EXPORT PESSIMISM

Developing Countries and Industrial Markets

Edited by HELEN HUGHES

EXECUTIVE SUMMARY

International Center for Economic Growth

—Executive Summary—

The Dangers of Export Pessimism

Developing Countries and Industrial Markets

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An International Center for Economic Growth Publication

ICS PRESS
San Francisco, California

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This is an executive summary of the book *The Dangers of Export Pessimism,* edited by Helen Hughes, published by ICS Press in 1992, and distributed to the trade by National Book Network, Lanham, Maryland.

Cover design by Lisa Tranter.

ISBN 1-55815-144-3

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Preface

As relationships in the international marketplace change, the negotiations on trade arrangements have replaced the Cold War as a focus of worldwide attention. In these times, it is particularly important for new participants in the global market to be able to learn from the experiences of others so that they will be ready to face the challenges—and benefit from the opportunities—of the future.

In *The Dangers of Export Pessimism: Developing Countries and Industrial Markets*, edited by Helen Hughes, the authors focus on the economic performance of twelve newly industrialized countries of the Pacific and the Pacific rim during the mid- to late 1980s, when many of these countries moved toward outward-oriented trade policies. Among the newly industrialized countries, some began the process of participation in free trade but failed to take it far enough. Their reluctance to encourage exports was a result of export pessimism—the fear that their exportable goods would be unable to compete in the international market. They chose instead to restrict imports and develop domestic industries in the hope of becoming self-sufficient.

Those newly industrialized economies that experienced successful economic growth did so because of increased participation in the export market and abandonment of inward-oriented policies for those that encouraged growth with the competition of free trade. Export pessimism may have appeared justified in the past, but openness promises greater success.

We are pleased to publish this executive summary of *The Dangers of Export Pessimism*. The lessons of these case studies speak for the benefits of full participation in the world market. The player who fails to act globally is in danger of being left out of the new world economic order.

Nicolás Ardito-Barletta
General Director
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Panama City, Panama
March 1992

Summary of Conclusions

Thailand's prosperity in the 1980s, the success of Korea's new technologies abroad, and China's gains after the reforms of the 1970s provide strong evidence of the value of abandoning inward-oriented, protectionist trade policies and venturing into the world market to create wealth. Reevaluating previously held economic theory has cleared the way for growth and has discredited the pessimistic view that a developing country cannot support a policy of export-led growth.

The prudent deregulation of trade, increased political stability, and careful reduction of government intervention in the developing countries will promote long-lasting success. As global interdependence increases, the elimination of debt, unemployment, and inflation in the developed market economies is equally important to the expansion of the free marketplace.

Helen Hughes and her coauthors offer the following lessons in an effort to guide developing economies through the transition to international market economics.

1. In many developing countries, export pessimism in the 1950s and 1960s, and a new wave in the 1970s and 1980s, led to import substitution and protectionism, with resultant damage to export capacity.

2. Empirical evidence does not support export pessimism. Penetration of industrial market economies by developing countries in the 1980s grew more rapidly than penetration by other countries. Developing countries increased their

exports of textiles, clothing, machinery, and production components to industrial countries, which, in turn, adjusted by moving to the production of more sophisticated goods and services.

3. The share of intra-industry trade in total trade is increasing, providing further market penetration. Developing countries' trade patterns in the 1970s and 1980s show substantial growth of intra-industry trade in manufactures with the major industrial countries. Growing intra-industry trade in manufacturing among developing countries will allow markets in more industrialized developing countries to accommodate the exports of less industrialized developing countries.

4. At the domestic level, export expansion requires a favorable climate generated by government's pursuit of trade liberalization policies, stable macroeconomic policies, effective encouragement of exports, reduction in price distortions, availability of new technology, the entrepreneurship of private firms, and an abundant labor force.

5. At the international level, the constraints to export expansion include trade imbalances among major industrial economies, their continued inflation, unemployment, and protectionism, and reduced flow of international finance to developing countries.

6. Multinational links are important in overcoming entry barriers that developing countries face as their exports expand. Developing countries that accept multinationals may be the ones best able to capture these export markets.

7. Success in negotiations on tariff and nontariff trade barriers will require developing countries to make concessions and

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join coalitions with developed market economies. The trade regulations of developing countries can be made compatible with GATT, leading to simplification of foreign trade transactions and reducing the bias against exports.

An Overview of
The Dangers of Export Pessimism

Export pessimism—the belief that exports from developing countries cannot successfully penetrate the industrial market economies of the developed nations—has undermined the export performance of many developing countries. It has been proved wrong in practice by rapidly growing developing countries. Yet many developing countries continue to take a pessimistic view of their export potential, only half-heartedly liberalizing their trade policies. Export pessimism thus becomes a self-fulfilling prophecy.

In this book seventeen scholars evaluate that evidence, first in the general trade performance of developing economies and then through the experience of twelve countries. Every chapter in some way addresses the theme of export pessimism, but the authors' interpretations are by no means unanimous. It is clear, on balance, that neutral trade policies, emphasizing exports, have led to rapid growth for developing countries. Half-hearted trade reforms and high levels of protection have been costly in terms of growth and equity.

Perspectives on Export Pessimism

The first six chapters consist of this introduction followed by five chapters written from a variety of perspectives.

In Chapter 2, Vasilis Panoutsopoulos examines the growth of exports from developing countries, to test the connection between export pessimism and reality. After outlining the success of export-oriented policies in supporting development in the 1950s and 1960s, Panoutsopoulos reviews the history of export pessimism. He shows that the work of Nurkse and Prebisch in the 1950s encouraged pessimistic views of the future of developing countries' exports and were influential in leading many developing countries to follow policies of import substitution and protectionism, damaging their export capacity. Another wave of pessimism in the 1970s and 1980s accompanied the so-called new protectionism.

Panoutsopoulos challenges export pessimism on several fronts, showing that, overall, penetration of industrial market economies by developing countries' exports in the 1980s grew more rapidly than penetration by other suppliers. Developing countries were winning market shares from industrial countries which were adjusting by moving to the production of more sophisticated goods and services.

Examining patterns of trade for Hong Kong, Taiwan, the Republic of Korea, and Singapore, he shows in detail that export pessimism was unwarranted in the 1950s and 1960s, and that industrial country markets were able to adjust to greater market penetration by developing countries in the 1970s. Finally, Panoutsopoulos finds that in the 1980s developing countries increased their exports of textiles and clothing, machinery, and production components to industrial countries. The newly industrializing countries were leaders of market penetration in both traditional products—such as toys—and in new products, such as machinery.

H. Don B. H. Gunasekera, in Chapter 3, examines the East Asian newly industrializing economies' intra-industry trade in manufactures. He asks what economic theory suggests are likely to be the patterns of trade specialization in the NIEs as their economies continue to grow and how these patterns are changing in the East Asian NIEs. He bases his conceptual framework on the theory of dynamic comparative cost and the theoretical explanations of intra-industry trade. He considers the importance of relative factor endowments, the roles of product differentiation, economies of scale, and monopolistic competition. In the growing NIEs, Gunasekera shows, the importance of intra-industry trade in total trade is increasing. The East Asian NIEs' changing patterns of trade in the 1970s and 1980s show substantial growth of intra-industry trade in manufactures with the major industrial countries (the United States, the European Community, and Japan). He points out that the growing intra-industry trade in manufacturing will allow markets in developing countries to accommodate the exports of developing countries that are at earlier stages of industrialization.

Chapter 4 discusses the implications of intra-industry trade theory and export-oriented strategies. The author, Rodney E. Falvey, looks at advantages in trade theory during the 1980s. Improved trade models, incorporating economies of scale and imperfect competition, suggest that as developing countries increase their manufactured exports (and thereby their intra-industry trade) these exports will encounter entry barriers characteristic of oligopolistic competition. Since multinational links are important in overcoming such barriers, the developing countries that have had an accepting attitude toward multinationals may be the ones best able to capture these export markets. Turning to the question of finding a sound basis for strategic trade policy, Falvey finds the shift to empirical investigation of specific product markets preferable to dependence on diverse and unobservable theoretical assumptions.

In Chapter 5, Ashok V. Desai discusses the role of developing countries, particularly India, in GATT trade negotiations at the start of the Uruguay Round. The author shows that success in negotiations on tariff and nontariff trade barriers, trade sectors, reform of GATT, greater access to developed market economies, autonomy in trade policy, south-south trade, and negotiating rules will require developing countries to make concessions and join coalitions with developed market economies. Yet involvement in the Uruguay Round is desirable because even countries with a small share of world trade stand to gain something from participation. India's experience is taken as a case in point, as Desai examines how trade regulations involving quantitative restrictions, tariffs, export subsidies, and export controls can be made GATT-compatible, leading to simplification of foreign trade transactions and reducing the bias against exports. India's position on entering the Uruguay Round focused on reducing barriers to textile exports and to food products and agricultural raw materials, as well as supporting a general effort to bring developed market economies' nontariff barriers under international discipline. Turning to the risk of an increased trade deficit as the result of a policy of reduced protection, Desai suggests that a reduction in India's trade barriers should create some scope for reciprocal concessions, although these might be minor. He sees more promise in the possibility of coordinated import liberalization by the developing countries. Policy coordination of this kind could particularly benefit India, which is surrounded by other developing countries and is geographically remote from developed economic powers.

Jayati Ghosh in Chapter 6 presents the case for export pessimism to reflect the persistence of this view as she asks whether the world markets can continue to absorb exports from developing countries. Ghosh reasons that conditions of the world economy at the time of writing—the late 1980s—were not conducive to export expansion by developing countries. She examines constraints to growth posed by industrial country imbalances, inflation, and unemployment in the developed market economies, trends in international markets (including protectionism in the industrial economies and international financial flows), and policy options available to developing economies. In examining alternatives, Ghosh rejects autarky but finds these countries' policy choices constrained by conditions such as the failure of the United States to reduce its deficits. She sees some advantage in countertrade and barter among developing countries, or in expansion of trade with Eastern Bloc countries, but finds the functioning of international markets in the late 1980s to be inimical to the interests of most developing countries.

Case Studies

The remaining chapters comprise a series of export case studies from countries of the Pacific and the Pacific rim.

China. Chapter 7 is a study of China's export performance, by Shujuan Lin and Yongzheng Yang. The authors show that since the economic reforms starting in the late 1970s, exports of labor-intensive manufactured goods created a substantial increase in China's share of world trade in such products. In the mid-1980s, buoyant demand favored increases in labor-intensive manufactured exports. The authors indicate that if China improved its macroeconomic policies, reduced its price distortions, and upgraded and diversified its exports it could continue its remarkable export growth. The case study ends before the repressive political events of 1989 and therefore does not incorporate their effect on China's export growth.

Republic of Korea. In Chapter 8, Eui-Tae Chang discusses the remarkable growth and transformation of the economy of the Republic of Korea through exported industrialization. The expansion of trade from the mid-1960s was made possible by the Korean government's vigorous encouragement of exports, by new technology, by the entrepreneurship of private firms, by an abundant labor force, and by favorable international free trade conditions. Korea introduced protective measures when it was a small, underdeveloped economy. Protection was offset to some extent by export-promoting measures, but by the mid-1980s it was clear that economic liberalization was essential if Korea was to participate effectively in international trade. The author shows that Korea's long-term interests would be served by changing its development strategy and pursuing trade liberalization policies.

Thailand. Chapter 9 is a case study of Thai textile exports, by Suphat Suphachalasai. The author details Thailand's mid-1970s change from import substitution to export encouragement. He indicates that the Multifibre Arrangement first benefited and then created costs for Thai clothing exports as the Multifibre Arrangement quotas became binding. By the mid-1980s, the Thai clothing and textile industry was growing rapidly and was expected to continue to grow, for several reasons. Macroeconomic policy in Thailand created long-term stability, making the industry competitive. The low level of government intervention permitted free entry into the industry. The new entrants took advantage of the world clothing market. In the 1970s the share of Thai clothing exports in the world market was low, allowing ample room for expansion. The Thai producers were very competitive and thus able to succeed in nonquota markets, notably in the Middle East, Singapore, Malaysia, and Hong Kong.

Malaysia. Gan Wee Beng's case study in Chapter 10 examines the changing pattern of industrialization in Malaysia and the emergence and growth of export-oriented industries. Malaysia had very modest import

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