outward-looking policies really work?

A. I. MacBean

This collection of recent papers by Professor Bela Balassa is densely packed with ideas and information on the process of industrial development and the evolution of comparative advantage in low to middle income countries. But a persistent refrain runs through the book: outward-oriented policies good, inward-oriented policies bad! All of the analysis in the papers supports that opinion and most of the policy recommendations are based upon it. Indeed a formidable array of economists and a massive body of research including the OECD studies by Ian Little, Maurice Scott and Tibor Scitovsky, Balassa's own earlier studies on protection in ldcs and the recent National Bureau of Economic Research (NBER) studies under Jagdish Bhagwati and Anne Kreuger lend considerable support to that thesis. But is it too simple a conclusion and is

the evidence adduced by Balassa adequate to justify the confident nature of his recommendations?

Part of the evidence is simply observation of the contrast in economic performance between those countries which have adopted import substituting industrialisation policies behind high import barriers and those which have promoted exports, allowed domestic prices to reflect international prices and interest rates to reflect the scarcity of domestic savings. But such comparisons inevitably prompt the question—was it really the differences in trade policies which produced the successes of the export promoting economies or was it something else? Much is usually made of the untypical nature of such exemplary economies as Hong Kong, Singapore, South Korea and Taiwan. High levels of education and skill, influxes of highly motivated and enterprising refugees, exceptional leaders [Wilson 1981:218], special relationships with America or Britain, relatively high aid or defence expenditures are other arguments put forward to explain their rapid growth of per capita income.

The period after the Korean War, 1953-73 was quite exceptional in the history of world trade. During that time according to Lewis [1978] world trade grew at eight per cent per annum and trade in manufactures grew at an annual rate of 11 per cent compared with growth in trade of 3.5 to 4.0 per cent from 1813-1900 and one per cent per year from 1910-1940. The buoyancy of world demand in the 1950s and 1960s could in part explain why countries with export-oriented policies grew so rapidly, and might suggest that these policies could be less successful in a less buoyant world situation. Slower growth and even stagnation in the OECD nations, the resistance in Europe and USA to structural change and the consequent pressures to increase protectionism may have so changed the economic environment that even if it were true in the recent past that export-orientation had proved a better growth policy than inward-looking strategies this might no longer be true in the 1980s.

Apart from the growth of barriers to ldc's exports of manufactures in the multifibres arrangement (MFA), voluntary export restrictions (VERs) and orderly marketing arrangements (OMAs), the rise in oil prices has greatly increased the costs of transportation. As most ldcs are far from the major OECD markets and the products they export tend to be lower in their ratio of value to bulk than the skill and capital intensive exports of dcs the increased cost of transport and communication may discriminate against ldcs' exports.

Yet another line is taken by opponents of outward-looking strategies. This is to argue that even if trade and per capita GDP grew faster with such policies the distribution of the gains from trade was such that the citizens of ldcs gained little from it. For example, the export sector may have been dominated by foreign firms so that a great deal of ldcs' exports have been in the form of intra-firm trade or trade between 'related parties' or collusion and market power among dc buyers has reduced the retained value added in ldcs from exporting [Helleiner 1981]. It is further argued that the promotion of exports does little for the really poor within the ldcs and may even harm them. The promotion of cash exports often benefits the larger farmers and lowers the incentives to produce food crops and so harms the poor both as producers and consumers of food. In other cases where food is exported domestic food prices may be raised and the poor suffer.

How does Balassa's advocacy of outward-looking strategies stand up to such criticisms? Pretty well in my view, when it is taken all together.

Balassa's evidence is not simply cross-country but also linear and in depth for several countries. While it is true that the number of developing countries who have wholeheartedly embraced outward-looking, market-guided strategies for ten or more years are relatively few, the sample does go beyond the 'gang of four' South-East Asian countries. Moreover the argument is based even more upon the proven damage which countries adopting import-substituting industrial development policies inflicted upon their economies. This is well documented, not only in many of Balassa's publications including this book, but also in the OECD and NBER studies cited above. Techniques such as calculation of effective protection levels, domestic resource costs and cost-benefit analyses have shown at industry, sector and macro level how resource allocation has been distorted away from optima, how this has led to low and even negative value added in many ldcs' manufacturing industries and in several developing countries may have cost as much as six to seven per cent of GNP (p 11).

There is of course much overlap between the samples of countries studied in the different sources, but if we pool their efforts they include at least Argentina, Brazil, Chile, Colombia, Egypt, Ghana, Greece, Hong Kong, Hungary, India, Israel, Korea, Mexico, Pakistan, The Philippines, Singapore, Taiwan, Turkey, Uruguay and Yugoslavia. The evidence from these countries shows that those who consistently adopted genuine outward-looking strategies (ie not just a phoney

devaluation accompanied by offsetting fiscal adjustments) did best among these countries, not only over the 1950s and 1960s but even in the post-oil crisis years. Those who moved to export promotion policies after persisting for a long time with second stage import substituting industrialisation did better with the outward-looking policies (pp 14-15 and Chapters 2 and 3) and did worse when they slid back into their old ways.

The argument that the past success of the export-oriented ldcs is to be explained by the exceptionally favourable circumstances of rapid world growth in the post 1950s era is weakened when it is recognised that these countries' exports not only grew very rapidly but they greatly increased their shares in world exports of similar goods, and in many cases continued to show success even through the recession in the 1970s. Of course they could be thwarted if the OECD nations' protectionism became much more restrictive. But although this continues to be a risk it has not happened yet. Up to 1978 Balassa argues that although the rate of imports of manufactures to industrial nations from ldcs slowed somewhat, the apparent income elasticity of demand for these imports actually rose for 1973-78 compared with 1963-73. This provides no evidence of any effects from increased protectionism (p 208).

The evidence on intra-firm pricing policies required to establish whether they tend to cheat the tax authorities in ldcs is just not available, but in any case indigenous entrepreneurs rather than foreign companies have dominated the manufactured exports sectors in the most successful NICs.

Far from worsening the internal distribution of income the outward-looking strategies were associated with more labour-intensive methods of production, reduced unemployment, lower average capital-output rates, less under-utilisation of capacity, higher productivity and higher real wages as compared with countries which stuck to or returned to inward-looking policies (pp 15-16).

On the whole agriculture also did better in the outward-looking economies such as Taiwan (p 420) and this too tended to reduce income disparities. A recent study of market-oriented strategies, growth and equity in Hong Kong shows that income distribution did not worsen, and especially after 1966 it probably improved [Chow and Papaneck 1981].

All in all, I believe Balassa has made out a convincing enough case for an open economy approach to industrial development. Where some doubts remain is in the lack of an explanation for some of the empirical relationships. Why, for example, should export industries have higher savings rates than import substituting ones? That aside, the book deserves to be read widely and a students' edition in soft cover would be welcome.

References

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