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TRADE LIBERALIZATION AND ECONOMIC REFORM IN DEVELOPING COUNTRIES: STRUCTURAL CHANGE OR DE-INDUSTRIALIZATION?

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(United Nations Conference on Trade and Development)

Abstract

The paper analyses economic performance of a sample of developing countries that have undertaken trade liberalization and structural reforms since the early 1980s with the objective of expansion of exports and diversification in favour of manufacturing sector. The results obtained are varied. Forty per cent of the sample countries experienced rapid expansion of exports of manufactured goods. In a minority of these countries, mostly East Asian, rapid export growth was also accompanied with fast expansion of industrial supply capacity and upgrading. By contrast, the experience of the majority of the sample countries, mostly in Africa and Latin America, has not been satisfactory. In fact, half of the sample, most of them low income countries, have faced de-industrialization. Even in some cases where manufactured exports grew extremely fast, e.g. Mexico, MVA did not accelerate and upgrading of the industrial base did not take place. Slow growth of exports and de-industrialization has also been accompanied by increased vulnerability of the economy, particularly the manufacturing sector, to external factors particularly as far as reliance on imports are concerned. Generally speaking, in the case of the majority group, trade liberalization has led to the development and re-orientation of the industrial sector in accordance with static comparative advantage, with the exception of industries that were near maturity. For example, in Latin America the expansion of exports has taken place mainly in resource based industries, the labour intensive stage of production, i.e. assembly operations, and in a few cases in the automobile industry. A number of industries which had been dynamic during the import substitution era continued, however, to be dynamic in terms of production, exports and investment. The industries which were near maturity when the reform started, such as aerospace in Brazil, benefited from liberalization as the competitive pressure that emerged made them more efficient.

The reform programmes designed by IFIs also failed to encourage private investment, particularly in the manufacturing sector; the I/GDP ratio fell even where the inflow of FDI was considerable – e.g. in the case of Latin America. Trade liberalization changed the structure of incentives in favour of exports, but the balance between risks and return changed against the manufacturing sector.

A major difference between the "minority" and the "majority" groups is that in the case of the former, i.e. East Asian NIEs, at least until recently economic reform, particularly trade liberalization, has taken place gradually and selectively as part of a long-term industrial policy, after they had reached a certain level of industrialization and development. By contrast, the "majority group" embarked, in the main, on a process of rapid structural reform including uniform and across-the-board liberalization.

The author argues that no doubt trade liberalization is essential when an industry reaches a certain level of maturity, provided it is undertaken selectively and gradually. Nevertheless, the way it is recommended under the Washington Consensus, it is more likely to lead to the destruction of the existing industries, particularly of those that are at their early stages of infancy without necessarily leading to the emergence of new ones. Further, any new industry that emerges would be in line with static, rather than dynamic, comparative advantage. The low income countries, in particular, will be locked in production and exports of primary commodities, simple processing and at best assembly operation or other labour intensive ones with little prospect for upgrading.

INTRODUCTION

The purpose of this paper is to analyse the performance of a sample of developing countries which undertook trade liberalization and economic reform since early 1980s. It will be argued that the failure of traditional import substitution (MS) strategies of 1950s–1970s has been followed by the lack of success, in most cases, of export promotion (EP) strategies of 1980s–1990s by countries, which implemented the reform programmes and trade liberalization policies designed by international finance institutions (IFIs).

The process of trade liberalization and market-oriented economic reform that had started in many developing countries in early 1980s intensified in the 1990s. The reform undertaken varied in ownership and contents in different countries. The reforming countries can be classified into three groups. The first group consists of a number of countries in East Asia which continued their own dynamic industrial and trade policies initiated in 1960s. The second group includes a large number of countries, mostly in Africa, which have gone through the reform programmes designed and dictated by the IFIs. The third group comprises a number of Latin American countries that undertook economic reform since early 1980s, initially under the pressure from IFIs. Nevertheless, in 1990s they intensified their reform process without having been necessarily under pressure of those institutions in all cases. The contents and philosophy of their reform programmes were, however, similar to those designed by the IFIs which in turn have been referred to as the “Washington Consensus” since the early 1990s. Universal and uniform trade liberalization was a part of that “Consensus”. “Universal” implies that all developing countries are to follow the same trade policy regime-trade liberalization-irrespective of their levels of development and industrial capacities. “Uniform” implies that all sectors and industries are to be subject to the same tariff rates-preferably zero rate, or low rate. Apart from trade liberalization, such reform programmes included mainly: capital account liberalization, devaluation at the early stages of reform to compensate for trade liberalization, fiscal and financial reform through contractionary macroeconomic policies such as budget cuts, increase in interest rates and privatization.

Trade liberalization measures, in particular, are believed to be a reaction to the failure of traditional import substitution (MS) policies of the 1950s–1970s. The philosophy behind the reform programmes was that the role of government in making decisions on resource allocation should be minimized and the incentive structure should change in favour of exports through import liberalization in order to follow an export promotion (EP) path instead of MS. It was argued that private agents, guided by the operation of market forces, would better achieve the objectives of growth and diversification of exports and output structure in favour of manufactured goods. Such objectives would in turn be