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HIGH-LEVEL EXPERT GROUP MEETINGS PREPARATORY TO THE FOURTH GENERAL CONFERENCE OF UNIDO

Industrial Development Strategies and Policies for Developing Countries
Lima, Peru, 18-22 April 1983

INDUSTRIALIZATION, RESTRUCTURING AND ADJUSTMENT

Paul Streeten
FOREWORD

As part of the preparatory activities for the Fourth General Conference of UNIDO (UNIDO IV), a high-level expert group meeting on industrial development strategies and policies for developing countries is being organized in Lima, Peru, 18-22 April 1983.

This particular meeting is considered to be of crucial importance to the preparations of UNIDO IV, since it has as its objective the review of strategies and policies of the past as well as the identification of key elements in industrial strategies and policies for the 1980s as perceived by national policy makers. On this basis, the meeting will identify those issues on which further detailed work in the strategies and policies area should proceed in preparation for UNIDO IV.

Industrialization, Restructuring and Adjustment focuses on two themes: on the impact of the process of industrialization on income distribution, on poverty, and on people in general; and on the nature of the process of adjusting to structural change in the developing countries.

The paper was prepared by Professor Paul Streeten, as consultant to the UNIDO Secretariat.
The World Setting

The last five years have been marked by an intensification of many of the problems that have affected the world economy since the early 1970s. Sluggish output and productivity growth in the advanced industrialized economies, a contraction of the rate of expansion of international trade, and with it growing protectionist pressures, sustained inflationary pressure on the prices of manufactured goods, together with highly unstable prices for the primary commodities that have fallen to their lowest level (in real terms) in thirty years, steep increases in the cost of energy, huge payments imbalances, high interest rates, fluctuating exchange rates, and a growing world food crisis, are among the most acute of these. Partly as a result of this unfavourable world economic environment, the industrial growth performance of the developing countries -- especially the low-income countries containing the bulk of the population -- has been poor, and their prospects for growth and development in the 1980s are not encouraging. The centrally planned economies have also experienced a decline in their rates of growth; and some of them have experienced acute balance of payments problems.

In the developed market economies aggregate output grew at an average of just over 5 per cent per year in the 1960s, and inflation and unemployment were at low levels. Growth between 1973 and 1980 declined to an average of 2.5 per cent per year. Moreover, the pattern of annual growth became irregular -- GNP actually fell in 1975, and, after recovering in 1976-78, the
growth rate declined to just over 1 per cent in 1980, declining further through 1982. Slackening growth was accompanied by an upsurge in unemployment and inflation. By 1982, there were over 30 million unemployed in the OECD countries, nearly 9 per cent of the labour force. Inflation, which averaged only 3 per cent per year in the 1960s, averaged 10 per cent in the 1970s. The persistence of inflationary pressure led to the intensification of restrictive monetary and fiscal policies by the Governments of these economies, pushing interest rates to exceptionally high levels and delaying the recovery of output and the process of expansion. Hence, even optimistic forecasts do not suggest that the growth of these economies in 1980-1985 will exceed the average for the 1970s as a whole, and actual performance will, in all probability, fall below this.

These developments were reflected in changes in the field of international trade. The rate of growth of international trade declined from 8.4 per cent a year in the 1960s to 6.3 per cent in the 1970s. Preliminary figures show further declines for the years 1980-1982. But certain marked differences in export performance and the terms of trade emerged between the developed market economies, oil-exporting developing countries, and middle-income and low-income oil-importing developing countries. The oil-exporting developing countries experienced a twofold increase in the purchasing power of their exports during the 1970s, due almost entirely to the effect of the OPEC price increases on their terms of trade. The developed market economies were able to counter the effects of the first round of oil-price increases by expanding their exports and through the effects of inflation on the prices of their manufactured exports: in the second half of the 1970s, their exports grew at 8.4 per cent per year and their average export prices rose by 9 per cent.
per year. The middle-income oil importing developing countries were also able to expand their exports vigorously -- their export volume almost doubled in the 1970s -- and there was actually a slight improvement in their terms of trade. The low-income oil-importing developing countries fared very badly however: their export volume increased by less than 50 per cent during the 1970s, and the effect of more than half of this was wiped out by a deterioration in their terms of trade due not only to oil price increases, but also to increases in the prices of other imports, including foodstuffs and manufactures.

The role of industrialization

Before the depression of the last five years had brought back an awareness of the blessings of economic growth, industrialization had come under fire from several directions. Those disenchanted with industrialization have called it "exhausted" or "distorted", accused it of lacking integration, or of leading to a new and more insidious form of dependence and exploitation than colonial-type primary product dependence, especially through transnational corporations and a domestic "lumpenbourgeoisie". It has been said that social objectives, such as income distribution, jobs and meeting the basic needs of the poor are more important than high rates of industrial growth; that the drive for industrial growth has destroyed the environment and has rapaciously used up exhaustible resources and, in particular, non-renewable sources of energy. It has been claimed that development in countries in which cultivable land and capital are scarce, and where the labour force grows rapidly and mass emigration is ruled out, must aim at raising the yield of land to grow food for domestic consumption; that food output can grow only if markets exist in which the food can be sold; and that, exports apart, these markets must be
found in the countryside, among the mass of the rural population. Rural
development, the argument goes, combined with income redistribution, is a
necessary condition of economic growth. Finally, it has been argued that
growth of agricultural productivity is the essential condition for progress on
other fronts: improved international terms of trade, higher real wages, a
larger marketable surplus to sustain industrial growth, etc.

In the face of all these apparent criticisms of industrialization the
developing countries have insisted that industrialization is the key to their
progress. At the 1975 World Conference in Lima the United Nations
Industrial Development Organization (UNIDO) proposed that at least 25 percent of global
industrial production (value added in manufacturing) by the developing
countries should be the target for the year 2000. (It was 10.3 percent in
1981.) *

It would be easy to meet these criticisms once the purpose of
industrialization is brought out more clearly, for most of the above arguments
are not arguments against industrialization as such but against an
inegalitarian, concentrated, dualistic, high-cost, inefficient form of
industrialization. A broadly based, labour-intensive, efficient style of
industrialization is not vulnerable to the strictures meted out above. But it
presupposes clarity of objectives and a rational choice of instruments to
achieve the objectives.

In a unified development strategy industrialization has a special role to
play. The poorer the country, the larger the proportion of the population
that is engaged in producing food. To rise above poverty, industrialization
is necessary, for industrialization means the application of power to
production and transport. Output and consumption per head can rise towards
* Recent revisions indicate a share in 1981 of 11.0%.
the desired modern levels only with the help of mechanical aids. In this sense development, including rural development, is industrialization.

In addition, manufacturing industry is subject to increasing returns, to learning effects and to cumulative processes. The exceptionally high growth potential of manufacturing industry has been demonstrated in several countries in recent years.

In the face of the charges against and criticisms of industrialization, it must be emphasized that in order to achieve the social objectives rightly advocated, and in order to fight the evils of pollution, premature raw material exhaustion, unemployment, inequality and market limitations, industrial growth is an absolutely essential condition. It must, of course, be growth that benefits the right groups, that is properly composed and properly measured, so that social costs are fully accounted for and proper relative weights are given to different components, to the working conditions and to the human relations in which production is carried out.

Statistically there is no evidence of an inevitable conflict between high rates of industrial growth and the achievement of other development objectives; if anything, there is evidence to the contrary. In many, though not in all cases, the achievement of social objectives has been consistent with high rates of industrial growth and, indeed, has depended on them. The causal links between these variables are complex, controversial, and still partly unknown, but the promotion of industrial growth is one of the strategic variables in the complex set of related national and international development policies.

Industrialization for what?

Many confusing and complex issues become clearer and simpler if the
purpose of development and the place of industrialization in a development strategy are borne in mind. In particular, questions about energy, the environment, pollution, appropriate technology, appropriate products and consumption patterns, markets, international trade and integration and the multinational corporation can be answered more easily if the objective is clear. Many apparently technical and separate problems are seen to be connected and become amenable to a solution if we know where we want to go.

Development is not about index numbers of national income, it is not about savings ratios and capital coefficients: it is about and for people. Development must therefore begin by identifying human needs. The objective of development is to raise the level of living of the masses of the people as quickly as is feasible. This implies meeting such needs as continuous employment or, for the self-employed, secure and adequate livelihoods, more and better schooling for their children, better medical services, clean water at hand, cheap transport and also a higher and growing level of measured income. Much of this can be achieved in ways which do not register a high growth rate of measured output, while a high and growing rate of national income growth is consistent with leaving these essential needs unsatisfied.

If development is approached in these terms the place of the motor car, of heavy demand on sources of energy, of highly sophisticated luxury goods, of the transfer of inappropriate products and technologies, of the role of the multinational enterprise, of urbanization, of the relation between industrial and agricultural policies, and of domination and dependence, all appear in a different light.

The disenchantment with industrialization has been based on a confusion: it is a disenchantment with the form that economic growth has taken in some
developing countries and with the distribution of its benefits. Certain types of modern product and modern technology have reinforced an income distribution and a style of development that is out of tune with the basic goals sketched out above. After a reorientation of goals, industrialization as the servant of development regains its proper place in the strategy. Industry should provide the producer and consumer goods required by the people, the majority of whom live in the countryside; hoes, simple power tillers and bicycles, not air conditioners, expensive cars and equipment for luxury flats.

An industrialization strategy guided by the goal of meeting the needs of the poor not only leads to a different composition of products and of techniques; it also contributes to stopping the drift to the towns and reduces the demands on highly skilled manpower and other scarce resources that rapid urbanization makes. By raising the level of living of the poor people in the countryside, it reduces the pressure to leave the farmsteads and to expand expensive urban services.

It also introduces different incentives and opportunities into international trade: it implies a reorientation towards more trade between developing countries. Starting with similar factor supplies and similar levels of demand, developing countries can more appropriately produce for one another what they consume and consume what they produce. This can be the basis of mutually beneficial trade. In simple mass consumption goods, often produced in a labour-intensive, capital-saving way, the developing countries have a comparative advantage and could expand their trade among themselves. The same goes for technical assistance. In agriculture, social services, family planning and appropriate technology, countries at similar levels of development are better suited to assist one another than countries with very
dissimilar experiences. But all this depends upon countries opting for a style of development that gives priority to satisfying the simple needs of the large number of poor people. Industries producing clothing, food, furniture, simple household goods, electronics, buses and electric fans would thrive without the need for heavy protection in a society that had adopted this style of industrialization and development. Much of the criticism of inefficient, high-cost industrialization behind high walls of tariffs and quantitative restrictions should be directed at the types of product and of technique which cater for a highly unequal income distribution and reflect entrenched vested interests. It is in no way a criticism of industrialization for the needs of the people.

This does not mean that opting for such a style is an easy matter. The required changes in the thrust of research and development expenditure and of science policy, the attack on the living standards of those profiting from the present type of technology and products, the more complex system of administration and the required co-ordination and changes in trade and investment policy are enormously difficult tasks. The point, however, is that no solution is possible unless the fundamental objective is borne in mind.

Technology and poverty

In analysing the impact of industrialization upon income distribution and poverty between and within countries, a major consideration is whether the beneficial spread and "trickle down" effects prevail over the cumulative effects of economies of scale, experience and learning. The unequalizing effects between countries arise from the fact that countries ahead in the race of industrialization have more opportunities to accelerate further their industrialization than those behind. The less industrialized countries would
have to make a very powerful effort at industrial promotion to catch up with those ahead of them. Eventually, the more industrialized developing countries will run into labour shortages and rising wages, offsetting and more than offsetting their advantages in labour productivity. But in some cases, such as India, this can be a long time ahead.

The impact on poverty and income distribution within a country will depend upon the factors mentioned above, i.e. the style of industrialization. Industrialization that is labour intensive and aims at simple products will create more jobs and primary claims of the poor on resources. There can, however, be a conflict between maximizing employment in the short run and eradicating poverty in the long run. The dilemma takes the following form. In order to use and adapt imported capital-intensive technology, a country needs an indigenous technological capacity and an indigenous capital goods sector, which may not generate many jobs. But they do generate the experience and skills that make future absorption of technology more suited to eradicating poverty. On the other hand, light consumer industries create more jobs now but do not lay the foundations for future adaptation and generation of appropriate products and processes.

Dualism and how to overcome it

Most developing countries suffer from industrial dualism. In the urban, organized industrial sector labour productivity and wages are high, but jobs are relatively few because capital is limited. In the informal sector productivity is low, in some cases at the margin approaching zero, but all surplus labour attempts to be accommodated in it. The situation is illustrated in the figure. We trace from left to right labour in the modern, organized sector, from right to left in the informal sector. OL is the total
labour force. The slopes of the two curves indicate the marginal productivity of labour, which is much higher in the organized sector, approaching zero in the informal sector at A, as new entrants only take away business from existing ones. As capital accumulates, AE shifts to the right. But as population and the labour force grow, OL also moves to the right from OL* to OL_{t+1}. The gap EF, which is a measure of the dualism, tends to be perpetuated.

Four measures are possible. First, capital might be accumulated at a faster rate, so that the organized sector can absorb more workers. Secondly, population growth may be slowed down, so that jobs have to be created for fewer people. Thirdly, modern technology may be adapted downwards, so that a given amount of capital can absorb more workers. And fourthly, the technology of the informal sector can be upgraded, so that its productivity rises and the gap of dualism is closed by higher earnings in the informal sector. The last method is the most promising, for it requires in the first instance only an end of the existing discrimination that many informal sectors now suffer from: better access to capital markets, information, foreign exchange and marketing facilities. Beyond that, it calls for a redirection of the thrust of R&D expenditure and an indigenous adaptive capacity for design of both products and processes.

Restructuring and Adjustment

The objectives of an industrial development strategy have to be pursued in a changing world. These changes have been particularly drastic in the last decade, and the future promises no relief from quite rapid and often unexpected change. The current world crisis has called into question the whole inherited framework of economic analysis and policy. The crisis has also underlined, if underlining is necessary, that economic and political forces cannot be treated separately and in isolation, for the demands of
organized political groups such as the trade unions, or the oil exporters are economic exercises in political power. Structural changes are both the cause and the effect of these radical changes in international economic and political relations, and adjustments in the industrial structure are called for.

Words like "structure", "restructuring" and "structural adjustments" suffer, however, from a lack of clarity, and it is therefore useful to begin by drawing some distinctions and clarifying the concepts.

Adjustment is adaptation to change, often unexpected change. The change may be favourable or unfavourable to the set of objectives pursued by a government. In the case of a favourable change (e.g., unexpected improvement in the terms of trade, unexpected additional capital available for investment), the challenge to policy makers is to derive the maximum benefits from it; in the case of an unfavourable change, to adapt with the minimum social costs, that is to say, the lowest sacrifice to the objectives and the minimum undesirable side-effects.

The adaptation to unfavourable change may be forced upon a country, the response may be "too little and too late", and therefore its social costs may be very high, or it may be anticipated and planned for, and therefore its costs minimized.

Change may be small and slow or large and sudden. For slow and gradual change, the price mechanism can be an effective instrument of adaptation. It combines a decentralized system of signals and incentives, to buyers and sellers, for the redeployment of resources in response to changes in demand and supply. Even then the growing importance of transnational corporations and of national governments limits the scope for the benign working of market forces. The growing volume of intra-firm transactions and transactions subject to government fiat is removed from the discipline of the market place.
For a large and sudden change, the price mechanism is less suited and has often to be supplemented by other measures. Some authors may even wish to define "structural" as those changes that cannot be accommodated through market forces. It may be useful to list possible meanings of "structural" change.

1. A large, drastic, and sudden change contrasted with "marginal" change. (This meaning may clash with the meaning 2 of a permanent though slow change.) An illustration would be destruction through war;
2. a permanent, compared with temporary or cyclical change;
3. change relating to real resources, such as capital or skill accumulation, technology, or tastes, compared with monetary change or policy change;
4. change in the fundamental conditions (parameters), ordinarily assumed unchanged, constant and given, for purposes of analysis, compared with change in dependent and independent variables;
5. change in the organization of markets ("market structure"), e.g. from competition to cartels or from arm's length transactions to intra-firm trade;
6. change in the distribution of economic power, either because some agents use the existing rules differently or because new rules are laid down, processes followed, or new institutions set up;
7. change in the sectoral, geographical, occupational or product composition of production and trade.

To illustrate the limits of the price mechanism and market forces as instruments to bring about adjustments to large and sudden changes, consider the rise in oil prices. A sudden and very large rise in price would have the following consequences:
1. It would not discourage demand by much in the short run, given the low short-term price elasticity of demand for oil.

2. It would have repercussions on other prices, raising the general price level and contributing to cost-push inflation, thereby offsetting to some extent the impact on incentives of the rise in the "real" price of oil.

3. It would reduce the resources available to explore and invest in alternative energy sources (except for the sellers of oil who, however, may lack the incentive) and, while raising the incentive, would reduce the means to speed up the transition to the post-oil economy.

4. It would have detrimental effects on income distribution, hitting some of the poorest groups in the poorest countries, who depend upon kerosene, oil for irrigation pumps, fertilizers (20% of fertilizer cost is oil) and other products into which oil enters as an input.

5. If the consequent inflation were to be fought by monetary (or fiscal) measures of contraction, production and employment would be unnecessarily reduced by a multiple of the contraction that would have been necessary in order to economize in oil. And the means and incentive to search for substitutes would be further reduced.

A similar analysis could be conducted for changes in exchange rates in response to growing balance of payments deficits. The balance of payments of a developing country both reflects attempts of domestic adjustments and imposes the need for domestic adjustments to changes in the rest of the world. Thus, a change-over to an export-oriented strategy, an attempt to grow more food at home, a land reform, a tax reform or a redistribution of income, may lead to a temporary balance of payments deficit. On the other hand, global inflation, a fall in demand for a country's exports or policy changes
in foreign countries may cause a deficit, to which the developing country must adjust. It is now widely agreed that the use of exchange rates to equilibrate payments at each moment ("clean floating") is not acceptable and would inflict unnecessary damage, even if effective. There is also growing disillusionment with "dirty floating", and a general desire to return to a regime of more stable exchange rates.

The major changes to which adjustments by the developing countries are called for are:

1. Oil price changes, both up and down, and the accompanying changes in international financial flows;
2. the possibility of growing scarcities of foodgrains;
3. high, though falling, levels of inflation in the world;
4. slower growth in the OECD countries;
5. relocation of industries in accordance with changing comparative advantage, especially the revolution in microelectronics;
6. changing composition of financial terms, such as less aid, more bank loans.

In addition, there are other changes calling for adjustments, such as:

7. continuing high rates of population growth;
8. urbanization;
9. scarcities of certain raw materials;
10. policies adopted by the developed countries: protection of industry, agriculture and services;
11. environmental pollution;
12. international migration;
13. debt service, aggravated by lower rates of inflation while nominal interest rates remain high;
14. the arms race.

It is of the essence of interdependence that a single nation state is, by unilateral action, capable of inflicting considerable harm on other countries, and that the motivation for doing so is often entirely rational from the national point of view. The main danger here arises from beggar-my-neighbor protectionist employment policies, often disguised as regional or industrial policies, even policies that go under the name of "adjustment assistance" but that truly amount to adjustment resistance. Such measures affect most directly the NICs, in search of markets for their exports. But the low-income countries, also, can be harmed by them.

Exchange rate flexibility on the part of developed countries has trade-reducing effects on developing countries, and if they peg their rates to one major trading country, trade-diverting effects from the rest of the world. Both represent costs for countries attempting to raise and diversify their trade.

The analysis of the adjustment process should be conducted in three stages.

1. How severe is the adjustment problem, as registered, in the first instance, in the balance of payments deficit? (A secondary calculation would be the costs imposed by the best corrective measure.)

2. What range of medicines are available? E.g. pegging exchange rates reduces the cupboard by one medicine; forswearing increases in tariffs by another. The greater the degree of integration of the world economy, the barer will be the national medicine cupboard.

3. How effective is any given medicine? E.g. with a more slowly growing volume of trade, demand elasticities will be lower: and exchange rate
adjustments less effective. On the other hand, in wider and larger trading areas one would expect demand elasticities to be higher than under more protective national regimes, and trade therefore more responsive to small changes in the exchange rate.

The task is to combine financing and correcting deficits in such a way as to minimize reductions in employment, output and growth (and any other objectives such as income distribution). Appropriate methods of financing deficits (the right type of conditionality) do not frustrate the process of adjustment, but facilitate it, and can reduce its cost.

The Imperatives of Industrialization

The four principal imperatives for industrialization policy are:

1. the urgency to reduce poverty;
2. the need to diversify the economy;
3. the need to create jobs;
4. the need to generate foreign exchange to service the foreign debt and to pay for imports.

1. The urgency to reduce poverty, one of the most basic objectives, was discussed above and it was argued that an anti-poverty focus in industrialization policy not only removes many criticisms but also renders many apparently disparate issues more tractable.

2. Diversification is necessary for two reasons. First, it reduces dependency on a few products and a few markets and therefore leads to greater self-reliance, an important objective of development policy. The best way to reduce dependency is not national self-sufficiency but a diversified structure of production and foreign trade. Secondly, diversification is the best way to hedge against an uncertain future. The world economic environment is changing
rapidly. Today's comparative advantage may be tomorrow's comparative disadvantage. If it were possible to forecast the future precisely, provisions could be made for the industrial structure required in the future, with the lowest costs for the predicted outputs. Clearly, it is not. Diversification, even at somewhat higher costs in certain lines that turn out to be underutilised, or for certain amounts that turn out to be wrongly predicted, is the best response to an uncertain future.

3. Job creation has high priority because the total labour force is growing rapidly. The need to find jobs is made more urgent by the changing age distribution, with a higher ratio of the population in the years of earning, as birth rates decline, and by the growing female participation rate in the labour force.

Two arguments on employment policy are often heard, which defeat each other. On the one hand, it is said that for a developing country in which, say, 20 per cent of the labour force are in industry and 80 per cent in agriculture and services, and with a labour force growing to 3 per cent per year, to absorb only the additional entrants into the labour force (without reducing already existing unemployment) in industry would call for an absorption rate in industry of 15 per cent per year. Nowhere has industry shown a capacity to create jobs at that rate. Therefore, it is concluded, agriculture and services must provide the extra jobs. On the other hand, it is argued that agriculture and services already suffer from large excess population and gross underemployment, and it is therefore for industry to create the jobs that the primary and tertiary sectors cannot provide.

In fact, an employment strategy should be guided by the optimum efficient employment linkages between the sectors, so that jobs in industry create and support jobs in agriculture and services, and vice versa. The task is not
on: to create jobs now, but also to accumulate the surpluses that will provide jobs in the future, for a growing labour force. The efficient use of labour is important for two reasons. First, it is necessary in order to avoid wasting other complementary factors of production, such as capital and management, in the present; secondly, it is necessary in order to accumulate the equipment and the wage goods for employment creation in the future. If the pressure for employment creation now leads to overmanning in industry and a reduced surplus for reinvestment because of a swollen wage bill, fewer jobs will be available in the future than would have been, had the surplus been used to produce additional machines and wage goods.

4. Industrialization is necessary in order to produce the manufactured exports that earn foreign exchange. Many industrializing countries are heavily in debt and if they are not to default need the foreign exchange to service this debt. With world inflation abating and interest rates remaining high, the real burden of the debt cannot be expected to be eroded as it has been in the past. Foreign exchange is also needed for inputs into the industrial sector, both capital goods and maintenance imports. The likely foreign exchange earnings from primary exports are limited, both because of the world recession and, were demand to pick up, because of the long time it takes to expand capacity. In industry, on the other hand, excess capacity can be mobilized and additions to capacity take less long, so that industrialization is an obvious response to the need for foreign exchange.

Industrialization and international adjustments

Of special interest is the relocation of industries resulting from changes in comparative advantage. More specifically, the impact of the microelectronics revolution (and other technical changes) on the international
division of labour, and the contribution of TNCs to the adjustments called for by continued technical change, deserve some attention.

Although fears are often expressed that the microelectronics revolution will reduce the comparative advantage of developing countries in labour-intensive activities, and although this is already happening in some sectors such as semiconductors and garments, there is also reason to believe that the new technology, by saving on specialized skills, will have a beneficial impact on the comparative advantage of developing countries. In addition, the rapidly expanding developing countries may find it easier to introduce the new systems technology that calls for human and institutional adaptation, than the more conservative and more slowly growing advanced countries. Which of these two counteracting forces will predominate is still difficult to predict, but it is likely that the impact will be quite different for different developing countries.

The high rate of growth of exports of manufactures until 1979, which was particularly noteworthy in the middle income oil-importing countries, was to some extent attributable to the growth of intra-firm trade in intermediate and finished goods among affiliates of related TNCs, and between parent companies and their affiliates, as well as to subcontracting arrangements. In addition, exports of machinery and equipment from the developed market economies often take place under turnkey contracts and other kinds of non-equity arrangements involving TNCs and the developing countries -- especially the oil exporters -- as well as the centrally planned economies. East-West trade in manufactured products has also grown rapidly as a result of co-production agreements and counter-trade arrangements involving the TNCs and the centrally planned economies.
Existing modes of thinking and analysis have not yet absorbed this rapid growth in intra-firm trade and the new types of arrangements, which have important implications for the distribution of the gains from trade, for the efficient allocation of world resources, and for the relationships between sovereign countries and TNCs.

The professional consensus among economists is that the liberal trading order established after the last war should be preserved, and that exports should be encouraged, not only because they yield foreign exchange, but also because they are the key to domestic growth, employment and poverty eradication. There is no doubt that some developing countries that have strongly promoted exports have done very well in achieving high growth rates with high degrees of equity and employment, and that countries that have promoted import substitution have grown more slowly, have often suffered from large unemployment and dualism, have been less able to withstand and adjust to the oil price shocks, and have in the end not saved foreign exchange.

It is common to advance a two-pronged argument. First, it is said that the key to the successful growth performance of a country such as the Republic of Korea has been the growth of exports, and, second, the instrument to achieving this good export performance has been the free market and the abstention from government interventions. Both prongs are doubtful as historical analysis or as policy guidelines. Successful export performance has indeed been associated with high growth, but exports can be the result of growth, rather than its cause. Or there can be a third factor, such as efficient management, that is responsible for both growth and good export performance. In view of the relatively small part that exports play in the economy of many countries, it is difficult to argue that they have been a very
important causal influence on economic growth, employment creation and income
distribution. As Carlos Diaz Alejandro has said, exports may be regarded as
the engine, the handmaiden, the brake or the offspring of growth. They may
fulfill these different functions differently for different countries, and for
the same country at different times.

As to the Invisible Hand guiding the successful export performance, there
usually is a strong visible arm of government intervention guiding the
Invisible Hand. This was certainly so in the Republic of Korea, which also had a
successful policy of import substitution, as well as of export promotion, and
efficient policies for the domestic sector. It is these policies together
that have achieved high growth, low unemployment and poverty reduction. It
is, however, true that government intervention is often done better by using
prices as instruments of policy, including subsidies and indirect taxes,
rather than quantitative restrictions, licences and rationing.

No doubt, non-discrimination between production for domestic use and
foreign trade is the correct canon. But since investments take time to
mature, policy makers have to anticipate the terms of trade some years hence,
and have to make assumptions as to what rival countries are likely to do.
There is no certainty that the nineteen-eighties will be like the 'seventies,
that export opportunities will be buoyant, that all developing countries
together can do what a few have achieved, and that neither protective barriers
will be erected against successful exporters, nor their terms of trade
deteriorate. It is true that small countries face higher elasticities of
demand for their exports than large countries. But, as Carlos Diaz Alejandro
has pointed out, in a recession or stagnant world economy, every country
becomes a large country. Foreign trade planning, whether by private
entrepreneurs or state planners, is a difficult matter and the canons of liberal trade policy are of limited value. Perhaps a useful guideline is to suggest that the costs of being wrong should be compared for different strategies. Would the country suffer more from having gone in for high-cost import substitution that turns out to be wrong in the sense that had foreign exchange been available the same products could have been more cheaply imported (over a specified time horizon, so as to meet the infant industry argument) than from having gone in for export promotion that turns out to be a failure, either because the terms of trade deteriorate more rapidly than costs for import substitutes rise, or because exclusion from markets through protection creates excess capacity? Alternatively, is it possible to put up industries and processes that are more costly for any given distribution between exports and import substitutes, but show lower costs if the actual outturn deviates from the expected, because they are flexible and adaptable from one to the other?

Planning industrial adjustment in an uncertain world involves decisions both at the macroeconomic level and at the industry and firm level. Some kind of guess must first be made about the probable shifts in the world economic environment. Next, an assessment is necessary as to the industrial structure appropriate for the alternative world economic environments. Next, some decision is necessary as to the techniques available for decision-making under uncertainty.

There are, of course, other methods of planning for an uncertain future, the costs and benefits of which have to be compared with those of flexibility. It would be possible to build industrial excess capacity or to hold inventories against unexpected price increases of imports, or foreign
exchange reserves or access to lines of credit against unexpected changes in the balance of payments.

Adjustments to changes in international comparative advantage are clearly much easier in a fully employed and rapidly growing world economy than in a stagnant economy with large-scale unemployment. First, changes in industrial employment can be brought about by relative adjustments. Normal attrition through retirement and death often looks after the whole or a large part of the adjustment, so that only new workers have to be steered into the growing industries. In a stagnant economy with unemployment, there is actual loss of jobs and the need for retraining and relocation. Second, the incentives to move are much weaker in a stagnant economy. If there is unemployment in all sectors and occupations, the signals as to where to move fail. Third, workers' and trade unions' incentives to accept productivity-raising, labour-displacing innovations are much stronger in an expanding economy where everyone can find a job, than in one where their acceptance can spell added unemployment. A primary condition for progressive expansion and readjustment is therefore the return to higher rates of growth and fuller levels of employment.