

Is export oriented
industrialization
indispensable for
economic growth



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INTRODUCTION

One of the key indicators, of economic development of a country, is its level of industrialization. That is, as many empirical investigations proved the main reason for increased divergence in living standards between the advanced countries and the developing countries is their level of industrialization. This being the fact, it is only after decolonization and end of world War II that, developing countries consciously adopted industrialization strategies for economic development purposes and as a solution, from their vulnerable dependence on export of few primary products and import of high valued manufactured goods (Brisbane, 1980). The low terms of trade in international market for primary goods from former colonies and the determination to get out of severe poverty and register sustained growth, were the main reasons for the diversification of the narrow structure of the colonial economy.

Industrialization is beneficial for developing countries for many reasons including the following (i) it reduces their vulnerable dependence; (ii) it speeds up their economic growth process; (iii) it modernize the economy through spill over or externalities effects associated with industrialization, from advanced countries; (iv) create more employment for the vast population in rural agricultural sector and accelerate income growth which is used as a means to re-distribute income to the impoverished masses; and (v) generate more foreign currency through export - which reduces balance of payment problems (Brisbane, 1980).

As Brisbane explained, to industrialize, developing countries adopted import substitution strategies from about 1945 to the 1970's. Import substitution strategy is designed to produce few luxury consumer goods for domestic consumption behind a very high tariff wall. However, most countries which followed the import substitution strategy failed, to meet the goal of industrialization, while spectacular growth and development was reported from developing countries that pursued an export oriented strategy, in the 1970's.

Defined simply, export-oriented Industrialization (EOI) often termed as export led industrialization (ELI) is a policy designed for the purpose of speeding up the industrialization process of a country through exporting goods for which the nation has a comparative advantage. This policy requires countries to open up their domestic market to foreign competition in return to getting access to international market. In order to promote EOI and ultimately economic development, complementary policies in relation to tariffs, trade, exchange rate, and others need to be adopted and employed.

This paper will critically examine how export oriented industrialization is essential for economic growth in developing countries, if it can be backed up by appropriate policies on trade, industrial policy and exchange rate policy, geared for that purpose. The paper also argues that export oriented industrialization has its own drawbacks. Thus, the essay is structured as follows: In section 2, It the paper analyses the significance of policies on the functioning of EOI, particularly: trade policy, industrial policy and exchange rate policy that developing countries need to adopt and identifies areas

where government intervention is needed to bring economic development. It <https://assignbuster.com/is-export-oriented-industrialization-indispensable-for-economic-growth/>

then explains the drawbacks of export oriented industrialization, on export dependence countries, in Section 3. Then section 4, empirically examines how EOI contributes to economic development and the conclusions are presented in section 5.

2. Significance of Policies on EOI

The role of complementary policies for effectiveness of export oriented industrialization is undeniable. This paper focuses mainly on how trade, industrial and exchange rate policies can support EOI policy.

2. 1 Trade policy:

Appropriate trade policy is one of the key tools used for effective of export oriented industrialization and for economic development, in general. That is, the better trade policy a country has, the better chance it has for industrial diversification, creating value added products and getting more income from export.

Theoretical context:

Even if, “ there has been little consensus on the relationship between trade and short- to medium -term economic growth-and even less on its role in long term economic development. The principle of comparative advantage, which prescribe countries to specialize as to their factor endowment, first described by David Ricardo, forms the theoretical basis for traditional trade theory and provides the rationale for free trade. The principle states that even if a country produced all goods more cheaply than other countries, it would benefit by specializing in the export of its relatively cheapest good (or

the good in which it has a comparative advantage)”(Murray Gibbs 2007, p. 10). And some classical economists believed that the principal base for this principle is the difference in factor endowments among countries determine the relative cost of production.

However, this traditional theory from classical economists has been challenged as it doesn't explain well the actual trade patterns and as the theory has unrealistic assumptions, like perfect competition, full employment etc (Murray Gibbs 2007). In addition to the unrealistic assumptions, in real situations the theory favors advanced countries, and developing countries hardly benefit anything from it. The controversial Singer Prebisch thesis, also explained this situation by stating that it is the center that gets all the benefits of international trade while the periphery gets nothing, which opposes to the Ricardian “ Theory of Comparative Advantage. He argued: given the differences in the existing economic, productive and labor market structures between the periphery and the center (in the application of technology in traded goods and in the market structures; oligopoly vs. competitive) – less-developed countries cannot benefit from international market, if they adopt comparative advantage doctrine (Todaro and Smith 2009). This is because developing countries usually produce and export primary products which have lower terms of trade. And the scope for diversification is too narrow, and these conditions put developing countries to have vulnerable dependence on international market.

Thus, unlike the classical economists' static comparative advantage doctrine, dynamic comparative advantage is a better option for developing countries.

This is because as more innovation, technology, capital, and other
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requirements for industrializations are met and as industrialization happens in developing countries, it will be easier to diversify their economic structure, as manufactured goods have better terms of trade than primary products.

Skarstein (2007) in his paper "Free Trade: A Dead End for Underdeveloped Economies,"...criticized the comparative advantage doctrine. He argued, what matters most in international trade is the absolute advantage that countries get out of it than a comparative advantage. And empirical evidences show that the doctrines of comparative advantage and free trade benefit the advanced countries only. This is mainly because the doctrines are likely to exclude international learning among countries. Particularly, the WTO agreement, Trade related intellectual property rights (TRIPS), which is a big challenge developing countries to acquire technology, skill and international learning from the rest of the world.

He also argued, for a trade policy to function effectively, developing countries have to make sure that, this policy is well integrated with their industrial policy. And in addition to these, developing countries have to get support from advanced countries, through reduced import tariffs for goods from developing countries and by giving developing countries a chance to protect their industries and to get easy access to international market. He also stressed that, developing countries have to ensure that food security is maintained in their countries, as it keeps them safe from their foreign account, balance of payment problems as well. Thus, governments of developing countries have to protect agricultural production for consumption.

Therefore, while designing policies, developing countries have to consider the dynamic comparative advantage or absolute advantage options. In addition to this, they also have to consider how their economic integration to the world economy should be in support of EOI.

2. 2 Industrial policy:

A proper industrial policy is also another important tool for effective export oriented industrialization, as a country's industrialization depends on how individual domestic firms are protected. This is because, it is individual firms that innovate and harness technological change and compete in the world market (Suranovic, 2002).

The basic policy component of industrial policy for developing countries is Infant industry protection. It is a necessary condition, because newly emerging firms in developing countries need some policy to help them grow strong and to safeguard them from intrusion of foreign firms in their market, that have a negative effect on their growth. Infant industries in developing countries can mainly be protected through import tariff mechanism, which reduce imports from the rest of the world and raises demand and production of domestic product. This protection enables the domestic firms to cover their higher production costs and to remain in business. Depending on the nature of the firm, infant industry protection strategy will help the domestic firms to produce efficiently and to be competent in international markets.

However, in order to use the infant industry protection policy as a tool for export oriented industrialization, government of developing countries need to have reliable information about what industry to protect, how large the

production tariffs need to be and over what period the tariffs will be reduced and eliminated. Because import tariffs have to be gradually reduced and eliminated, to increase efficiency of domestic firms.

A complementary policy component to infant industry protection in export oriented industrialization is export promotion. This component stimulates export and allows the infant industry to have access to international market, while Infant industry protection policy allows the new domestic firm to grow strong.

For industrial policy to be effective it has to be complemented by competition policy, as some regulations are required for the competition among domestic firms and simultaneously, as there is a need for policy to protect the domestic firms from intrusion of foreign firms in their market.

A coherent execution of industrial policy requires a coordinated approach to trade policies. This is because trade policies are designed usually in accordance with a country's trade negotiations, which include: policies related to investment, tariff, Intellectual property, and others.

“ The effectiveness of tariffs as a tool for industrialization is also linked to the monetary policy framework within which it operates. When the capital account is liberalized control over exchange rates may be lost and the appreciation of exchange rates can obviously undermine export competitiveness and the impact of tariff protection” (Murray Gibbs 2007, p. 19).

2. 3. Exchange rate policy:

The role of exchange rate policy in the success of export oriented industrialization strategy is undeniable. Exchange rate is a policy on the level of exchange rate of a country's currency. The main challenge in formulating the exchange rate policy is in keeping balance between maintaining exchange rate stability and maintaining export price competitiveness, which requires devaluation. Devaluation increases the value of imports, while it gives options for exporters to choose either to reduce the prices of their products or to keep them as they are, to increase their profit margin. Thus, devaluation, at a cost of higher inflation, enables domestic industries to be competent internationally, by keeping the volume of import down and by raising the volume of export (domestic output) higher. The role of government in controlling inflation, to stabilize the economy is very essential, here. Thus, this phenomenon in addition to supporting the export oriented industrialization process it helps countries to improve their current account balance in Balance of payment problem (Jacob, Atta ; Keith R., Jefferis ; Ita, Mannathoko and Pelani, Siwawa-Ndai 2000)

3. Drawbacks of Export dependence

A country is dependent on export, if export constitutes the largest portion of its gross domestic products. However, even if EOI strategy contributes for economic development, the extent to which this strategy is applied has to be considered for various reasons. To mention some of them, as dependency theorists argue: first, export dependent developing countries cause chaos on the long-term economic planning capacity of a nation-state (Barratt-Brown Prebisch) as these countries have little or no control over the market, to

allow sustained economic growth through stable revenue. Second, Income from export is not a reliable source for economic development for developing countries. As many of the export oriented industrializations in these countries are owned by multinational corporations, and large portion of revenue from such sources are not repatriated, to be used for re-investment (Jaffee, 1985).

4. Empirical evidence:

Skarstein, 2007 paper " Free Trade: A Dead End for Underdeveloped Economies," showed the empirical evidences on EOI's contribution for miraculous economic development of the Asian tigers and the now developed countries. It mainly showed the relationship between economic development and effective implementation of infant industries protection policy and export promotion policy.

In support of this, it is argued, that many people have argued that Infant industry protection was precisely the industrial development strategy that was pursued by countries like the US and Germany during their rapid industrial development before the turn of the 20th century. Both the US and Germany had high tariffs during their industrial revolution periods. These tariffs helped protect fledgling industries from competition with more efficient firms in Britain and may have been the necessary requirement to stimulate economic growth (Suranovic 2002)

Bairoch also analyzed data and concluded that the different the effect of free trade on developed and developing countries is. In all the cases he analyzed, free trade has a positive effect on developed countries while it lets the least

developed countries to suffer. He mentioned that United Kingdom registered its fastest growth during the period (1860 - 1880). In those cases he analyzed, how effective import tariffs for developing countries were in their economic development (Bairoch, 1972, p. 211).

In his paper, Skarstein, illustrated, with detailed data how the East Asian tigers used industrialization policy for their economic development. That is: first by implementing a policy of protected import substitution and then, as their industries grow competent, by shifting their industrialization strategy to export oriented industrialization, with a slow reduction of import barriers for industrial good. And, at the same time, how implementing high import protection for their agriculture helped them to maintain food security and helped their success in industrialization

The miraculous performance of the East and South East Asian countries during 1970s to 1990s cannot be analyzed without considering the connection between the export -oriented policies and economic growth. In the Newly Industrialized Economies from East and South East Asia, the general macroeconomic policies as well as selective export promotion policies facilitated the high export and economic growth. Following their path China and India also changed their policy stance in favor of export oriented policies and moved on the high growth trajectories.

5. Conclusions:

In sum industrialization is a key process for developing countries for economic development. However, as many economists agree, the process of economic development is very complex, as it depends on large number of

variables such as political system, socio economic structure, capital accumulation (both physical and human), trade, price fluctuations, and income distribution, and even more on geographical characteristics. As such, while export oriented industrialization contributes to economic growth, it is not necessarily indispensable to the growth and development of developing countries.

As explained in this essay, EOI can be one of the key strategies to register economic growth. And in order for it to function effectively it has to be supported by appropriate components of the policy like: infant industry protection strategy, competition policy, export promotion strategy and others. More specifically, it requires well functioning and well integrated macroeconomic policies like: trade policy, industrial policy, exchange rate policy, investment policy, tariff policy and others. Government intervention also plays a key role in making the export oriented industrialization effective for economic development.

Examined empirical evidences also reveal that Export-oriented Industrialization was particularly the characteristic of the economic development of the Asian Tigers: Hong Kong, South Korea, Taiwan and Singapore in the post World War II period . In addition to Asian Tigers, evidences also tell how EOI strategy contributed for the economic development of US, Germany and others, who are now in developed world category. However, though the role of export oriented industrialization in economic development is undeniable, countries have to also carefully consider its share in the gross domestic product, as larger export dependence has a negative effect on economic growth.

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