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

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

S.M. Shafaeddin

(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 attained through the expansion of investment, better channelling of resources and allocation of investment outlays to productive sectors. The change in the structure of incentives would not only lead to growth and diversification but also to the upgrading of the production structure, facilitated by imported technology and improved skills enhanced by trade.

To what extent have the objectives of reform been achieved? Has growth of exports of manufactures accelerated? If it did, has it been accompanied with growth of MVA (manufacturing value added), structural change in exports and output and upgrading of the export structure necessary to sustain export expansion? Has investment been stimulated?

As the performance of countries varies, there is a controversy in the literature on the causes of failure in attaining the objectives of reform. Some scholars attribute the lack of success to improper implementation or incompletion of the reform programmes (e.g. Baumann 2001). Others have cast

doubts on the rationale and "the same-size-for-all" approach to reform (e.g. Katz 2000a, Krugman 2002, Weisbrot 2002, Lora et al. 2002 and Garrido and Peres 1998). On the particular issue of trade liberalization,[1] Krueger (1998), Ben-David and Loewy (1998), and Greenaway et al. (1998) continue to argue in favour of the positive impact of trade liberalization on growth and industrialization. Greenaway et al. (1998) further believe that there is a lag response to liberalization. By contrast, Ocampo and Taylor (1998), Rodrik (1998), Shafaeddin (1995) and Weisbrot and Baker (2002) are doubtful.

Although the origin of the literature on trade liberalization and economic reform goes back to the publication by Little et al. (1970), followed by Krueger (1974), in the 1970s, the process of the reform started by the introduction of the Structural Adjustment Programmes (SAPs) and Stabilization Programmes (SPs) of the World Bank and the IMF in early 1980s. Therefore, we first briefly review the development in the views expressed by the World Bank, which has been the main advocator and implementor of SAPs, on the issue. Growth and structural changes in exports and output will be dealt with in the second and third section followed by an analysis of the impact of liberalization on industries, which are near the stage of maturity. Changes in investment and vulnerability of the economies of the exporting countries will be discussed in sections V and VI. As some countries in Latin America and Africa show sever pattern of de-industrialization we will subsequently review the debate on the subject before concluding the study.

I. EVOLUTION OF THE WORLD BANK'S APPROACH

The work of the World Bank on trade policy and economic reform has been dominating the field in recent decades. It started with the study on trade policy reform in *World Development Report* (World Bank 1987). This study takes outward-orientation and liberal trade regimes as synonymous and shows that countries that followed outward orientation succeeded better. The study placed the countries of the East Asia in the category of outward oriented regimes and attributed their success to liberal trade regimes. The study was questioned on methodological deficiencies, particularly definition of outward orientation, treatment of statistics and failure to distinguish among countries according to their level of development (e.g. Singer 1988, Singer and Gray 1988, Shafaeddin 1991a). The World Bank study, as well as many other Banks' studies (see e.g. Papageorgiou et al. 1990) takes neutrality of a trade regime, i.e. zero rates of protection for importables and exportables, and liberal trade regimes as synonymous. "Trade liberalization is defined as any act that would make the trade regime more neutral – nearer to a trade system free of government intervention" (ibid. Volume 7, 13). Nevertheless, one should note that a neutral trade regime could be achieved at positive but equal rates of protection for exports and imports. Hence, outward orientation does not necessarily imply a liberal trade regime (Shafaeddin 1991a).

This point is later well recognized by the staff members of the Bank in their study of *Best Practices in Trade Policy Reform* (Thomas and Nash 1991). Nevertheless the authors still consider that "relatively low and relatively uniform tariffs are preferable for reasons of efficiency and political economy, even though they agree that uniformity of import tariffs cannot be demonstrated in theory to be optimal in many circumstances" (ibid. p. 214*)*. In other words, despite the fact that in practice the selective trade policy has been successful in East Asia and that "uniformity of tariffs can not be demonstrated to be optimal", the authors' value judgment tilts in favour of uniformity of the incentive structure. Further, they attribute the lack of success of many countries which followed uniform trade policy regimes to

[1] See Greenaway et al. 1998 for a short review of the literature.

other factors, including the lack of proper implementation. This line of argument has more or less continued in other empirical studies of the World Bank (1993), including the *East Asian Miracle.*

This study is a breakthrough in the work of the Bank on industrial policy. Generally speaking, it recognizes the fact that trade policy regime alone is not sufficient for rapid growth. It appreciates the importance of the institutional factors in success, or failure, of policies. Further, it advocates that interventions are required to enhance investment in physical and human resource capacities. More importantly, it recognizes for the first time that "economic policies and policy advice must be country-specific, if they are to be effective" (World Bank 1993, p. iv).

Nevertheless the study suffers from a few important weaknesses, including the contradictions between its recommendations and its general findings. Here, we refer to a few of these inconsistencies. First, despite the fact that the authors recognize the importance of country specific policies, they advocate almost a universal trade and industrial policies for all developing countries during the process of their development.

Second, they advocate that government involvement in the economy should be limited to functional, not selective, intervention. The functional intervention should concentrate on "getting the fundamentals right". By fundamentals it is meant good macroeconomic management, stable macroeconomic policies, measures to enhance savings and investment and avoidance of excessive distortions. Otherwise, "our assessment is that promotion of specific industries generally did not work and therefore holds little promise for other developing countries" (ibid. p. 32*)*. It is concluded that "We find little evidence that industrial policies have affected either the sectoral structure of industry or rate of productivity change."*(* ibid. p. 30), and that "Indeed, industrial structures in Japan, Korea, and Taiwan, China have *evolved* [my italic] during the past thirty years as we would expect on the basis of factor-based comparative advantage and *changing factor endowments.*[my italics]"(loc. cit.). The authors of the report do not however take into account the fact that the industrial structure did not evolve automatically through market forces in these countries. It was the result of selective and "careful policy interventions" which, elsewhere in the text, they admit to have been effective.

Third, the success of the East Asian countries was attributed to their low level of general "nominal" tariff rates, "the fact that East Asia's relative prices of traded goods were closer, *on average,* to international prices than those of other developing countries" (ibid. p. 29). Nevertheless, the figures on tariff rates refer to those of 1980s and early 1990s, i.e. the end period. The dimension of time for each country, and the difference in stage of development of various countries in each period is not appreciated in this statement. Considering that at the time of publication of the World Bank (1993) Report, East Asian countries were at, or close to, maturity in most industries, it was in fact essential that their trade regime would be, *on average, more* liberal than other developing countries. Otherwise they had been strongly, although on selective basis, protective of their importables and exportables in the past. In fact, in the same study it is admitted that "Most HPAEs [High-performing Asian economies] began industrialization with a protectionist orientation and gradually moved towards increasingly free trade"[2] (loc. cit). Moreover, it should be mentioned that neither nominal rate nor average rate of protection is a good indication of selective protection policies. As recent as mid-1980s, the effective rate of protection for consumer goods and machinery industries of the Republic of Korea was 135 per cent (Arndt 1987).

[2] It should be mentioned however that liberalization of the trade regime is taken as an indication of reversal of protectionist policies of the past (ibid. pp. 33–34). This is not the case. Selective liberalization was the evolution of protectionist policies as the industries concerned became mature; it was not an indication of the past mistakes.

Fourth, it is concluded that protection of domestic market coexisted with promotion of exports through countervailing subsidies in most East Asian countries (World Bank, op. cit. p. 31*).* However, a similar policy is not advocated to other developing countries because it is believed to be difficult to manage and is incompatible with the changing world trade environment (ibid. p. 33). While there is some truth in this statement, there are still ways to promote exports through government intervention (Amsden 2000). Further, the rules are not god given; they can be changed.

Fifth, it is also recognized that "externalities are an important source of rapid productivity growth", particularly through the spillover effect to the rest of the economy of exports of manufactured goods (World Bank*,* ibid. pp. 31–32). Nevertheless, the fact that certain industries, whether for export or domestic production, involve more externalities than others is not appreciated.

Another feature of the empirical studies undertaken by the Bank in general is that they attribute the failure of trade liberalization to achieve development objectives, particularly in the case of Africa, to insufficient liberalization and inappropriate implementation of liberalization and adjustment programmes. Often the government is blamed for lack of appropriate sequencing and speed of liberalization or inappropriate macroeconomic policies (see e.g. World Bank 1994 and Husain and Faruqee 1994). In the latter study by the staff members of the Bank, it is admitted that "Import liberalization, if done too rapidly, will reduce the profitability of domestic firms competing with imports ..." (ibid. pp. 435–436). Nevertheless the appropriateness of universal trade liberalization to all countries, at different stages of development, is never seriously questioned and uniform liberalization of different activities within a country, at any point in time, is never questioned. The critics of the neo-liberals also often neglect this factor, with few exceptions. The exceptional cases include Singer and Gray (1998), Helleiner (1986), Michaely (1977) Wheeler (1984), and Shafaeddin (1991 and 2005) who make some allowance for countries at different levels of industrialization and development. Further, Lall et al. (1994, Chapter 7) are among those who distinguish four groups of activities within a country as far as the impact of trade liberalization is concerned.

The first group include those with strong resource advantage or well-developed capabilities so they are already competitive internationally, and those that benefit from natural protection because they are heavy and difficult or expensive to transport, or require close producer-buyer interaction. They benefit from liberalization. The second group consists of those which are in "a short distance from the technological frontier", i.e. those which are near the stage of maturity. They may also benefit from liberalization. The third group include activities which are potentially viable, but require time to learn, i.e. are still at the stage of infancy. Sudden liberalization of imports will hurt them. Finally, there are activities, which are not economically viable currently, or potentially, so they suffer from liberalization but they should be allowed to die. Such categorization would imply that protection/liberalization should take place on selective basis.

II. GROWTH IN EXPORTS AND OUTPUT

A. Methodology and data

To analyse the performance of developing countries we have used the data for a sample of countries reported in Shafaeddin (2005). The sample includes three different categories of countries. The first consists of countries which have already developed their industrial capacity and have substantial

capabilities in exports of manufactured goods. This group includes mainly of East Asian countries and other NIEs (newly industrializing economies). The second group cover countries which have developed some industrial capacity through import substitution, with some export capabilities. When they started liberalization, some of their industries were near maturity but not all. Further, they had developed a large number of industries due to balance of payments restrictions and not as a result of a designed industrial strategy. They include many Latin American, Middle Eastern and North African countries. The third group include countries with little industrial base which are located mainly in Africa. The period 1990s was used for the analysis when the reform process was intensified in most countries.

Figures on growth of exports are inflated by increases in import intensity of exports in recent years due to import liberalization and changes in the organization of production towards networking and assembly operation, particularly in export processing zones (see Shafaeddin 2005, Palma 2002 Table 2, Buitelaar and Pérez 2000 Table 2). The data on the purchasing power of exports, rather than export value, are used for the analysis, as they better represent the ability of the country to acquire imports of manufactured goods; but the figures on the value of exports are also reported for comparison.

The expansion of exports does not necessarily indicate the growth in production capacity. If export expansion is not accompanied by a corresponding expansion of MVA and investment, it is either because resources are diverted from domestic markets to exports, or because the import intensity of exports has increased for the reasons mentioned above. Therefore, we have studied changes in MVA as well as investment and absorptive capacity of the sample countries. The data on MVA are derived from World Bank sources that are based on the UNIDO definition of manufactured goods which include all processed and semi-processed primary products.

Despite all these shortcomings, Tables 1 to 5 provide some information on relative performances of the sample countries over the period 1989–2000. In these tables, countries of the sample are classified into three groups, according to their rate of growth of purchasing power of exports of manufactured goods: high (I), moderate (II) and low (III) as defined at the bottom of Table 1. Within each group they are classified according to their rate of growth of MVA and shown as sub-groups. The list of individual countries is presented in the Annex**.**

B. Performance of the sample countries

Table 1 indicates first that, rapid expansion of exports of manufactured goods has not been widespread. Only group I, which consists of 20 out of 46 countries, show high rates of growth of exports of manufactured goods;[3] the rest show moderate (group II), low, or negative, export growth (group III). For group I, rapid growth of exports of manufactured goods has also corresponded to rapid growth of total exports except for sub-group “c”. The base of manufacturing exports, thus their weight in total exports, has been small for most countries in this sub-group.

3 In the analysis related to table 1, exports refer to purchasing power of exports.

Table 1
Average annual growth rates of output and trade
(1989–2000)

	Country groups	Purchasing power of exports: Manufactured goods	Purchasing power of exports: Total	Value added: Manufactured goods	Value added: GDP	Domestic absorption	Exports value: Manufactured goods	Exports value: Total
I.	**High export growth (20)**	**17.0**	**10.6**	**5.2**	**4.8**	**4.8**	**16.7**	**10.0**
	a. High output growth (11)	*16.6*	*12.3*	*7.6*	*5.9*	*5.5*	*16.7*	*11.6*
	b. Moderate output growth (2)	*21.5*	*12.4*	*4.5*	*5.0*	*5.3*	*21.4*	*11.8*
	c. Low output growth (7)	*16.3*	*7.5*	*1.6*	*2.9*	*3.4*	*15.2*	*6.9*
II.	**Moderate export growth (20)**	**7.7**	**7.2**	**3.1**	**4.0**	**3.9**	**7.8**	**6.6**
	d. High output growth (5)	*8.3*	*8.4*	*6.8*	*4.8*	*3.9*	*8.8*	*7.8*
	e. Moderate output growth (6)	*7.7*	*7.4*	*4.2*	*4.7*	*4.7*	*7.9*	*6.8*
	f. Low output growth (9)	*7.4*	*6.3*	*0.0*	*3.1*	*3.2*	*7.1*	*5.7*
III.	**Low export growth (6)**	**-1.5**	**3.7**	**0.7**	**2.4**	**3.6**	**-1.2**	**3.1**
	g. High output growth (1)	*3.2*	*-1.4*	*6.2*	*4.5*	*4.1*	*3.1*	*-1.9*
	h. Moderate output growth (3)	*1.5*	*5.4*	*3.5*	*3.1*	*3.9*	*1.8*	*4.8*
	i. Low / negative output growth (2)	*-8.2*	*3.7*	*-4.9*	*0.3*	*3.1*	*-7.8*	*3.1*
	Total sample (46)	**10.6**	**8.2**	**3.8**	**4.1**	**4.3**	**10.5**	**7.6**

Sources: Based on Shafaeddin (2005) Table 2.1 which in turn is based on World Bank *World Development Indicators* and UNCTAD *Handbook of Development Statistics*, various issues, for exports and unit export values.

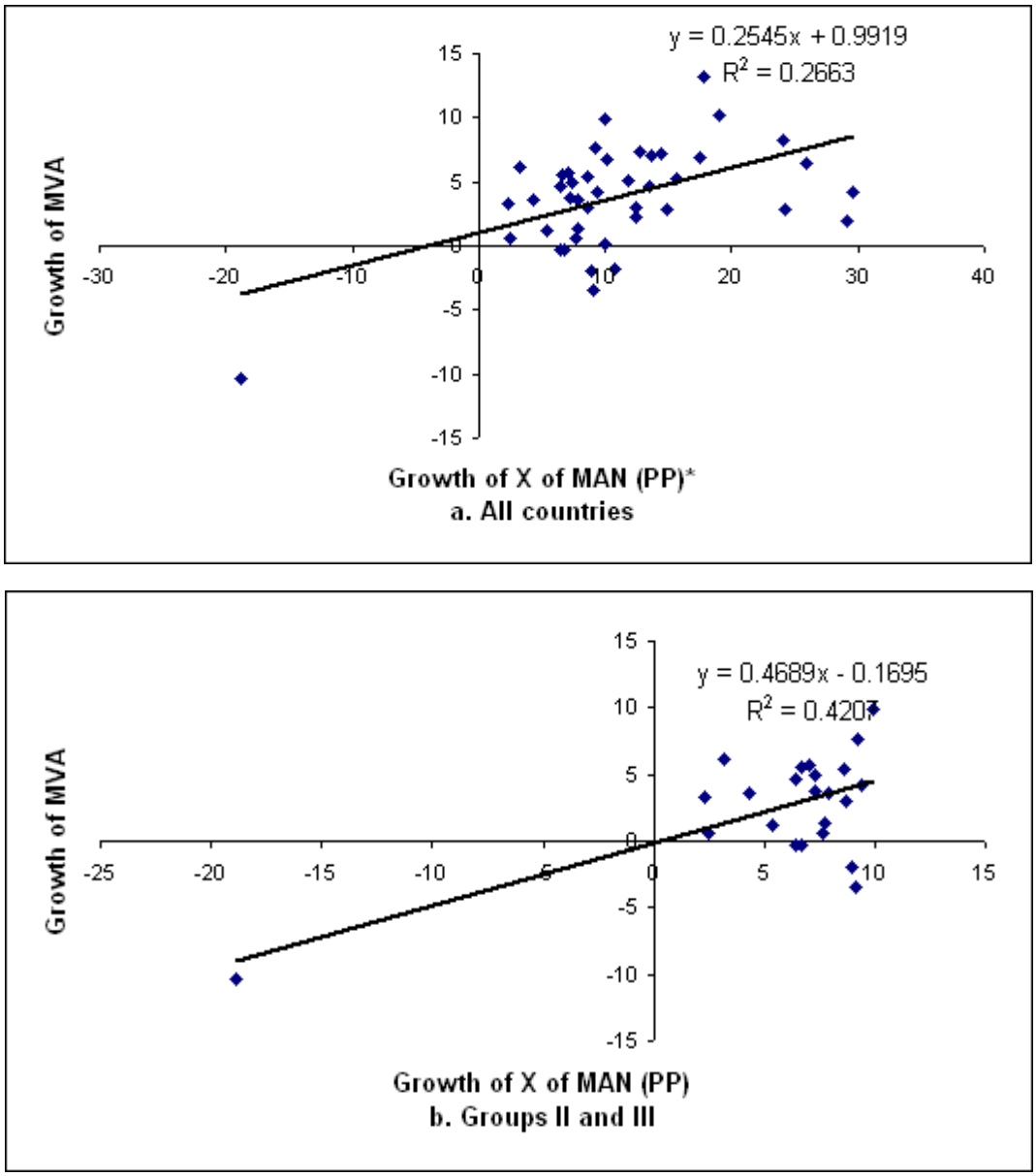
Notes: (1) The notations for growth rates are as follows: Exports: high - more than 10; moderate - between 10 and 5; low - less than 5; MVA: high - more than 5; moderate - between 5 and 3; low - less than 3. (2) Exports and output in the first column (*Country groups*) refer to purchasing power of exports and MVA, respectively. (3) Purchasing power of manufacturing exports was calculated by deflating the export value by the unit value of manufacturing exports of developed countries. (4) The figures in brackets in the first column refer to number of countries.

Secondly, in group I only for sub-group "a" (11 countries) rapid expansion of exports of manufactured goods has been accompanied with rapid growth in production (MVA, GDP) and domestic absorption[4]. With the exceptions of Costa Rica and El Salvador, the countries in sub-group "b" are among those that had already shown rapid growth in exports and output in the 1980s and are mostly located in East Asia (see Annex).

Third, the association between growth of export of manufactured goods and growth of MVA is reasonably high particularly when group I is excluded from the sample (Chart 1); nevertheless, the direction of causation is not clear. The fact that assembly operations and export processing zones are very important in export operations of many of the countries in this group (e.g. Mexico, Costa Rica, Sri Lanka, Bangladesh, Bolivia, and the Philippines) may explain, at least partially, the weaker association in the first group. In fact, in a few countries (Jamaica, Ghana, Colombia, Uruguay and Paraguay) high, or moderate, growth rates of exports of manufactured goods are accompanied with negative growth rates of MVA (Shafaeddin 2005). By contrast, some countries have managed to achieve relatively fast expansion of their MVA with little or moderate export growth (e.g. sub-group "g" and "d").

[4] Chile in sub-group "b" shows the same picture (Shafaeddin 2005).

Chart 1
Association between growth of exports of manufactured goods and MVA



Source: Based on UNCTAD database.

* PP, MAN, X and MVA stands for purchasing power, manufactures, exports and manufactured value added, respectively.

Fourth, the performance of Mexico, Brazil and Ghana, is worth mentioning[5]. Mexico was among one of the top reformers in Latin American countries in areas of trade liberalization and economic reform and received significant inflows of FDI (foreign direct investment) (see ECLAC 2001, Table 11.3 and Shafaeddin 2005). It achieved the rate of growth of exports of manufactured goods of nearly 30 per cent. Yet, its growth rate of MVA was not particularly impressive – over 4 per cent as against 7.6 per cent for sub-group "a". Brazil's growth rates of exports of manufactured goods and MVA were 5.4 and 1.1, respectively, in spite of its deep reforms and significant inflows of FDI. Notwithstanding two decades of reform, Ghana's growth in MVA added was significantly negative (-3.5 per cent) during the 1990s, implying severe de-industrialization.

[5] The situation in both Ghana and Brazil has somewhat improved recently; the sustainability of the recovery is, however, questionable.

An important characteristic of the 1990s is that the rate of growth of absorption grew faster than GDP in most countries, i.e. for the sub-group of countries with moderate or low output growth (Table 1).[6] On average, during 1990s groups II and III not only did not manage to increase their exports substantially, but they also suffered from increases in their current account deficits in relations to their total exports of goods and services (Table 2). Many Latin American countries are in this category (see Annex). The debt service ratios increased for some countries in these sub-groups substantially. For example, the ratios for Brazil and Argentina were, on average, 92.8 and 68.3 per cent, respectively for 1998–2000. In many countries, capital flows played an increasing important role in financing the current account deficits. This is in contrast with the situation in 1980s when export expansion was at the cost of domestic absorption, which grew slower than GDP. During this period, export expansion together with import compression was used to repay debts (Shafaeddin 1991b). In the 1990s, capital flows allowed the expansion of domestic absorption, but not necessarily investment (see below).

Table 2
Changes in debt and current account indicators for selected countries
1979/1981–1989/2000

		Debt service / Exports of goods and services			*Current account / Exports of goods and services*		
Country groups		*1979-1981*	*1989-1991*	*1998-2000*	*1979-1981*	*1989-1991*	*1998-2000*
I.	**High export growth (20)**	**23.4**	**25.2**	**19.1**	**-35.1**	**-15.9**	**-7.0**
	a. High output growth (11)	*16.7*	*21.0*	*14.3*	*-27.5*	*-15.6*	*1.4*
	b. Moderate output growth (2)	*51.4*	*25.5*	*24.0*	*-45.8*	*-11.7*	*-9.7*
	c. Low output growth (7)	*24.1*	*31.2*	*24.5*	*-42.9*	*-17.4*	*-19.6*
II.	**Moderate export growth (20)**	**19.3**	**21.7**	**23.0**	**-23.7**	**-7.7**	**-12.2**
	d. High output growth (5)	*9.3*	*14.0*	*12.2*	*-12.6*	*-14.8*	*-4.0*
	e. Moderate output growth (6)	*20.2*	*19.5*	*20.5*	*-20.2*	*-17.0*	*-19.4*
	f. Low output growth (9)	*25.8*	*28.7*	*32.4*	*-31.8*	*1.3*	*-12.8*
III.	**Low export growth (6)**	**11.5**	**16.2**	**9.5**	**-22.4**	**-5.7**	**-11.0**
	g. High output growth (1)	*12.3*	*21.6*	*9.7*	*-23.0*	*7.7*	*-12.8*
	h. Moderate output growth (3)	*12.9*	*17.5*	*9.8*	*-20.8*	*-8.7*	*-6.0*
	i. Low / negative output growth (2)	*7.8*	*7.9*	*8.5*	*-24.5*	*-7.8*	*-17.7*
	Total sample (46)	**20.4**	**22.8**	**19.8**	**-28.4**	**-11.1**	**-9.7**

Sources: Based on Shafaeddin (2005) Table 2.2 which in turn is based on World Bank, *Global Development Finance 2002* and *World Development Indicators* and UNCTAD *Handbook of Statistics*, various issues, and UNCTAD database.

III. CHANGES IN THE STRUCTURE OF PRODUCTION AND EXPORTS

One argument used in favour of universal and uniform trade liberalization is that it would help diversification of the structure of exports and output in favour of manufactured good. Has it happened?

A. Diversification

We have used changes in the share of manufactures in total exports of goods, and the ratio of total exports of goods and services to GDP as indicators of the reorientation of the structure of exports and output. Change in the MVA/ GDP ratios is taken as a general indicator of diversification of output in favour of manufactured goods. The necessary data is provided in Table 3. Accordingly, first of all, the diversification of exports in favour of manufactured goods is very impressive for all groups, particularly Group I. Nevertheless, once again the increase in the share of manufactured goods is partly due to assembly operations and increased import intensity of exports. Further, for all sub-groups

[6] Some African and East Asian countries had to run a surplus to repay their debts. China ran a surplus in its current account for most years.

the diversification has taken place mainly during the 1980s rather than the 1990s. This is not unexpected as the introduction of trade liberalization and other reform measures in the 1980s provided a once-and-for-all shift in incentives in favour of exports. Except for the first group, the reform measures have failed to sustain fast growth in exports of manufactures in the 1990s**.**

Table 3
Changes in indicators for manufacturing sector and total exports for selected countries
1979–2000

		Exports of goods and services to GDP			*Exports of manufactures to total exports*			*Share of manufacturing value added in GDP**		
			Change over			*Change over*			*Change over*	
Country groups		*1998-2000*	*1979-1981*	*1989-1991*	*1998-2000*	*1979-1981*	*1989-1991*	*1998-2000*	*1979-1981*	*1989-1991*
I.	**High export growth (20)**	**41.5**	**9.8**	**7.3**	**64.8**	**35.8**	**16.8**	**21.4**	**2.6**	**1.5**
	a. High output growth (11)	*52.2*	*12.5*	*10.9*	*76.6*	*40.8*	*16.9*	*25.0*	*5.7*	*3.4*
	b. Moderate output growth (2)	*30.1*	*14.3*	*3.8*	*50.7*	*39.4*	*21.7*	*17.1*	*-1.5*	*-0.6*
	c. Low output growth (7)	*27.5*	*4.1*	*2.8*	*49.4*	*25.4*	*14.6*	*16.4*	*-2.5*	*-1.8*
II.	**Moderate export growth (20)**	**36.7**	**7.3**	**3.2**	**55.4**	**19.9**	**4.9**	**16.0**	**-1.3**	**-1.3**
	d. High output growth (5)	*46.5*	*11.3*	*4.9*	*83.6*	*23.6*	*6.4*	*17.0*	*2.3*	*2.1*
	e. Moderate output growth (6)	*34.2*	*1.1*	*1.9*	*70.2*	*22.8*	*6.4*	*15.8*	*-1.1*	*-1.0*
	f. Low output growth (9)	*33.0*	*9.1*	*3.2*	*36.1*	*16.1*	*3.5*	*15.6*	*-3.8*	*-3.7*
III	**Low export growth (6)**	**52.7**	**5.8**	**1.6**	**67.8**	**13.1**	**1.8**	**11.6**	**-3.6**	**-2.3**
	g. High output growth (1)	*15.8*	*-15.4*	*-6.1*	*40.5*	*27.3*	*3.1*	*17.9*		*2.3*
	h. Moderate output growth (3)	*78.9*	*23.6*	*4.7*	*95.0*	*-1.0*	*0.4*	*13.6*	*2.0*	*0.3*
	i. Low / negative output growth (2)	*32.0*	*-10.2*	*0.7*				*7.4*	*-6.5*	*-5.8*
	Total sample (46)	**40.9**	**8.2**	**4.8**	**61.3**	**28.2**	**11.0**	**18.0**	**0.3**	**-0.2**

Sources: Shafaeddin (2005) Table 2.3 which in turn is based on World Bank*, World Development Indicators*, various issues*,* and United Nations COMTRADE database and estimates.

* Calculated with variables at constant 1995 prices.

Secondly, dependence on external markets has increased substantially during the last two decades, particularly for the first group during 1990s as indicated by the ratio of total exports of goods and services to GDP. Yet, such dependence has not been accompanied with diversification of output structure in favour of manufacturing sector in all cases even when manufactured exports expanded fast. In fact, for groups I and II which have shown high and moderate export growth only I.a and II.d, (15 out of 31 countries), mostly in East Asia, show increases in MVA/GDP ratio over 1980–2000. For the rest MVA/GDP ratio declined continuously in 1980s and 1990s. For the whole sample, 20 out of 40 countries, for which data are available, (Singapore and Hong Kong (China) excluded),[7] show decline in their MVA/GDP ratio, without recovering, implying a sort of pre-mature de-industrialization.[8]

Most countries that experienced de-industrialization are among those with initial low levels of development and industrial bases (e.g. Ghana, Guatemala, Peru, Panama, Zimbabwe, Paraguay, Barbados and Haiti). In other words, the industrial sector has been more vulnerable to trade liberalization in countries at lower levels of development and low industrial bases. Nevertheless, de-industrialization has not been confined to low-income countries. A number of other countries, particularly in Latin America, have also suffered from pre-mature de-industrialization. Such countries as Chile despite its long period of reform, Argentina, Jamaica, Colombia, Venezuela, Uruguay, Brazil,

[7] For Singapore and Hong Kong (China), the decline in MVA/GDP ratio is due to the expected change in the structure of output from the secondary to the service sector beyond a certain level of development *à la* Chenery (see section VI). In the case of Hong Kong (China), the exceptional expansion of financial services has been also a contributory factor as Hong Kong (China) has become a regional financial centre.

[8] The corresponding figures are in constant prices. If one uses current prices, the number of countries that have been victims of de-industrialization increases. Nevertheless, as the relative price of manufactured goods has declined in relation to average price of total output due *inter alia* to trade liberalization, constant prices were used to avoid the impact of relative changes in the deflators for MVA and GDP.

the Philippines and Tunisia provide examples in this respect. Some of the countries with declining MVA/GDP ratio also show negative growth rates of manufacturing sectors over 1990s**.** They include, fro example, Jamaica, Ghana, Colombia, Uruguay, Paraguay and Haiti[9].

B. Upgrading the production and export structure

Upgrading the production capacity and export structure is necessary for a number of reasons. First, it is essential for sustainability of exports. Second, it helps technological development and spillover effects of the export sector to the rest of the economy. Third, it reduces the vulnerability of the economy to external factors, balance of payments crisis, fallacy of composition and terms of trade losses.

Most countries in Africa have achieved little in exports of manufactured goods to speak of upgrading; their structure of exports is still concentrated in primary commodities particularly in sub-Saharan countries (see UNCTAD 1999, Shafaeddin 1995 and Lall et al. 1994). In the case of East Asia, the first-tier NIEs have managed to continue to diversify and upgrade their manufactured exports mainly by pursuing their own selective industrial policy (UNCTAD 1996).

Most Latin American countries had already developed some industrial capacity through import substitution when they initiated structural reform. Nevertheless, one criticism of import substitution strategies implemented in Latin America was that it failed to upgrade the industrial and export structure (Hirschman 1992). Let us see what they have achieved after going for an outward-orientation strategy.

With few exceptions, there has been a major regression, rather than upgrading, in the structure of production and exports in Latin American countries. Regarding the production structure, there has been a significant shift in favour of some non-tradeable items, natural resource-based industries and food processing during the last two decades. Assembly operations in electronic and automobile industries have grown rapidly, mainly through TNCs (transnational corporation) in a few countries. By contrast, labour intensive industries (except assembly operations in electronic products), engineering and R&D intensive sectors producing capital goods, fine chemicals and scientific instruments have shrunk inmost countries. (Benavente et al. 1997b, Katz and Vera 1997, Katz, 2000a). The relative expansion of non-tradeables and the decline of labour intensive items are contrary to the claims made by the proponents of "Washington Consensus" as liberalization was supposed to favour tradeable goods. Nevertheless, they are not unexpected as non-tradeables, were not subject to competition from imports.

The change in the pattern of specialization in exports is, more or less in conformity with change in pattern of production. Following OECD, one may distinguish five categories of goods according to the nature of input intensity, skill, technology and scale requirement as follows:[10]

- Primary commodities and processed food
- Labour intensive and resource-based industries with low skill/capital intensity
- Products with low-to-medium level of skill/technology and scale requirement
- Those with medium-to-high level of skill/technology and scale requirement
- Products with high level of skill/technology and scale requirement

[9] Haiti's situation was, however, partly due to the political unrest in the country.
[10] For details of the methodology, see UNCTAD, *Trade and Development Report, 1996,* pp. 115–121.

A study of a sample of 10 countries with different initial industrial bases (MVA/GDP ratio) in 1989/1991(Brazil, Mexico, Chile, Colombia, Argentina, Venezuela, Bolivia, Haiti, Costa Rica and Uruguay) has shown that there has been a significant diversification away from group I, but it was mainly due to the decline in the price of primary commodities (Shafaeddin 2005, Chapter 2). Otherwise, according to the same study almost all countries, particularly those with a lower initial industrial base, e.g. Bolivia and Haiti, concentrated in exports of resource-based industries such as wood and paper products and/or non-metallic mineral products (in group II). Further, with the exception of Mexico, Colombia, Bolivia and Haiti, their main labour intensive exports (textiles, clothing, footwear, toys and sports products), have suffered. Mexico enjoyed improved market access to the United States through NAFTA (North American Free Trade Agreement). However, a couple of countries (Costa Rica, and Mexico) enjoyed rapid expansion of assembly operations figured under group V.

In the case of Chile, after 25 years of economic reform and liberalization, primary products constitute over 81 per cent of its exports; it shows little upgrading beyond the expansion of its natural resource-based industries – namely wood and wood products and chemicals. In fact, in the case of copper, which constitutes the bulk of export of the country, the share of refined product declined in favour of primitive copper concentrates (Palma 2002, p. 24 and the sources therein).

The expansion of the car industry, in group IV is noticeable in large countries (Brazil, Mexico, Argentina, and Venezuela) and Uruguay due to three main factors: arrangements through MERCOSUR (Mercado Común del Sur/Southern Common Market), the attraction of a large domestic market to TNCs and the exceptionally relative high rate of tariff protection. Nevertheless, in most cases, particularly Mexico and Argentina, assembly operations dominated the industry (see UNCTAD, 2002). Only Brazil has an important production capacity in this industry.

IV. LIBERALIZATION HELPS INDUSTRIES THAT ARE NEAR THE STAGE OF MATURITY

Despite the fact the Brazil did not perform well in the expansion of exports of manufactured goods as a whole, rapid expansion of exports of vehicles and machinery, particularly non-electric, in group IV and "other" items – mainly aircraft in group V – are of an exception and interest. These industries were near the stage of maturity and trade liberalization helped them to become more efficient. The spectacular performance of Brazil's aerospace industry is in fact an example of the success of "targeting" and "selectivity"; it is also the proof that liberalization can be effective in making an industry competitive when it is near the stage of maturity[11] – as it harms infant industries or inefficient industries subject to prolonged protection. Aerospace is a high technology and skill intensive industry. Although it faced a crisis of competitiveness after the shock of liberalization and privatization, it soon recovered to become the most important exporter of manufactured good of Brazil. The value of exports of Brazilian aircrafts increased from $182 millions in 1995 to $1.7 billion in 1999 and $2.7 billion in 2000. In 1998 Embraer, the Brazilian aircraft manufacturer became the world leader in commuter and regional jet market.

If a country can succeed in such an industry, it can succeed in any industry provided the industry enjoys dynamic industrial and trade policies. The aerospace industry of Brazil was established in 1945. Throughout its operation until its privatization, in the mid-1990s, it received government support through tax incentives, budgetary allocation, financial benefits, procurement, etc. Both government

[11] The following paragraphs are based on UNCTAD (2003b).

policy and the company's strategy were coherent, cumulative and continuous and targeted. In particular, the company concentrated on the technology of system integration and developed local designs for a family of aircrafts to become independent and produce a differentiated product suitable for regional flights. To acquire the necessary technology, it focused on organizational and technical training, both know-why and know-how, through learning by doing, by training, by adapting, by interacting, by using and by hiring.

After facing liberalization in the mid-1990s, the company went through some restructuring and innovation in its organizational and institutional strategy to consolidate its technical knowledge. It also established partnership and strategic alliance with other local and international companies. In addition, the Federal Government continued its support of the industry through export financing, and the Programme for the Expansion of Brazilian Aerospace industry.

In short, the impact of structural reform on the structure of output and exports has so far been disappointing for the majority of countries which undertook trade liberalization and economic reform designed by IFIs and through the "Washington Consensus". De-industrialization has taken place in a large number of countries, including some of those with a high rate of export growth. Moreover, little upgrading took place except for industries which had been dynamic during the import substitution era and near the stages of maturity. Has investment for the expansion of the production capacity and upgrading been encouraged?

V. INVESTMENT

To create production capacity that is to sustain export and upgrade its structure requires investment. In fact, investment has been the main contributory factor in structural change and competitiveness of NIEs in the international market.[12] Similarly, capital accumulation played a key role in the relatively rapid growth of Africa during the 1960s and 1970s (Berthélemy and Söderling 2001). The interrelation between investment and exports are strong and complicated. On the one hand, investment is the main factor in growth of exports, supply capacity and upgrading (Amsden 2001, Chapters 4 and 5). On the other hand, exports can have positive effects on investment through their "income effects" and "supply effects" and "vent for surplus effects". However, under certain circumstances, exports can be at the cost of investment, e.g. if they divert material inputs from investments to exports and/or if the "supply effects" of exports are not present due to the "import compression" needed for payment of debts.[13] It is also possible that liberalization policies which are pursued to encourage exports may not necessarily encourage private investment. Rather than providing incentives to investors, the structural reform may change the perception of investors regarding the balance between risks and return on investment particularly against the manufacturing sector (Shafaeddin 2005).

One needs also to distinguish between domestic investment and FDI. The latter often facilitates export expansion as TNCs have a better export marketing and distribution channels. Nevertheless, FDI may not necessarily always contribute to the expansion of production capacity when the inflow is spent on the purchase of existing assets.

A reform programme succeeds in accelerating growth of total output/or MVA if it achieves, *inter alia,* greater I/GDP ratio, and, or, leads to changes in the structure of investment in favour of the

[12] For details and references, see Shafaeddin 1995a and UNCTAD 1996.
[13] For details see Shafaeddin 1991a.

manufacturing sector. Comprehensive data on the sectoral allocations of investment are not readily available for all countries. We therefore analyse the data on total investment for the sample countries before referring to some evidence at sectoral and industry levels. Table 4 provides some indicators of investment. The data on FDI should be regarded as sources of investment fund rather than additions to the stock of capital. According to this table, despite its recovery for some sub-groups, over the 1990s, the reform and liberalization programmes have not been able to lift investment. On the contrary, I/GDP ratio at the end of the period is lower than that of 1979/19881, i.e. prior to reform.

Table 4
Changes in investment indicators for selected countries
1979/1981–1989/2000

Country groups	Dom-estic invest-ment	Investment / GDP ratio			FDI net / GDP in %			
	Ave-rage growth rate 1989-2000	1998-2000	Change over 1979-1981	Change over 1989-1991	FDI Net (US$ million) 1998/2000	1998-2000	Change over 1979-1981	Change over 1989-1991
I. High export growth (20)	**5.7**	**23.2**	**-1.0**	**1.2**	**4045.0**	**2.9**	**2.0**	**1.2**
a. High output growth (11)	*5.8*	*24.9*	*-1.7*	*-1.0*	*4736.7*	*2.5*	*1.5*	*0.6*
b. Moderate output growth (2)	*7.0*	*25.9*	*-0.5*	*4.4*	*6742.6*	*2.4*	*1.4*	*0.5*
c. Low output growth (7)	*5.2*	*19.9*	*-0.3*	*3.8*	*2187.3*	*3.6*	*2.8*	*2.4*
II. Moderate export growth (20)	**4.7**	**21.6**	**-4.2**	**0.3**	**1976.0**	**2.8**	**2.0**	**2.2**
d. High output growth (5)	*5.5*	*24.0*	*-4.6*	*-1.7*	*843.4*	*2.8*	*1.9*	*2.0*
e. Moderate output growth (6)	*6.9*	*23.6*	*-1.9*	*3.3*	*54.1*	*1.5*	*0.9*	*1.6*
f. Low output growth (9)	*2.6*	*18.6*	*-5.6*	*-0.6*	*3886.6*	*3.6*	*2.9*	*2.8*
III. Low export growth (6)	**3.3**	**17.8**	**-7.0**	**1.2**	**605.1**	**0.6**	**-1.5**	**-0.1**
g. High output growth (1)	*4.9*	*21.7*	*-15.1*	*0.2*	*1683.3*	*1.9*	*-2.2*	*0.1*
h. Moderate output growth (3)	*3.2*	*20.1*	*-5.7*	*3.3*	*637.7*	*0.1*	*-2.1*	*-0.4*
i. Low / negative output growth (2)	*2.6*	*12.4*	*-2.5*	*-1.9*	*17.0*	*0.5*	*-0.2*	*0.1*
Total sample (46)	**5.0**	**21.8**	**-3.1**	**0.8**	**2696.7**	**2.5**	**1.5**	**1.5**

Sources: Shafaeddin op.cit. Table 3.1 based on World Bank, *World Development Indicators 2003* and *Global Development Finance 2003* for investment and GDP; and UNCTAD op.cit. for FDI.

Further, investment seems to have had a strong influence on growth of both export and MVA at the group level. The group with the highest growth rate of exports (I) shows the highest growth rate of investment and the greatest I/GDP ratio seconded by group II. Within each group higher rates of growth of MVA is associated with higher growth rate of investment and I/GDP ratios. Moreover, the correlation between I/GDP ratios and growth of MVA is stronger than that between the ratio of exports of manufactures to GDP and growth of MVA (Shafaeddin 2005, Chapter 3). Furthermore, the direction of causation seems to be from investment to MVA leading to exports of manufactured goods rather than the other way round (loc. cit.).

Finally, the relation between FDI and GDFC is not clear. When one compares the figures for the 1979/1981–1998/2000 period, the table indicates that the increase in the FDI/GDP ratio was not accompanied by an increase in the I/GDP ratio for all sub-groups. At the level of individual countries only in a few cases both ratios increased (particularly for China, El Salvador, Chile, Bolivia, and Jamaica in group I and Panama in group II) (op. cit.). In a large number of countries, particularly in Latin America I/GDP ratio fell despite increases, in FDI/GDP ratio (ibid.). In other words, the attraction of FDI has been accompanied by crowding out of investment by national entrepreneurs (see also Agosin and Mayer 2000). For the 1990s the situation is only slightly better.

The significant attraction of FDI to most Latin American countries, with the exception of Mexico which is a member of NAFTA, could be in most part a once-and-for-all phenomenon as the flow of FDI was allocated mainly to purchases of national plants rather than to Greenfield investment. Foreign investors so far have shown less interest in investing in new capacity except for raw materials and simple processing and some assembly operations.

The allocation of investment to productive activities, particularly manufacturing sector, also suffered from the reform. In most Latin American countries that started their reform programmes or intensified them in the early 1990s, private investors preferred, more than before, investment in residential construction which usually involves less risk than investment in plants. The structure of investment also changed against the manufacturing sector and infrastructure; infrastructure suffered as public investment was drastically cut in most countries. In countries where the share of public investment in total investment and GDP did not decline, or regained ground after a period of decline (Colombia, Chile and Costa Rica), the infrastructure did not suffer (Shafaeddin 2005, Chapter 3).

Generally speaking, within the manufacturing sector of the post-reform period, almost all countries consolidated their industrial base already established during the period of import substitution with little upgrading. In most cases the industries which attracted investment in the time of import substitutions continued to be dynamic in terms of investment during 1980s and 1990s. In rare cases where a new product figures in the list, it is simple processing and/or labour intensive products in which the country concerned has static comparative advantage: e.g. metal in Chile and Colombia, press and publications in Chile and clothing in the case of Peru. Otherwise, in all other cases, the share of the previous dynamic industries, as a group, in total investment has increased sharply. The food industry, which produces mainly for the domestic market and involves little processing, remains the most favourite industry in post-reform period in Chile, Colombia and Mexico, and iron and steel in Brazil. Nevertheless certain items, most notably transport equipment in Mexico and Brazil, has been targeted for expansion for the reasons mentioned earlier[14]. Generally speaking, the gains in allocative-temporary-efficiencies in resource-based industries, resulting from trade liberalization have been limited, and attaining dynamic efficiencies are inconclusive and doubtful (Dijkstra 2000).[15]

In short, investment, rather than exports, has been the main factor in expansion of industrial capacity. Changes in economic policies have so far depressed the investment environment in most countries despite some temporary improvement during the second half of the 1990s. In many cases, particularly in Latin America, I/GDP ratios are lower as compared with the pre-reform period despite significant increases in FDI because of a deteriorating investment environment for domestic investors.[16] Public investment was cut and private investors shifted to less risky investment. Nevertheless, dynamic industries of import substitution era continued attracting investment.

[14] The differential changes in the productivity level at the industry level are in conformity with changes in the structure of exports and investment within the manufacturing sector (Benavente et al. 1997a). Further, the increases in productivity were mostly due to "labour saving", labour shedding, restructuring and displacement efforts rather than being the result of growth in manufacturing production (Katz 2000b).

[15] While this study concentrated on the manufacturing sector, the failure of the adjustment programmes is not confined to the manufacturing sector. The experience of the agricultural sector is not any better. For example in the case of Mexico "the hoped-for benefits first of sectoral reform, then of macroeconomic reform, have not materialized."(Davis 2000).

[16] For the explanation of the behaviour of investors see Shafaeddin 2005, Chapter 3.

VI. INCREASE IN VULNERABILITY

What has been the implication of reorientation of production towards exports for the vulnerability of the economy, particularly the manufacturing sector, to external factors? If a country cannot finance its imports because of disruption in the flow of foreign capital and/or borrowing, or because of changes in external demand due to changes in world economic conditions, growth of MVA and GDP will be seriously affected.

Export expansion has been accompanied with mounting vulnerability of the exporting countries to external factors. Reliance on external markets is reflected in the ratio of X/GDP already shown. Moreover, the vulnerability to external markets, as a source of supply, has increased significantly, particularly for the manufacturing sector. We have shown data on M/GDP and the ratio of trade balance[17] of the manufacturing sector [(X-M) man.] to GDP as indicators of the vulnerability of the economy as a whole, and the manufacturing sector to imports respectively in Table 5. Accordingly, import-GDP ratio has increased substantially during the 1990s for all groups, particularly group I whose exports of manufactured goods expanded the fastest. Further, for 1997–1999 the (X-M) man./GDP is substantially negative for all groups. In fact, it is also negative in all individual countries with the exception of a few countries in Group I.a, and the Republic of Korea, Taiwan Province of China and Pakistan (Shafaeddin 2005, Table 3.4).

Table 5
The ratios of trade balance of manufactures and total imports to GDP
1979–2000

		Trade balance of manufactures to GDP			*Exports of Manufactures to total exports*	
			Change over			*Change over*
Country groups		*1997-1999*	*1979-1981*	*1989-1991*	*1998-2000*	*1989-1991*
I.	**High export growth (20)**	**-5.8**	**9.0**	**3.3**	**42.3**	**5.6**
	a. High output growth (11)	*-1.2*	*15.6*	*6.9*	*49.5*	*5.1*
	b. Moderate output growth (2)	*-8.0*		*0.8*	*31.2*	*6.3*
	c. Low output growth (7)	*-12.2*	*1.3*	*-1.6*	*34.5*	*6.1*
II.	**Moderate export growth (20)**	**-11.6**	**1.2**	**-2.1**	**40.3**	**4.1**
	d. High output growth (5)	*-8.2*	*8.1*	*0.6*	*49.7*	*2.0*
	e. Moderate output growth (6)	*-9.3*	*-1.6*	*-1.8*	*36.2*	*1.1*
	f. Low output growth (9)	*-12.6*	*0.3*	*-1.9*	*37.7*	*7.3*
III.	**Low export growth (6)**	**-34.8**	**-8.1**	**-3.2**	**57.4**	**2.7**
	g. High output growth (1)	*-9.3*	*10.8*	*-0.1*	*24.3*	*-9.3*
	h. Moderate output growth (3)	*-51.6*	*-38.0*	*-16.9*	*78.7*	*6.0*
	i. Low / negative output growth (2)	*-26.7*	*-1.4*	*-7.0*	*42.1*	*3.9*
	Total sample (46)	**-11.0**	**3.2**	**0.3**	**43.4**	**4.6**

Source: Shafaeddin op.cit. Table 2.4 which is in turn based on World Bank, *World Development Indicators,* various issues, for GDP and UNCTAD op.cit. for trade figures.

Except for Group I.a, during the 1990s, when reform was intensified in most countries, the (X-M) man./GDP ratio deteriorated for most sub-groups. The increase in the ratio is due to two main factors resulting from trade liberalization and FDI. One factor is the competition of imports in the domestic market for capital goods and consumer products. Another is the increase in import intensity of production of manufactured goods. According to available data for 1990–1994, the import intensity of the industrial sector as a whole increased from 54.4 per cent to 60.4 per cent for Chile, from 23.9 per cent to 35.9 per cent for Colombia, from 10.3 per cent to 19.9 per cent for Peru and from 6.7 per cent to 11.5 per cent for Brazil (UNCTAD 2000, Table 7). Since then, the import intensity of production must have increased further due to import liberalization through the Uruguay Round and the expansion

[17] Goods and services.

of foreign direct investment in assembly operations. For example, in the case of Mexico, the share of Maquila Industry in total manufactured exports increased from 38 per cent in 1991 to 48 per cent in 2000. Over the same period the share of Maquila Industry in total imports of the manufacturing industry increased from 24 per cent to 36 per cent. While exports in the Maquila sector increased by 4.01 times, its imports increased by 4.19 times. By contrast, in the non-Maquila sector, exports and imports increased by 2.59 times and 2.36 times, respectively (Palma 2002, Table 2). In the particular case of Maquila industry for exports, the percentage share of imported inputs in gross production has been continuously increasing from 64.3 in 1974 to 74.4 in 1990 and 78.3 in 1998 (Buitelaar and Pérez 2000, Table 2).

VII. THE DEBATE ON DE-INDUSTRIALIZATION

One would expect that in the process of economic development of a county, first the share of the manufacturing (secondary) sector in GDP would increase (and the share of the primary sector decline) up to a certain point before it declines (Chenery and Syrqin 1985). Such a decline, together with a decline in the share of the sector in employment, normally takes place when a country reaches a certain level of development in terms of per capita income (around US $12000). In such cases "... de-industrialization is simply the natural outcome of successful economic development and is generally associated with rising living standards" (Rowthorn and Ramaswamy 1997, p. 5).[18] There is no general agreement also on causes of de-industrialization in developed countries. For example, the following factors are regarded the main cause by different authors:

- Differential growth rates of productivity in the manufacturing and services sector, resulting from innovation, in favour of the former as well as shift in the income elasticity of demand in favour of services (Rowthorn and Ramaswamy (1997) and Craft (1996).
- Competition of imports from the South, relocation of industries to developing countries and outsourcing (Saeger 1997).
- Underinvestment in the particular case of Britain (Kitson and Michie 1996).
- Dutch disease

In the cases studied in this section, the situation is different: de-industrialization is premature. We have defined de-industrialization as a premature decline in MVA/GDP ratio without recovering. It is due to the re-orientation of the production structure of the economy from import substitution strategies towards production on the basis of static comparative advantage due to trade liberalization. In addition, in some cases in developing countries commodity boom resulting from a price jump, e.g. the case of oil exporting countries in the 1970s and the early 1990s, has led to the decline in the share of manufactures in GDP and employment due to so-called Dutch disease.

In the case of developing countries, there is a controversy in the literature on this type of de-industrialization as there is no general agreement on the definition of the term. As a result, the empirical results are mixed. For example, in the case of sub-Saharan Africa, Bennell (1998), Shafaeddin (1995), Noorbakhash and Paloni (2000) and Thoburn (2001) concluded that trade liberalization has led to de-industrialization in many countries. Stein (1992) also argued in favour of

[18] According to Rowthorn and Ramaswamy (1997), the share of MVA in GDP, in constant prices, did not decline in advanced countries during 1970–1994 for which the authors studied. The decline in MVA/GDP ratio in current prices was due to relatively higher productivity growth in the manufacturing sector as compared with services.

the hypothesis. By contrast, Tribe (2000), Jalilian and Weiss (2000) and the World Bank (1994) argued against the hypothesis.[19]

Michael Tribe studying 34 sub-Saharan countries for 1980–1997 uses the evidence on the *recovery in production of manufactured goods* in Ghana and Uganda over 1985–1996 as an argument for his lack of support for "the hypothesized 'de-industrialization' based on the liberalization process" (Tribe, ibid. p. 279). Nevertheless, apart from the fact that temporary recovery in production alone cannot be taken as an indication of the lack of de-industrialization, his conclusion is dubious and is not supported by data. On the one hand generalizing the case of Ghana and Uganda, he maintains that "The overall conclusion must be that the case for the existence of sub-Saharan African de-industrialization in the 1990s and into twenty-first century is not strong …" (ibid. p. 280). On the other hand, his final verdict is that "Claims that liberalization has 'worked' supported by reference to evidence of short-term recovery in the manufacturing sector without consideration of the more significant long-term prospects are seriously defiant" (ibid. p. 280). Three points need to be emphasized with respect to his conclusion. First, the data he provides on the performance of the 34 countries included in his study cannot support his generalized conclusions. He uses the ratios of value added in industrial sector, rather than MVA, to GDP as an indicator of structure change. The figures on industrial sector include such non-tradeables as construction and utilities as well as mineral industries. These activities have been less affected adversely, if at all, by liberalization than the manufacturing sector. Therefore, the negative impact of liberalization is understated. Notwithstanding these caveats, the data provided by him for the period 1990–1997, in fact, indicate that the share of the industrial sector to GDP fell in 16, out of 32 countries for which data were available and did not change in another two cases (based on ibid. Table 15.1). Further, in 7 out of the 16 cases where the ratio fell, the growth of the sector was negative: in two cases it was zero, in three cases between 0 and 1 per cent; and in four cases between 1 and 2 per cent. Overall, the average rate of growth of the industrial sector for the region fell from 2.7 per cent in 1980s to 1.6 per cent during 1990–1997 (based on loc. cit.). The comparable growth rate for 1970s was 11.4 in current terms and 7.7 per cent in constant 1995 prices.[20] Further, even for countries, which have shown positive growth rate in MVA, the expansion was in most cases mainly due to simple processing of primary commodities such as precious metals and food and wood processing (Lall et al. 1994 and Shafaeddin 1995**).**

Second in the case of Ghana, the increase in production was mainly due to capacity utilization, rather than capacity expansion as investment did not increase much. This is, in fact, acknowledged by Tribe himself (Tribe 2002, p. 279 and Acheampong and Tribe 1998b, p. 39). It is obvious that the ample foreign exchange provided to the economy by the IFIs and foreign borrowing, allowed by the resulting improvement in the country's creditworthiness in international financial market, facilitated imports and eased production through capacity utilization. Despite such availability, considerable excess capacity still existed in the manufacturing sector by the end of 1990s as shown in the previous section. Further, the increase in capacity utilization took place mainly in such natural resource based industries as metals, non-metallic minerals, rubber, wood processing, or industries with local markets such as tobacco and beverages, food processing, and paper and printing. Otherwise, the rate of capacity utilization declined considerably in the case of electrical products, bicycles and motor cycles, cosmetics and leather and it remained almost stagnant in the case of textiles (Tribe 2000, Table 6.6, p. 90). Both of these industries are labour intensive with potential for exportation. According to the same source, the total number of people employed by the manufacturing sector dropped from 51.7 thousand

[19] For a short review of the literature see Tribe 2001a. See also Jalilian et al. (2000), and Palma 2003.
[20] Deflated by price index of exports of manufactured goods from developed countries based on UNCTAD (1994).

in 1985 to 20.6 thousand in 1991 (ibid. p. 91).[21] Moreover, the structure of exports further changed in favour of gold, other primary commodities and a few simple processing and resource-based item items rather than labour intensive items and other manufactured goods (Shafaeddin 2005, Chapter 3).

Thirdly, it is true that MVA increased in 1997 as compared with 1985, but even at the end of the 1990s it was still lower than its level in the early 1970s (see section II).

Overall, the short and temporary recovery of the manufacturing sector in a couple of countries is not an argument for long-term industrialization of the country, let alone generalizing it to sub-Saharan countries as a whole.

Jalilian and Weiss (2000), using a different definition of de-industrialization for the 1975–1993 periods, concluded that "In general, our results provide no support for the general proposition that as a region Africa has been experiencing a degree of de-industrialization not found elsewhere". The main issue, however, is not whether Africa as a *region* shows more de-industrialization in response to trade liberalization or not. As we have shown in the previous section, countries at early stages of industrialization and development whether they are located in Africa or not, are more vulnerable to import competition resulting from trade liberalization. This is not unexpected as their industries are more likely to be at earlier stages of infancy than other countries. Moreover, in fact, for the period they studied (1975–1993), they found about 44 per cent of the African countries included in their sample experienced de-industrialization. "We find seven countries where we can identify a pattern of de-industrialization and nine where there is no evidence of such a trend." (ibid. p. 154.) Furthermore, their time and country coverage is such that it underestimates incidences of de-industrialization. Their sample does not include all (37) sub-Saharan countries which are at a low level of development and industrialization, but includes two North African countries and South Africa which are at higher level of development and industrialization than sub-Saharan countries. Had the time period they used been extended to late 1990s, they would have possibly noticed more incidences of de-industrialization.

The World Bank's view on the subject is theoretical and ideological. Accordingly, the sort of de-industrialization which has taken place in developing countries is regarded welcome. It is argued that where the manufacturing sector had expanded excessively in relation to its *comparative advantage* as a result of protection, the de-industrialization is justified if it is *transitory*, *improves efficiency and promotes growth*. The World Bank's implicit assumption in this argument is that SAPs improve efficiency, promotes growth and as inefficient industries disappear, efficient ones emerge. In fact, these are explicit argument and objectives of SAPs. It is not unexpected that sudden and drastic trade liberalization under SAPs would lead to destruction of some industries as they become subject to sever competition from imports. Nevertheless, while these industries may disappear, there is little evidence that new and efficient ones emerge sufficiently to replace those destroyed. It is true that under traditional import substitution strategies excessive and prolonged protection was provided to some industries which rendered them inefficient. But certain industries were also at the stage of infancy and could have under certain conditions been developed in accordance with the principle of *dynamic comparative advantage* as has been the case in East Asian countries. Similarly, given time some inefficient industries were more likely to become gradually efficient if trade liberalization was undertaken selectively and gradually. The problem is that it is *static comparative advantage, rather than dynamic comparative advantage* which is at the back of mind of designers of SAPs. In other words, the issue of de-industrialization implies intensification of specialization in accordance with the static comparative advantage. As shown in the previous section, even in some Latin American

[21] See also Thoburn (2001) for the case of Zimbabwe.

countries where export expanded and MVA showed noticeable growth, let alone sub-Saharan countries, the expansion took place to a large extent in resource-based industries, simple assembly operation and in some cases traditional labour intensive industries with little upgrading.

VIII. CONCLUSIONS

The analysis of a sample of developing countries in this study indicates that the structural reforms that have been undertaken in developing countries since the early 1980s have shown different results. Forty per cent of the sample countries have shown 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 of their industrial base. These countries were among those with a substantial industrial base and capabilities in exports of manufacturing goods already prevalent in the early 1980s, not to mention the early 1990s.

By contrast, the experience of the majority of the countries, with or without industrial capacity, has not been promising. In most African and Latin American countries, growth of exports of manufactures was slow, or moderate, and the structure of GDP has not changed in favour of the manufacturing sector. More importantly, half of the sample countries for which data are readily available faced de-industrialization – most of them in low income countries which are more vulnerable to liberalization. In fact, a number of them were among those which experienced a high rate of manufactured exports. Chile and Argentina in Latin America are notable examples in this respect. Brazil did not achieve acceleration of exports, and faced considerable de-industrialization. In the important case of Mexico where exports grew extremely fast, acceleration of manufactured exports was not accompanied by an acceleration of MVA. Much upgrading of the industrial base did not take place and the non-maquila industries which performed better than others were those which had enjoyed high investment during import substitution era.

Slow growth of exports and de-industrialization has also been accompanied by increased vulnerability of the economy, particularly the manufacturing sector, to external factors. The reliance of this sector on imports has especially increased because of increased import intensity of production and consumption particularly in cases where upgrading of exports has not been achieved. In fact, in Latin America, the expansion of exports has taken place mainly in resource based industries, and 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 to be dynamic in terms of production, exports and investment. It appears that 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. By contrast, those inefficient, or those at infancy stage, could not well survive. Faced with severe import competition, some industries, including labour industries in a number of countries, suffered.

The reform programmes designed by IFIs also failed to encourage private investment in general, particularly in the manufacturing sector. Despite substantial increases in FDI in some Latin American countries, by the end of 1990s the I/GDP ratio was less than that before the reform period. Trade liberalization changed the structure of incentives. Nevertheless, the balance between risks and return in manufacturing activities also changed in favour of residential construction and other non-tradeables. 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. Nevertheless, before they reached a certain level of industrialization and development, expansion of supply capacity whether aimed at domestic markets or exports played a significant role. By contrast, the "majority group" embarked, in the main, on a process of rapid structural reform including uniform and across-the-board liberalization. Therefore, the pattern of industrial development that emerged in Latin America and Africa is not unexpected. 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. In short, 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, trade liberalization is more likely to lead to the destruction of the existing industries, particularly of those that are at its early stages of infancy without necessarily leading to the emergence of new ones. Some have argued as mentioned that there is a lag between trade liberalization and emergence of new and efficient industries. How long such a lag could be is not clear. Nevertheless, one thing is clear: any new industry that emerges would be in line with static, rather than dynamic, comparative advantage. In the particular case of low income countries, it would imply that they would 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 upgrade, and subjecting them to the fallacy of composition.

Annex

List of countries in the sample*

a: Costa Rica (25.9), Sri Lanka (24.1), Malaysia (19), China (17.8), Bangladesh (17.5), El Salvador (15.5), Thailand (14.4), Singapore (13.7), Indonesia (12.8), Turkey (11.8), India (10.2).

b: Mexico (29.6), Chile (13.4).

c: Bolivia (29.2), Philippines (24.3), Guatemala (14.8), Kenya (12.4), Argentina (12.4), Jamaica (10.8), Madagascar (10).

d: Nepal (9.9), Republic of Korea (9.2), Trinidad and Tobago (8.6), Mauritius (7.1), Jordan (6.7).

e: Tunisia (9.4), Peru (7.9), Panama (7.9), Taiwan Province of China (7.3), Pakistan (7.3), Papua New Guinea (6.4).

f: Ghana (9.1), Colombia (9), Morocco (8.7), Venezuela (7.8), Zimbabwe (7.7), Uruguay (6.7), Paraguay (6.4), Malta (6.2), Brazil (5.4).

g: Egypt (3.2).

h: Senegal (4.3), Fiji (2.3), Hong Kong (China) (-2.2).

i: Barbados (2.5), Haiti (-18.9).

* The figures in brackets are the average rate of growth of purchasing power of exports of manufactures during 1989–2000. Within each subgroup, countries are ranked according to the growth rates of purchasing power of exports of manufactured goods.

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