# Export promotion and import substitution

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The emphasis that Countries have placed in their development strategies in favor of either export led growth strategy or import substitution has influenced the evolution of current account balances and growth of output. In the case of import substitution, by contrast, the costs of the strategies have often turned out to be greater than anticipated. In particular, the methods used to shield domestic sectors from foreign competition such as those used in many western hemisphere Countries have in the event been more prone to produce distortions and resource misallocation than those used to favor exports as in certain Countries in Asia.

This paper will attempt to discuss the relationship between exports, economic growth and development and the differences between export promotion and import substitution industrialization. Those advocating export led growth strategy usually do so on the basis that it is the rational and efficient alternative to other strategies of development. Outward orientation and export led growth are argued to generate the necessary flexibility in shifting the economy's resources to take account of the changing pattern of comparative advantage (World bank, 1987).

Import Substitution strategy is a strategy for economic growth and development which believes in protecting domestic producers from foreign competition by substituting domestic production of goods previously imported with domestic sources of production and supply and then substitute through domestic production for a wider range of more sophisticated manufactured items by levying tariffs and imposing quotas on some commodities then try and set up a local industry to produce those goods. The idea behind this is to raise the price for domestic substitutes for

the imported goods. The increased price provides greater incentives for production for the home market by domestic firms relative to production for foreign markets (exports). From a development perspective, the goal of such a strategy has been to promote the growth of the manufacturing sector and therefore transform the economy from an agricultural one to an industrial base.

The departures from uniform incentives under import substitution regimes are typically characterized by import tariffs, import quotas and prohibitions on the importation of certain commodities. Such measures have resulted in effective rates of protection for manufacturing industries that have high and variable between different sectors of the economy. These rates reached a peak in the late 1960s and early 1970s when in one western hemisphere Country for example the effective rates of protection were estimated to vary from -23% for one sector to +1140% for another, while in a large predominantly agricultural Asian Country, the range of variation was from -19% to +5400%. Although, import duties and restrictions are often utilized for reasons other than protection. For example, to raise budgetary revenue or to enhance national security, changes in the scope and average height of effective rates of protection are clear indications of whether a foreign trade strategy is being altered toward either greater import substituting bias or more uniform incentives.

Neoclassical economists argue that free trade leads to an optimal allocation of resources both between and within Countries. Thus, all Countries benefit through trade. Thus, free trade would inhibit the industrial transformation of these Countries. Newly established manufacturing firms in less developed

Countries are not likely to operate at too small a scale and to lack complete understanding of manufacturing technologies. In other words, they are unable to benefit from the economies stemming from large scale operations and from learning by doing.

The objective of import substitution strategies would be to protect infant industries in developing nations. The protection would allow these industries to expand operations so as to achieve economies of scale, as well as to give them time to learn. Once this process was complete, these industries would be able to compete internationally without protection.

Unfortunately, in much of the world these policies have failed. Economies of scale failed to materialize and little learning seems to have occurred. As a result, the protected industries have failed to become competitive. Even more importantly, the protected industries have used much of their resources to accumulate political power allowing them to gain significant control over policy making. This has been labeled rent seeking activities.

## Export Led Growth Strategies

Export led growth strategies refers to Government efforts to increase exports on the assumption that they can improve not only foreign exchange earnings but also increase productivity and growth.

In the post war period, export promotion in Europe and Japan sought to overcome the severe foreign exchange constraints associated with reconstruction. Japan pioneered a new model of trade policy that combined relatively restrictive policies towards imports and inward foreign investment with aggressive promotion of export industries.

Initially, developing Countries did not show a strong interest in promoting exports as dependence on the export of raw materials was seen as increasingly vulnerable to international fluctuations and multinational fluctuations and multinational corporations (MNCs). While developing Countries did pursue efforts to increase productivity in export industries and stabilize earnings through international commodity agreements (ICAs), the main thrust of policy turned away from exports towards the development of domestic industrial capacity.

The overvalued exchange rates and protectionist trade policies associated with these efforts had the unintended consequence of determining exports. As a result, a number of developing Countries particularly in Latin America supplemented their ISI efforts with various subsidies to exports.

Export promotion efforts also included the formation of export- processing zones (EPZs) and the encouragement of export oriented FDI. Free trade enclaves provided foreign investors with infrastructure and logistical support for export oriented manufacturing. The EPZ model was pioneered in Korea, Taiwan and along the Mexican border with the United States, but rapidly spread elsewhere from Ireland to Bangladesh.

## Arguments in favor of Export Led Growth Strategies

Abstracting from such factors as initial level of economic development, population size and natural resource endowment, developing Countries that have pursued strategies based on export promotion and export led growth have tended to achieve greater success in terms of real GDP growth, than those Countries that have sought to achieve growth based on import

substitution and domestic demand. This result may be partly due simply to the gains from trade, but seems also related to the tendency for Countries with export promotion strategies to maintain more uniform incentives among activities and therefore to develop more efficient production structures than Countries with a strong bias toward import substitution. This is especially true when the export promotion strategy has been accompanied by a policy of allowing international trade prices to be adequately reflected in the domestic price structure through maintenance of a realistic unified exchange rate.

The export led growth strategy has been implemented most successfully in East Asia where seven Countries Hong Kong, Singapore, South Korea, Taiwan which are known as the newly industrializing Countries and Indonesia, Thailand and Malaysia ( South East Asia) have set the pace for the rest of the developing world in using outward looking strategies to stimulate rapid growth and industrialization.

The newly industrializing Countries are primarily exporters of manufactured goods while the three South East Asian Countries are still moving from their primary export bases toward greater reliance on manufactured exports.

Brazil changed from an import substitution strategy to an export led growth strategy and saw increased economic growth. By the 1970s, their economic growth was in double digits, much higher than previous years. There was also a dramatic change in Columbia as well but the most dramatic change was in South Korea which began in the 1970s from a change from an import substitution strategy to one relying on trade and export growth.

More Countries have started changing their economic policies from inward looking to outward looking based on the experience of Brazil, Columbia and South Korea. Mexico also lowered it imports in the 1980s and joined the US and Canada in a free trade area in the 1990s.