

**THE STATE OF INDUSTRY IN THE THIRD WORLD  
IN THE 1980s:  
ANALYTICAL AND POLICY ISSUES**

**Ajit Singh**

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**Ajit Singh**, an Indian economist who graduated from Punjab University and obtained his Ph.D. at the University of California, Berkeley, is currently Fellow and Director of Studies in Economics at Queens' College, University of Cambridge. He is a Visiting Departmental Fellow of the Kellogg Institute and holds the Dr. William M. Scholl Visiting Chair in the Department of Economics at Notre Dame. He has been a senior economic advisor to the governments of Mexico and Tanzania and a consultant to the ILO, FAO, UNCTAD, and UNIDO. He is the author of *Takeovers: Their Relevance to the Stockmarket and the Theory of the Firm* and coauthor of *Growth, Profitability and Valuation*, both published by Cambridge University Press. His most recent research has been concerned with North-South interactions and problems of the long-term growth of the world economy.

## **ABSTRACT**

This paper examines the state of industry in the Third World during the 1980s in a longer term perspective and comments on a range of analytical and policy issues connected with its future development. Two main questions are addressed: In what ways and to what extent has Third World industrialization been affected by the post-1979 world economic crisis? What factors account for the widely divergent industrial performances in the developing countries in the 1980s? Specifically, why has Asian industry done so much better than industry in either Latin America or Sub-Saharan Africa? It is argued here that the industrial crisis in the Third World has been overwhelmingly caused by international market forces. The superior performance of the Asian countries in the 1980s is not due to their greater openness; it was made possible because they were less subject to interest rate, demand, and capital supply shocks. The paper points to serious flaws in the industrial policy proposals of the IMF and the World Bank—privatization, deregulation, liberalization, and closer integration with the world economy. In place of these the author gives an alternative perspective on industrial policy for the developing countries in the 1990s.

## **RESUMEN**

Este artículo examina la situación de la industria en los países del Tercer Mundo durante los años ochenta desde una perspectiva de largo plazo y discute una serie de cuestiones analíticas y políticas relacionadas con su desarrollo futuro. Dos problemas centrales son tratados: ¿De qué manera y en qué medida la industrialización del Tercer Mundo ha sido afectada por la crisis económica mundial posterior a 1979? ¿Cuales son los factores que explican la gran divergencia de los desempeños industriales en los países en vías de desarrollo durante los años ochenta? Específicamente, por qué la industria asiática se ha desempeñado mejor que la industria en América Latina o en la región Sub-Sahariana del Africa? Se argumenta que la crisis industrial del Tercer Mundo ha sido preponderantemente causada por las fuerzas del mercado internacional. El desempeño superior de los países asiáticos en los años ochenta no se debe a su mayor apertura, sino a su menor exposición a shocks en las tasas de interés, y en la demanda y la oferta del capital. El artículo señala serios defectos en las políticas de industrialización propuestas por el Fondo Monetario Internacional y el Banco Mundial—privatización, desregulación, liberalización y estrecha integración con la economía mundial. En su lugar, el autor propone una perspectiva alternativa de políticas de industrialización para los países en vías de desarrollo en la década de los noventa.

## I. Introduction

This paper examines the state of industry in the Third World (the South) during the 1980s in a longer term perspective and comments on a range of analytical and policy issues connected with its future development. After outlining the broad contours of southern industrialization during 1960-80 and comparing them with those observed in the 1980s, the paper addresses itself to two analytical questions:

- (i) In what ways and to what extent has southern industrialization been affected by the post-1979 world economic crisis?
- (ii) What factors account for the widely divergent industrial performances of the countries of the South during the crisis? More specifically, why has Asian industry done so much better than industry in either Latin America or Sub-Saharan Africa during the 1980s?

The answers to these questions are not merely of intellectual interest but have a direct bearing on the policy debate regarding the future development of industry in the South. An influential and important line of argument in this debate holds that, although general macroeconomic conditions associated with the world economic crisis may have adversely affected southern industry during this decade, its setbacks are in large measure due to inefficient domestic utilization and allocation of resources and to myriad inefficiencies at the microeconomic level in the developing countries themselves. In this view, which is routinely put forward by international financial institutions (the World Bank and the IMF) and is shared by many mainstream economists,<sup>1</sup> the inappropriate policies of import substitution and inward orientation, excessive regulation of private enterprise leading *inter alia* to resource misallocation, rent seeking and corruption, the large role of the state controlled enterprises which are invariably poorly managed, have all greatly contributed to industrial failure in the South. A very important place is accorded in this thesis to the industrial success of the East Asian NICs in the last decade. It is argued that the far superior industrial performance of these countries, relative to those in Latin America and Africa, provides a practical demonstration of the desirability of outward and more market oriented economic policies. In addition to prudent macroeconomic management in line with the Fund/Bank prescriptions, the developing countries are therefore urged to undertake far-reaching structural reforms in order to achieve fast and "efficient" industrial and economic development. These reforms involve measures such as import liberalization, encouragement of foreign investment, privatization of state-owned enterprises, and deregulation of domestic product and

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<sup>1</sup> For the views of the international financial institutions, see for example the World Bank's *World Development Reports* for 1987 and 1988, and some recent issues of the IMF's *World Economic Outlook*. See also De La Rosiere (1986). For examples of more academic and rigorous analyses within this approach, see Lindbeck (1984, 1986).

financial markets. In short, in this policy programme, a substantial diminution in the role of the state in the industrial sphere and *pari passu* an expansion of that of the market is called for.

The second part of the paper will analyze these policy issues. It will also outline a feasible alternative policy perspective that the developing countries could and should follow in the conditions of the 1980s and 1990s. Specifically, the alternative policy programme is based on two premises. First it is assumed that in the foreseeable future, the world economy will continue to grow at its slow post-1973 trend rate, i.e. that it will not revert to the high growth trajectory of the Golden Age (1950-73).<sup>2</sup> Secondly, notwithstanding the continued slow growth of the world economy, the compelling social imperative of Third World countries to industrialize rapidly has in no way diminished. These countries still need to achieve fast and sustainable long-term industrial development in order to meet the employment needs of their growing labour forces as well as to meet the minimum basic requirements of their populations for food, health, education and shelter.<sup>3</sup>

## **II. Industrialization in the Third World during 1960-80 and the 1980s**

### **II.1 Industrial Revolution in the Third World: 1960-1980**

In a paper I wrote four years ago (Singh 1984), I noted that in the post-war period, the Third World countries had embarked on and were carrying out a virtual industrial revolution—a revolution that they had been prevented from implementing fifty or a hundred years earlier by the rather different world economic and political conditions. With their political independence and with the new world economic conjuncture that followed the end of the Second World War, most Third World countries initiated a serious process of industrialization and, during the 1960s and 1970s, a large number of them made rapid industrial progress. A group of nations in Asia and Latin America—the so-called newly industrializing countries—were particularly successful in establishing a technical scientific and industrial infrastructure, in training their labour forces and in developing a relatively broad based industrial structure. By the 1970s these countries were providing formidable competition to countries of the North in a range of consumer and producer goods industries.

Overall, the Third World's industrial revolution contributed to a significant degree to major structural changes in the world industrial economy during 1960 to 1980; these are summarized in

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<sup>2</sup> For a full analysis of this question, see the long essay by Glyn, Lipietz, Hughes and Singh (1989).

<sup>3</sup> On the necessity of industrialization to achieve the basic needs of the people and to meet the employment requirements of developing countries, see Singh (1979, 1984). See also Section VIII below.

Table 1. Three points deserve attention. First, the table shows (the third part) that the Third World's share of world manufacturing production, though still quite small increased appreciably (by nearly 50 per cent) over the two decades.<sup>4</sup> Similarly, there was rapid industrialization of the socialist countries of Eastern Europe, whose share of world manufacturing also increased by about 50% during this period, starting from a much higher initial level. There was a corresponding reduction in the proportion of manufacturing output produced in the developed market economy countries (DMEC).

Secondly, the middle part of the table indicates that there was a significant transformation of the internal economic structure of the developing countries. The contribution of manufacturing to GDP in these countries increased from an average of 13.4% in 1960 to nearly 20% by 1980. Moreover, there is evidence (not reported in Table 1) of positive qualitative changes in the structure of manufacturing itself in the Third World over this period. Starting from an extremely low level, there was an enormous expansion of capital goods production in the developing countries. Disaggregated data show that the latter's share of world manufacturing increased significantly not only in the consumer goods industry but also in most branches of capital goods [Singh (1984), UN (1984)].

Thirdly, the last part of the table indicates that in the 1970s, the rate of growth of manufacturing production slowed down considerably in the OECD countries, from nearly 6% per annum to less than 4% per annum. However, there was no such slow-down in the pace of expansion of manufacturing in the Third World; if anything, the growth of manufacturing in the developing countries in the 1970s was slightly faster than in the 1960s.

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<sup>4</sup> China is not included in the data reported in Table 1. China's share of world manufacturing production in 1980 was approximately 4% (see UN 1982).

TABLE 1

**Structural Changes in the World Industrial Economy,  
1960-80: Manufacturing Output (Value Added) for Major Economic Groups**

	1960	1970	1980
<b>Value added</b> (Billions US dollars at 1975 prices)			
Developing countries	49	101	218
DMEC <sup>a</sup>	533	942	1358
Socialist countries	119	283	574
TOTAL	701	1326	2150
<b>Contribution to GDP</b> (percent)			
Developing countries	13.4	15.7	19.7
DMEC <sup>a</sup>	24.3	26.5	27.8
Socialist countries	24.6	30.7	36.7
<b>Share in world manufacturing output</b> (percent)			
Developing countries	6.9	7.6	10.2
DMEC <sup>a</sup>	76.0	71.1	63.2
Socialist countries	17.1	21.3	26.6
	1960-1970	1970-1980	
<b>Average annual growth</b> (percent)			
Developing countries	7.6	8.0	
DMEC <sup>a</sup>	5.9	3.7	
Socialist countries	9.0	7.3	
All Countries (Weighted Average)	6.6	4.9	

Source: UNCTAD, *Trade and Development Report*, 1981, New York.

<sup>a</sup> Developed market economy countries.

This very brief and highly schematic view of the rise of southern industry during the 1960s and 1970s would be seriously incomplete without reference to the following aspects:

1) As there was an enormous heterogeneity in the initial levels of economic and industrial development in the countries of the South (deriving in large measure from their different economic and political histories), the spread of industry to these countries was far from uniform. Starting from a much higher base, the Asian and Latin American countries were able to achieve much greater industrial success than the African countries; but even many of the latter were able to take the first systematic steps towards industrialization during this period (see UNIDO, 1983). Nearly 80% of the South's entire manufacturing value added in 1980 was produced in just ten countries (in descending order of the size of their manufacturing production): China, Brazil, Mexico, Argentina, India, Republic of Korea, Turkey, Iran, Venezuela, and the Philippines. However, these countries also accounted for more than 60% of the Third World's population.

2) In the light of the experience of the last three decades, it is easy to forget that the rise of industry in the South in the post-war period was by no means a foregone conclusion. As Arthur Lewis (1980) has reminded us, at the end of the War, there was an enormous skepticism amongst many professional economists concerning substantial economic and industrial development in the developing countries:

In 1950...these people were skeptical of the capacity of LDCs to grow rapidly because of inappropriate attitudes, institutions or climates. The sun was thought to be too hot for hard work, or the people too spendthrift, the government too corrupt, the fertility rate too high, the religion too other-worldly, and so on.

Significantly this pessimism of the mainstream economists about the South's economic prospects was shared by Marxist economists, though for rather different reasons. Thus Paul Baran, a highly influential Marxist writer on economic development, argued that the developing countries could achieve a significant degree of industrial development only if they had socialist revolutions. In terms of the Marxist paradigm, he put forward a number of cogent reasons to suggest that the current ruling elites in the Third World could not perform the historic task of implementing an industrial revolution in the way the "bourgeoisie" had been able to carry out this task in the nineteenth century in the older industrial countries of Europe (Baran, 1957).

3) The actual economic and industrial record of the South has conclusively shown both these perceptions to have been incorrect. The record shows that during 1960 to 1980 countries with widely different economic and political systems and with equally divergent industrial strategies were able to achieve fast industrial development. Thus not only did socialist China industrialize, so did capitalist Brazil, Mexico, and South Korea. Amongst the capitalist or "mixed economies" South Korea and Brazil followed outward oriented policies but India and Mexico, with

their import substitution programmes and inward orientation, were also able to build a substantial industrial and technological base. Similarly, democratic countries as well as military dictatorships were able to achieve significant industrial success. This is not to say that the specific economic policies followed by a country do not affect the pace and the content of its industrial development or do not have a marked bearing on how the fruits of industrial progress are distributed. However, the essential point is that Third World countries with widely varying economic and political regimes were successful in the post-war period in creating an industrial base—“successful” in the sense of having a large and diversified manufacturing sector and possessing a trained labour force and the necessary skills for future industrial development to be self-sustaining.

## **II.2 The State of Industry in the South in the 1980s**

Table 2 provides data on how the shares of different economic groupings and developing regions in world manufacturing production have changed from 1970 to 1985.<sup>5</sup> The table, which does not include China, shows that the share of developing countries as a whole increased markedly between 1970 and 1980 (and at a particularly fast pace between 1970 and 1977) but that since 1980, the share has declined. However, if China is included, the southern industry’s share in world production would still show an increase, from 16.2% in 1981 to 18.6% in 1985.<sup>6</sup>

The right half of Table 2 indicates how different regions of the South have fared in the world industrial economy during 1970 to 1985.<sup>7</sup> Whilst the South and East Asian countries (even excluding China) continued to increase their share of world manufacturing production throughout this period, the Latin American countries’ share rose from 6% in 1970 to 7% in 1980 but in the 1980s, it has declined, reverting to the 1970 level by 1985. The African countries’ share, which is extremely small, increased between 1970 and 1975 but, since then, has been constant.

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<sup>5</sup> The composition of “developing countries” in Table 2 is different from that in Table 1. This does not, however, affect the broad trend movements over time portrayed in these tables.

<sup>6</sup> See UNIDO (1988).

<sup>7</sup> The table omits two other developing regions identified by UNIDO, viz West Asia and “developing countries in Europe.”

**TABLE 2**

**Share of Economic Groupings and Developing Regions  
in World Manufacturing Production, \* 1970-85**

	Developing Countries Economics	Centrally Planned	Developed Market	Developing Regions **		
				Africa	South & East Asia	Latin America
1970	10.4	16.0	73.6	0.8	2.3	6.1
1975	12.0	19.5	68.5	0.9	2.8	6.8
1980	13.0	20.2	66.8	0.9	3.4	7.0
1985	12.8	21.2	66.0	0.9	3.9	6.1

\* Manufacturing value added at constant 1980 prices.

\*\* UNIDO also identifies other developing regions (e.g. developing countries in Europe); the data for these other regions is not reported here.

Source: UNIDO (1988).

**TABLE 3**

**Growth Rates of Manufacturing Production, \* 1970-85 and Subperiods:  
Various Economic Groupings and Developing Regions \*\*  
(percentage per annum)**

	1970-85	1970-73	1975-80	1980-85
Centrally Planned Economies	5.6	7.5	5.1	4.0
Developed Market Economies	2.6	6.4	3.9	3.0
Developing Countries	5.1	8.2	5.9	2.8
Eastern and Southern Africa:	1.1	6.8	0.3	1.5
Latin America	3.5	7.9	4.9	0.3
South and East Asia	7.7	7.0	8.3	6.2

\* Manufacturing value added at constant 1980 prices.

\*\* See note under Table 2.

Source: Data extracted from UNIDO (1988).

The divergent industrial records of the different developing regions in the 1980s is revealed more clearly by Table 3, which provides data on the rates of growth of manufactured production for various time periods since 1970. Two main points emerge from this table, which again does not include China. First, compared with the 1970s, the rate of growth of manufacturing production slowed down in the 1980s in all the main economic groupings and in all the developing regions. However, the deceleration was much greater in the developing countries than in the OECD countries—in fact between 1980 and 1985 industrial production in the latter group expanded at a faster rate than in the former. Second, within the South, there was only a slight slowdown in industrial expansion in South and East Asia (where production still rose by over 6% in the 1980s, more than twice the rate of the industrial countries). In the Latin American and the group of 27 East and South African countries on the other hand, the deceleration in industrial growth between 1980 and 1985 (relative to the 1970s) was particularly severe.

In the light of Tables 2 and 3, it is not surprising that Table 4 should indicate that the rate of internal structured transformation in the developing countries slowed down in the 1980s. In the East and South African and in the Latin American groups of countries there was in fact a retrogression in this regard—the share of manufacturing in GDP fell between 1980 and 1985.

A further important feature of the industrial performance of the developing countries in the 1980s is brought out by the World Bank data given in Table 5.<sup>8</sup> The table shows that the developing countries' performance with respect to manufacturing exports has been much better than that with respect to industrial production. Even in the depressed 1980s, the developing countries' exports were expanding at a rate of nearly 10% per annum—only slightly lower than the rate these achieved in the period 1965 to 1973.

This is in sharp contrast to the exporting record of the industrial countries. In 1965 to 1973, manufacturing exports of these countries were increasing at almost the same rate as that of the developing countries (i.e. at about 10% per annum); however in the 1980s, the industrial countries' exports have grown only at 2.5% per annum. Consequently, there has been a continuing marked increase in the developing countries' share of world manufacturing exports. Between 1973 and 1985, the South's share in the

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<sup>8</sup> Note that the composition of the developing countries group in the World Bank data is different from that in the UNIDO data reported in Tables 2 to 4. In particular the World Bank data do include China. Again, it is the trends over time that are relevant to the discussion in the text.

**TABLE 4**

**The Percentage Share of Manufacturing in GDP,\*  
Economic Groupings and Developing Regions,\*\* 1973-85**

	<b>1973</b>	<b>1980</b>	<b>1985</b>
Centrally Planned Economies	42.9	47.2	49.1
Developed Market Economies	25.9	24.7	25.3
Developing Countries	16.2	16.9	17.7
Eastern and Southern Africa:	11.5	10.7	10.2
Latin America	24.8	24.2	23.4
South and East Asia	13.0	16.4	17.0

\* The share of manufacturing value added in GDP at constant 1980 prices.

\*\* See note under Table 2.

Source: UNIDO (1988).

**TABLE 5**

**Rates of Growth of Industrial Production and Exports,  
1965-86: Developing and Industrial Countries**

	<b>1965-73</b>	<b>1973-80</b>	<b>1980-86</b>
<b>Industrial Production</b>			
Developing Countries	8.6	6.4	3.7
Industrial Countries	5.0	2.0	2.5
<b>Manufactures Exports</b>			
Developing Countries	11.6	13.8	9.5*
Industrial Countries	9.4	5.4	2.5*

\* 1980-84

Source: *World Development Report 1988*, Tables A6 and A8.

world exports of manufactures has nearly doubled—it has risen from 9.9% to 17.4% (World Bank 1987).

To put the broad, aggregate picture of Third World industry in the 1980s described above in perspective, Table 6 provides information on the growth of manufacturing activity in a small number of individual developing countries in Asia, Latin America, and Sub-Saharan Africa. The table shows that in Mexico manufacturing expanded at a rate of 7.5% per annum in the second half of the 1970s; in the 1980s production has hardly increased at all. In fact more detailed data show that industry in Mexico continued to expand at a fast rate until 1981. However in 1982, following the debt crisis, manufacturing production fell by 4% and in 1983 by a further 8%. By 1984 average real wages in Mexico had fallen by nearly 50% compared with 1982. In Sub-Saharan African countries like Nigeria and Tanzania, there has been a considerable degree of deindustrialization in the 1980s. By 1985 manufacturing production was 20 to 25% less than in 1980 in both these countries with, not surprisingly, serious adverse consequences for real wages, employment, and capacity utilization. On the other hand, in the Asian countries like India and South Korea, manufacturing has continued to expand quite satisfactorily into the 1980s. India has in fact witnessed a trend increase in its industrial growth in the 1980s compared with earlier periods. In the case of Latin American countries (Brazil, Mexico) it is significant that their manufacturing export performance in the 1980s has been far better than their record in production. This is mainly due to their need to service their huge debts.

**TABLE 6**  
**Growth Rates of Manufacturing Production\***  
**in Selected Countries, 1970-85 and Subperiods (% per annum)**

	<b>1970-85</b>	<b>1970-73</b>	<b>1975-80</b>	<b>1980-85</b>
Mexico	5.4	8.2	7.5	0.2
Brazil	5.5	14.4	6.9	0.0
India	4.6	3.9	5.0	5.9
South Korea	13.3	20.3	14.5	9.0
Nigeria	9.1	15.0	12.5	-5.6
Kenya	8.1	11.1	11.9	3.8
Tanzania	0.2	7.5	1.8	-4.7

\* Manufacturing value added at constant 1980 prices.  
Source: Data extracted from UNIDO (1988).

### **II.3 The Lima Target**

In 1975, the developing countries had set themselves the task of increasing their share of world manufacturing production from 7% at that time to 25% by the year 2000.<sup>9</sup> UNIDO (1979) showed that for the Lima target to be met, manufacturing production in the developing countries had to expand at almost twice the rate of growth in the industrial countries. As the data in Table 1 indicated, this condition was being met in the 1970s and the developing countries were well on their way to meeting the Lima target. However, as noted in Section II.2, the industrial growth rates in the two groups of countries in the 1980s have been more or less similar so that if this situation were to continue, the Lima target will never be reached. Nevertheless, it is significant that even in the 1980s, the Asian countries have been expanding their manufacturing capacity at a rate that would adequately fulfil the requirements of the Lima target. In view of the experience of the South as a whole in the 1970s and that of the Asian countries in the 1980s, the Lima target was clearly not an unrealistic one for the developing countries to have set themselves in the mid 1970s.

There is however another important aspect of the Lima target to which Singh (1984) called attention. On the basis of the ILO's projections on basic needs and other relevant data (in particular the anticipated growth of the labour force at a rate of almost 3.5% per annum in a number of developing countries) he suggested that industrial production in the South needs to expand at about 8% per annum in order to fulfil two primary social objectives:

- (a) to provide jobs for the new entrants to the labour force;
- (b) to meet the minimum basic needs of the people for food, shelter, health, and education by the year 2000.

In relation to the Lima target, the main analytical point here is that since the fulfilling of the target essentially depends on the relative rates of growth of industry in the South and the North, the target may in principle be reached at a much lower rate of industrial expansion in the South than would be compatible with meeting these two major social objectives. Since 1973, the industrial growth rate in the North has slowed down to about 2.5% per annum. At this rate, industry in the South has to grow only at a rate of 5% per annum to fulfil the Lima target, but this is unlikely to be adequate for either meeting the basic needs of the people or the employment requirements in the developing countries.

### **II.4 Stylized Facts to Explain**

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<sup>9</sup> As China was not a member of the UN then it had not taken part in the Lima meeting. The figures in the text refer to those for a group of developing countries excluding China. See further UNIDO (1979).

The essential facts concerning the industrial record of the developing countries in 1960 to 1980 and in the 1980s discussed in Sections II.1 to II.3 may be summarized as follows: the developing countries embarked on a process of industrial revolution in the post-war period and a large number of them were carrying out this task by and large successfully in the 1960s and 1970s. This process has got interrupted in the 1980s and there has been a sharp trend decline in the rate of growth of industrial production in the developing countries since 1980. However, industrial development has not suffered a uniform setback in all developing countries. There has in fact been a continental divide: industry in the Asian countries has continued to prosper, while in Africa and Latin America the deceleration in the rate of industrial expansion has been particularly severe, with a number of countries suffering deindustrialization.

These stylized facts lead to the following questions:

1. Why has there been a trend decline in industrial development in the South during the 1980s?
2. Why has the performance of the Asian countries been so much better than those of the Latin American and sub Saharan African countries?

Two main hypotheses, which are by no means mutually exclusive, have been put forward to account for these phenomena:

- i. The South's economic and industrial setback in the 1980s is essentially due to world economic forces over which the developing countries had no control.
- ii. The economic and industrial decline has been caused by domestic mismanagement, incorrect economic policies and microeconomic inefficiencies in the South.

The second hypothesis is given some credence by the fact that despite the world economic crisis, industry in the Asian countries has continued to do well. These hypotheses will be explored in the following three sections.

### **III. The World Economic Crisis and Industrial Development in the South in the 1980s**

#### **III.1 The Channels of Transmission**

The most important channels through which the slow-down in world economic activity since 1980 has affected economic and industrial development in the Third World countries are the following:

- (a) a reduction in the demand for Third World products, including commodity and mineral exports;
- (b) as a consequence of (a), a fall in commodity prices and hence adverse movements in the terms of trade;
- (c) an increase in the real burden of interest and debt service payments partly due to (a) and (b) and partly due to an enormous increase in interest rates;
- (d) a reduction in the quantum of aid and other capital flows.

The end of the 1970s witnessed a far-reaching change in the domestic macroeconomic policies of industrial countries. This change was heralded by the appointment of Paul Volcker as the chairman of the Federal Reserve in the United States in 1979. Following the second oil price increase, the United States government embarked on highly contractionary monetary and fiscal policies. These policies were later emulated either willingly (as in the case of the UK) or unwillingly (through a process of competitive deflation) by other industrial countries.<sup>10</sup> The net result was a prolonged recession in the advanced economies. Their real rate of growth of GNP fell from 4.2% in 1978 and 3.3% in 1979 to 1.2% in 1980 and 1.4% in 1981, to -0.4% in 1982 at the bottom of the recession and to 2.6% in 1983. (IMF, 1986).

In a recent paper Marquez and McNeilly (1988) have estimated income elasticity of demand for South's exports to the industrial countries to be of the order of 1.4 to 1.9 for non-oil imports and 2.4 to 3.0 for manufactures. Reduced growth of economic activity in the North not only depressed Third World manufacturing exports but also led to a sharp fall in commodity prices. The latter are particularly sensitive to short-run changes in demand. According to the IMF data, the prices of non-oil commodities exported by developing countries fell by 20% in US dollar terms between 1980 and 1982. In the more relevant "real" terms, i.e. deflated by the price index of manufactures exported by the industrial countries, the fall was about 17% and brought commodity prices to their lowest level in the post-war period, 13% below the previous lowest point reached in

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<sup>10</sup> For an analysis of the process of competitive deflation and of the reasons for the change in the US policy, see Glyn, Hughes, Lipietz, and Singh (1989).

1975.<sup>11</sup> UNCTAD (1986) estimated that the cumulative loss of export earnings due to adverse changes in non-oil commodity prices in 1980-83 amounted to about \$28 billion for 48 commodity-exporting developing countries. This accounted for almost one third of the total current account deficits and nearly half the increase in indebtedness of those countries during that period.

The IMF data further indicate that although commodity prices improved in 1983 and 1984 as the world economy and particularly the US economy began to recover, they deteriorated again in 1985 and by the last quarter of that year the index of real prices of non-oil commodities exported by developing countries stood at 78.1 (with 1980=100). Thus the real non-oil commodities prices fell by over 20% in the first half of this decade and compared with the high point of 1977, the fall was more than 40%.

In addition to the demand shock and the commodity price shock, the developing countries at the beginning of this decade were also subject to an enormous interest rate shock. The Federal Reserve chairman Volcker's new monetary policy for the United States, based on the quantitative targeting of monetary aggregates, led to an unprecedented rise in interest rates. The real interest rates, measured as the London Interbank Offer Rate (LIBOR) on three month US dollar deposits less the rate of change of GDP deflator in the US, increased from an average of only 0.5% during 1974-78 to more than 7% in 1981, 1982 and 5% in 1983. If the real interest rates are defined more appropriately in terms of the difference between LIBOR and the rate of change of export prices of non-oil developing countries, the recorded increase in these rates has been astounding. Reisen (1985) shows that the average real interest rate, so defined, on developing country floating rate debt increased from -11.8 per cent in 1977 to 15.9% in 1983. The real interest rates on the external debt of developing countries have continued to remain at a high level for most of the 1980s.

The three factors (a), (b) and (c) above (i.e. reduced rate of growth of demand for Third World exports, adverse movements in terms of trade, and increased real interest rates) played havoc with the balance of payment situation of the non-oil developing countries. Their combined current account deficit rose to \$174 billion in 1980, \$95 in 1981 and to \$73 billion in 1982, almost twice the average annual level during 1978-79.

Cline (1984) has provided some rough and illustrative estimates of the impact of external shocks on the balance of payments position of the non-oil developing countries in 1981 and 1982. These are given below.

	<b>Effect</b>
Oil price increase in excess of US inflation, 1981-1982	\$119 billion

<sup>11</sup> See IMF (1986) supplementary note 3 on non-fuel primary commodity prices.

Terms of trade loss 1981-1982	\$ 79 billion	
Real interest in excess of 1961-80 average, 1982	\$ 41 billion	1981-
Export volume loss caused by world recession, 1981-1982	\$ 21 billion	
<b>TOTAL</b>	<b>\$260 billion</b>	

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The total impact is far more than the deterioration in the current accounts of the non-oil developing countries during these years, implying that the countries had in fact undergone considerable domestic adjustment to the external shocks. For a slightly different period, the IMF Annual Report for 1983 reached a very similar conclusion on the effects of the external shocks:<sup>12</sup>

For the oil importing developing countries, *the entire deterioration of the combined current account balance from 1978 to 1981 can be ascribed essentially to these three adverse factors.* Indeed, the deterioration of their oil trade balance and their non-oil terms of trade, together with the large excess of the rise in their external payments of interest over the increase in interest earnings on their reserves and other financial assets abroad, amounted to nearly \$80 billion over these three years, against a cumulative increase of only \$53 billion in their total current account deficit.

Another extremely important shock to the foreign exchange and the balance of payments position of the developing countries, which is not often given adequate recognition in mainstream accounts, is that arising from a sharp reduction of capital flows to the developing countries during the 1980s. According to the UN (1986) estimates for eighty-eight developing countries, there was a net resource transfer of \$40 billion dollars per annum to these countries during the period 1978 to 1980.<sup>13</sup> However, in 1982, the year of the Mexican debt crisis, the net resource flows to developing countries fell to a mere \$7.1 billion. In 1984 and in subsequent years there has been a negative net transfer, i.e. resources have been flowing from the developing to the developed countries rather than *vice versa*. The position is particularly serious in Africa and Latin America, the two continents which have suffered most during the world economic slow-down in the 1980s, as the figures below show.<sup>14</sup>

	<b>1977-78</b>	<b>1984-85</b>
	(in billion US dollars per year)	
Africa	+8.6	- 5.4

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<sup>12</sup> Quoted in Singh (1984).

<sup>13</sup> The UN estimates refer to the net flow of foreign financial resources available for imports of goods and services (i.e. after payment of income on foreign capital outstanding). The flows include both private and public capital flow as well as direct investment and official grants.

<sup>14</sup> The source of these figures is Cornia, Jolly, and Stewart (1987). These figures pertain to the net transfer of funds which are calculated as current account balance less interest payments.

Latin America	+4.9	-39.0
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In 1984-1985, the Latin American countries alone transferred annually \$40 billion to the rich countries. The corresponding negative transfer from the much poorer African countries was more than \$5 billion in 1984-85, compared with the positive net transfer of more than \$8 billion annually to these countries during 1977-78. The adverse implications of these changes in net resource flows to the foreign exchange constrained developing countries in the 1980s cannot be exaggerated (see further Section IV below).

### III.2 The Foreign Exchange Constraint and Industrial Development

It is important to emphasize that the deterioration in the balance of payments' position of the developing countries has far reaching consequences for all spheres of the economy, real as well as financial. The effect on industrial production is direct and for many countries often immediate. The external payments' constraint can become so binding that the country has to curtail not only the imports of luxuries or other consumer goods, but also the essential imports required for maintaining the existing levels of domestic production. As the necessary complementary inputs in the form of industrial raw materials, spare parts, etc. could no longer be imported into countries like Tanzania, Mexico, or Brazil, the level of industrial capacity utilization became very low and industrial production declined sharply in the 1980s. Khan and Knight (1988) report that over the period 1982 to 1986 the volume of imports into the fifteen most heavily indebted developing countries *fell* at an average rate of nearly 10%; in the first two years of the debt crisis, 1982 to 1983, the decline in the volume of imports averaged about 19% per year. The two authors suggest that though less pronounced, a similar pattern has been evident in most other developing countries.<sup>15</sup> To illustrate with examples of individual countries, the dollar value of Mexico's imports fell almost 40% in 1982 and 70% from the first quarter of 1982 to the first quarter of 1983. The fall in the dollar value of Brazil's imports was 12% and 23% in the corresponding periods, on top of an earlier fall in 1982 [World Bank (1984)].

Agricultural production is affected both directly by the foreign exchange constraint and indirectly by reduced industrial production. Reduced imports as well as lower domestic production of fertilizers and other agricultural inputs, together with lower oil imports, hamper agricultural production directly. Indirectly, there is an unfavorable effect on production because of lower availability of the so-called incentive goods for the farmers (soaps, bicycles, etc).

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<sup>15</sup> The only exception to this was a group of Asian countries that were relatively little affected by the balance of payments crisis and hence not subject to import compression. See further Section IV below.

Import compression not only threatens agricultural and industrial production but paradoxically it also reduces exports. The reason for this is not far to seek. Raw cotton may, for example, be produced in the Tanzanian hinterland, but an acute shortage of foreign exchange may mean that it cannot be processed (due to the lack of spare parts for the operation of the ginning mills) or transported to the port of Dar es Salaam for exports abroad (because of the shortage of fuel etc for transportation). From their study of this phenomenon, based on a sample of thirty-four developing countries, Khan and Knight (1988), concluded that:

Broadly speaking, an exogenous real exchange rate shock that gives rise to a 10% reduction in the volume of imports would, other things being equal, lower the volume of exports in our model by about two percentage points in the short run, and by over 5 percentage points in the long run. The fall in exports would in turn reduce the volume of imports further.

Finally it is important to note that these disequilibria in the real economy in turn generate inflation and disequilibrium in government finances. As in many developing countries sales and excise taxes on industrial production, as well as import duties, are a major source of government revenue, the balance of payments constraint is directly and indirectly responsible for the enormous increases in budget deficits or the public sector borrowing requirements that these countries are experiencing. Again taking the Tanzanian example, it has been estimated that if industry was operating at a normal level of capacity utilization instead of its present low level, sales and excise tax revenues would be doubled, which would not only eliminate the current fiscal deficit, but also make a sizeable contribution to the capital account [see JASPA/ILO (1982)].<sup>16</sup> Similarly Sachs (1987) has rightly reminded us that for many heavily indebted countries, the balance of payments crisis soon translates itself into an acute fiscal crisis with serious consequences for economic, social and political stability, as well as for investment and future growth. (This point is developed further below).

#### **IV. The Crisis and the Differential Industrial Performance in Developing Countries**

It has been argued in Section III that world economic forces were wholly responsible for the serious deterioration in the balance of payments position of non-oil developing countries. This in turn led to “external strangulation” or import compression with extremely deleterious consequences for industrial and economic development as well as for price stability and fiscal balance. However, as noted in Sections I and II, notwithstanding the world economic crisis, the

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<sup>16</sup> This is the familiar distinction between a “cyclical” and a “structural” budget deficit that is often made with respect to deficits in the US and other advanced countries. Unfortunately such distinctions are often ignored in relation to the developing countries.

South and East Asian countries continued to prosper and register relatively satisfactory industrial development in the 1980s, whilst it is the Latin American and Sub-Saharan African countries that have suffered industrial retrogression or decline. How is this differential industrial performance in the different regions of the South to be explained?

#### **IV.1 The Comparative Performance of Asian and Latin American Economies**

The South and East Asian countries did not only have a superior industrial record in the 1980s but their overall economic performance was much better than that of the Latin American countries. Thus, in a comparison of ten Asian and nine Latin American countries, Singh (1986) found that over the period 1980 to 1985, only two countries in the former group had a growth rate of GDP of less than 5% per annum (Philippines 2.3% and Pakistan 4.4%). In sharp contrast, none of the Latin American countries registered a corresponding GDP growth of more than 2% per annum. Five of the nine Latin American countries (Argentina, Peru, Chile, Bolivia, and Venezuela) actually recorded a fall in the level of the GDP (at constant prices) between 1980 and 1985. Similarly, the inflation record of almost every Asian country in the first half of this decade was much better than that of every Latin American economy except Venezuela. Singh (1986) noted that this continental uniformity in economic performance is remarkable in view of the wide inter-country differences in economic structure, economic policy, and even in the basic economic system. This is particularly true in Asia where countries like China, India, and the Republic of Korea not only have different economic systems, but the two market economy countries (India and the Republic of Korea) have traditionally followed very different economic strategies.

The reasons for this differential economic performance of Asian and Latin American countries in the wake of the post-1979 world economic slow-down have been the subject of considerable controversy. [See Balaasa (1984), Sachs (1985), Maddison (1985), Singh (1985), Hughes and Singh (1988)]. In the context of this paper, the treatment of this question will necessarily be brief.

*A priori*, there are three main factors that may help to explain the superior economic record of the Asian countries relative to those in Latin America: (a) differences in economic structure; (b) differences in the economic policies pursued; (c) differences in the size of the economic shocks experienced by the countries on the two continents. Balaasa (1984) and Sachs (1985), as well as the IMF and the World Bank, suggest that a very important reason for the better Asian economic performance is that these countries have more open and export-oriented economic structures, compared to those in Latin America. Differences in economic and industrial structures between the Asian and Latin American economies have been examined in detail in Singh (1985) and Hughes and Singh (1988). However, this analysis reveals very little evidence in support of the Balassa-Sachs openness hypothesis. The least open Asian economies like China and India have

been able to cope at least as effectively with the post-1979 world economic crisis as the highly export-orientated Korean economy.<sup>17</sup> Similarly, among the smaller Latin American countries, the more “open” economies such as Chile (with an exports to GDP ratio of 24%) and Venezuela (with exports to GDP ratio of 33%) have a much poorer record of GDP growth over the period 1979-84 than the less open economy of Colombia (exports to GDP ratio of 17%).<sup>18</sup>

Hughes and Singh (1988) and Singh (1986) argue that certain exogenous shocks emanating from the post-1979 world economic crisis had a much greater impact on the economies of the Latin American countries than on the Asia economies. First, it is suggested that the rise in interest rates had a far bigger effect on Latin American countries than on those in Asia since a larger proportion of the Latin American debt was of the floating rate variety. Moreover, the Latin American countries were starting from much less favorable initial conditions. In the period preceding the post-1979 world crisis, i.e. during 1973 to 1979, the medium debt service to exports ratio of the Latin American countries was more than twice as high as that of the Asian countries—22.9% compared with 10.7% [Hughes and Singh (1988)]. Sachs (1985) suggests that with a few exceptions the impact of the rise in interest rates on the developing economies was not particularly significant. He writes

at the peak the measured US real interest rate rises by about 10 percentage points and is multiplied by a debt/GDP ratio of the order of 20%, producing a peak annual loss of 2% of GDP and an average annual loss of about 1% of GDP.

However, this is not a valid argument since as Hughes and Singh (1988) report, the medium current account deficit in the Latin American countries was only about 3% of GDP in the late 1970s. The impact of the increase in interest rates (whether measured in nominal or real terms) on the current balance of these economies was therefore highly significant. The dynamic consequences (particularly in terms of capital flows) of an increase (or decrease) in the current account deficit by nearly a third for a balance of payments constrained economy cannot be exaggerated.

Secondly, Hughes and Singh emphasize that the Latin American countries were far more subject to capital supply shocks than the Asian economies. [On this point, see also the excellent detailed analysis of Fishlow (1987).] To illustrate the nature of these shocks, consider Mexico. During the oil boom years, 1977 to 1981, the Mexican economy had been growing at a rate of 8% per annum with even the non-oil GDP rising at a roughly similar rate. However, despite the enormous increase in oil exports, the balance of payments position had been deteriorating. The

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<sup>17</sup> The Korean economy is certainly not open in the sense of having free trade. Despite some recent import liberalization measures, it has traditionally implemented rigorous selective import controls. See Singh (1985).

<sup>18</sup> There is a complex relationship between “openness” and the vulnerability of an economy to external shocks. For a further analysis, see Hughes and Singh (1988).

current account deficit rose from nearly 5 billion dollars in 1979 to almost 7 billion dollars in 1980 and to 11.7 billion dollars in 1981. Notwithstanding this deterioration, the international banking community was happily willing to lend Mexico ever increasing amounts to finance the deficits. Thus from 1978 to 1981, while international bank loans to developing countries as a whole increased by 76%, they rose by 146% to Mexico, already a large debtor in 1978. To meet the Mexican government's increased demand for foreign loans to finance the current account deficit, the international banks accelerated their lending to Mexico in 1981, albeit with an increasing shortening of the term structure of the new loans [Ros (1986)]. In that year, the capital account of the balance of payments indicate that Mexico's net public short-term liabilities rose by \$12.7 billion (compared with \$6 billion in 1980 and \$1.7 billion in 1979). However, in the crisis year of 1982, these capital flows were abruptly halted and the capital account shows that Mexico's net public external short-term liabilities actually *decreased* by \$614 million. Brailovsky and Barker (1983) rightly note that this capital supply shock had a devastating effect on the Mexican economy.

Most of the other Latin American economies were subject to similar capital supply shocks. These emanated from what Williamson (1985) has named the "contagion effect" whereby, following the Mexican debt crisis in 1982, voluntary private capital flows to most Latin American countries were greatly reduced if not stopped altogether. The important point is that because of the "contagion effect," capital flows were reduced much more to the Latin American than to the Asian economies. This in turn will have worsened the balance of payments constraint in the Latin American countries more so and more suddenly than in the Asian countries.

Thirdly, it is suggested that reduced world economic growth and world trade during 1980-82 had a differential impact on the normal export markets for countries in the two continents. In particular, the Middle Eastern market, which was the most rapidly expanding market during this period, was much more significant for many of the Asian countries than for Latin America. There are two important channels by which the Asian countries have benefited from the economic prosperity in the Middle East: (i) workers remittances and (ii) the growth of merchandise exports.

Relative to the Asian countries it is argued that the above three factors together made the balance of payments constraint on the Latin American economies much more severe, which in turn led to greatly reduced economic growth and higher inflation in these countries. In the institutional circumstances of the heavily debted Latin American economies, a very important consequence of the balance of payments crisis has been a fiscal crisis. In addition to the reasons given in Section III, this arises from the fact that the foreign debt has been consolidated to become largely the liability of the government and there is therefore a huge burden of interest payments on the budget. Sachs (1988) provides data to show that in Argentina and Mexico, in the mid 1980s, interest payments represented nearly a third of the government's revenues. As the government in many Latin American countries has a direct and major role in undertaking or

financing industrial activity and investment, the fiscal crisis leads particularly to reduced industrial and infrastructural investment. A number of WIDER studies on macroeconomic adjustment in developing countries (see Taylor, 1988) have shown that in general, in the South, public investment “crowds in” rather than “crowds out” private sector investment. This compounds the effects of the fiscal crisis on industry.

In view of all the direct and indirect effects of the foreign exchange constraint and the balance of payments crisis, it is not surprising to observe the poor industrial and overall economic record of the Latin American countries relative to the Asian countries.

#### **IV.2 The Sub-Saharan African Economies**

The industrial and the overall economic performance of Sub-Saharan African countries in the 1980s has been, if anything, poorer than that of the Latin American countries. The Sub-Saharan Africa consists typically of small open economies at a very low level of economic development. These economies are much more open than those in other regions, with exports on average accounting for nearly a quarter of their GDP. Not only are these countries, therefore, much more vulnerable to changes in world economic conditions, being industrially underdeveloped, they also have a limited capacity to adjust to changes in the international economy.

External factors—both those relating to the world economy as well as to the weather and the wars—have played a primary role in the poor economic performance of a large number of the Sub-Saharan countries. The World Bank (1983) data show that, of all the developing regions, the low-income African countries experienced the largest adverse movements in their terms of trade both between 1973 and 1976 and 1979 to 1982; in the former three year period, the terms of trade of these countries fell by 15% and during 1979-82 by nearly 14%. According to the IMF statistics, in 1983 and 1984, the terms of trade of the Sub-Saharan African countries (other than South Africa and Nigeria) improved by 1.6% and 6.4% respectively. However, since then, they have deteriorated again; in 1985 by 1.6%, and in 1986 by a massive 14.5% and in 1987 by 4.8% [IMF (1988)]. It has been estimated by the UN (1986) that the accumulated loss for Sub-Saharan Africa from the deterioration of its terms of trade in the period 1980 to 1985 was approximately \$11 billion.

The impact of the external shocks (arising from the decline in the growth rate of world demand for the developing countries products, changes in the terms of trade, and increases in the interest rates) on the balance of payments has been estimated by the World Bank (1985) for three Sub-Saharan African countries, the Ivory Coast, Kenya and Tanzania.<sup>19</sup> As an average

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<sup>19</sup> See World Bank (1985) Table 4.2.

annual percentage of GDP, the net effect of these shocks for Kenya amounted to -8.1% in 1974-75, -8.7% in 1979-80 and a gigantic -19% in 1981-2. Similarly for Tanzania, the net loss due to the external shocks was on average 9.3% of GDP in 1974-75; 6.0% of GDP in 1979-80 and a huge 14.3% on GDP in 1981-82. For the Ivory Coast, the corresponding figures for the three periods are 0.5%, -5.6% and -18.9% respectively. To put these figures in perspective, it may be recalled that the impact of the adverse change in the terms of trade for the UK (not then an oil exporter) as a result of the first oil shock in 1974-75, is estimated to have been equivalent to a reduction in GDP of about 4%. This led to an enormous redistributive conflict and near doubling of the rates of inflation and unemployment. The government was obliged to undertake extraordinary measures (including a recourse to the IMF) to restore economic stability. Yet the Sub-Saharan economies, which are much poorer, have suffered relatively far greater external shocks than the UK did in the mid-1970s.

Moreover, many Sub-Saharan economies were also subject to drought and to other exogenous events. Thus, for example, in the case of Tanzania, apart from the adverse impact of the world economic crisis, the economy after 1979 was subject to two other major external upheavals: the war with Idi Amin in Uganda and the break-up of the East Africa Economic Community. The foreign exchange costs to Tanzania of the last two events is estimated to be equivalent to that due to the terms of trade loss discussed above. Green (1985) estimated that, in aggregate, Tanzania's combined loss from external shocks since 1979 was of the order of \$1.5 billion, which amounted to about three years of total exports earning (the Tanzanian exports normally total about \$500 million annually). Similarly, Green suggests that for the nine Southern African Development Co-ordination Conference (SADCC) states, the cost of civil war and South African inspired external aggression has been enormous, well above the total foreign capital inflows into the countries over this period.

The overwhelming importance of the world economy and the economic policies of the *industrial* countries for economic growth in the Sub-Saharan Africa is demonstrated by an IMF analysis. [See IMF (1985)]. This investigation provided a forecast of economic growth in the Sub-Saharan African countries during 1987-90 on the basis of past economic relationships and certain baseline assumptions. The IMF projected the growth of GDP to be 4.2% per annum for this period. It is, however, significant that deviations from this average growth path were influenced far more by "better" or "worse" policies in the industrial countries than by "better" or "worse" policies in the Sub-Saharan countries themselves. As the ILO (1987) notes in relation to this analysis, "most strikingly the debt service ratio is about 24% in all scenarios except that of worst policies in the industrialized countries where it increases by a good 10 percentage points, causing a considerable drop in GDP growth."

Although the above account has concentrated on the period since the second oil shock, external events (changes in the terms of trade and drought) were also a major cause of the deterioration in economic performance of the Sub-Saharan African countries in the 1970s. Many of these countries were, however, able to recover relatively quickly from the experience of the first oil shock. As Green (1985) notes, “the period 1976-1979 showed a 6 percent annual growth for Africa as a whole, well above its historical average and somewhat above that of the aggregated developing countries... A reading of continuous drift towards stagnation and decline or of a failure to overcome the external shocks of 1973-74, is not historically accurate in a majority of Sub-Saharan economies.” Similarly, Wheeler (1984), on the basis of a cross-section econometric study of the Sub-Saharan African countries during the 1970s, concluded that inter-country differences in growth rates are much better explained by differences in external environment than by policy differences.

## **V. Microeconomic and Supply Side Inefficiencies and Industrial Development in the South**

As against the view, developed in Sections III and IV, that the industrial deceleration in the South during the 1980s has overwhelmingly been due to external shocks and the associated foreign exchange constraint, it has been argued that microeconomic inefficiencies, misallocation of resources and supply side deficiencies in the developing countries themselves have all played a major role in this process. It is clearly important to provide some assessment of the influence of these factors in relation to the current industrial crisis of the developing countries.

### **V.1 Growth of Productivity and Efficiency of Capital Utilization**

Lindbeck (1984, 1986) has drawn attention to the poor record of developing countries in “speeding up the rate of productivity growth.” He notes that: “while output in manufacturing in developing market economies increased by 5% per year during 1960 to 1981, the accompanying increase in labour input was as high as 3.7%, which implies that the increase in labour productivity was only about 1.3%.”<sup>20</sup>

The figures below provide information on the growth of manufacturing output, employment, and productivity for the developed market economy countries and the developing countries over the periods 1963-1973 and 1973-1983.<sup>21</sup>

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<sup>20</sup> Lindbeck (1986), page 3.

<sup>21</sup> The source of these data is UNIDO (1984), Table III.10, last row, page 75.

	<b>Output</b>	<b>Employment</b>	<b>Productivity</b>
Developed Countries			
(1963-73 % p.a.)	5.2	1.2	4.0
(1973-83 % p.a.)	2.3	-0.5	2.8
Developing Countries			
(1963-73 % p.a.)	7.1	4.2	2.8
(1973-83 % p.a.)	5.0	4.2	0.7

Both groups of countries recorded a decline in output and productivity growth after the 1973 oil shock. However the decline in productivity growth was greater in the South than in the North, mainly because manufacturing employment declined in the North while in the South it continued to grow at much the same rate as before. Nevertheless, from the standpoint of overall economic efficiency, it should be observed that a high rate of expansion of the manufacturing labour force in the labour surplus countries of the South raises productivity in the economy as a whole, since the level of productivity in manufacturing in these countries tends to be greater than in most other sectors. Similarly the North's relatively higher rate of productivity growth does not necessarily denote greater economic efficiency. This is because there was a decline in manufacturing employment and there is evidence that this reduced labour force in manufacturing was not redeployed elsewhere but in fact contributed to an overall increase in unemployment in the North. (Glyn and Rowthorn, 1989).

Turning to the productivity of capital, Table 7 reports UN data on incremental capital output ratios (ICOR) in the world market economies during the 1960s and 1970s.

The table indicates that in the 1970s, the ICORs rose in all market economies, the developing as well as the developed. This, however, by itself again need not imply a growing inefficiency in resource utilization since an important reason for the increase in the ICORs in most countries during this period was clearly the world economic crisis with its adverse impact on the balance of payments and domestic capacity utilization. Moreover, in the case of the developing countries, it is also essential to consider the composition effect: a rise in aggregate value of the ICOR may simply reflect structural changes in the economy towards, perhaps, heavy industry or infrastructural development.

Thus more disaggregated and microeconomic data as well as an examination of productivity trends over time, particularly of capital productivity at "normal" levels of capacity utilization, are required to establish whether or not industrial resource utilization in the developing countries had been becoming progressively more inefficient before the



onset of the 1980s crisis. In this context, Table 8 on Tanzania, a country that the international financial institutions have often put forward as an example of unsuccessful industrial development because of the heavy involvement of the government in its economy and its socialist orientation, is instructive. The table provides summary indicators of Tanzania's long-term industrial performance in the pre-crisis period 1971-72 to 1971-78. Bienefeld (1982) rightly assesses this record in the following favorable terms:

In short the aggregate statistics present a picture of a healthy and positive *long-term* trend where substantial industrial growth had been achieved with an almost constant capital/labour ratio, and a falling real product wage (labour cost per worker deflated by implicit GDP wage deflator for manufacturing), together with a declining share of labour costs in value added. For a situation where labour absorption is itself an important objective such a combination has much to recommend it and is in no sense necessarily inferior to a strategy which increases output per worker faster, but at the cost of higher wage costs... At the macroeconomic level the role played by industry has been dynamic. It has helped to raise productivity in the economy as a whole, has produced substantial amounts of investable surplus, and has developed skills in Tanzanian workers and managers.

**TABLE 8**  
**Summary of Trends in Tanzanian Manufacturing\***

	1970-72	1976-78	Ratio <u>1976-78</u> <u>1970-72</u>
1. Value added in constant (1966) prices (Shs.m)	536.9	874.3	1.63
2. Employment (000)	51,560.0	84,819.0	1.65
3. Capital (Shs.m) Constant (1966) prices	1,049.3	1,833.0	1.75
4. Capital—Output ratio (3/1)	1.95	2.10	1.08
5. Capital—Labour ratio	20.35	21.61	1.06
6. Output per worker (1/2)	10,413.0	10,308.0	0.99
7. Labour costs as share of value added (%)	41.3	34.3	0.83
8. Real product wage (Shs. per worker)	4,065.3	3,579.0	0.88
9. Actual real rate of return on capital (%)	21.1	21.0	

\* Firms employing 10 or more workers.  
Source: Bienefeld (1982).

Similarly, in a detailed disaggregated long-term study of Mexican industry in the period 1960 to 1979, Brailovsky (1981) has reported successful learning by doing and markedly improved trade balance coefficients over time for many Mexican industries, particularly the capital goods industries.

## **V.2 Allocation of Resources**

In his comparison of East Asian and Latin American economic performances in the 1980s, Sachs (1985) has argued: "Latin American and Asian borrowers have differed not only in the amounts borrowed, but also in the uses to which the loans were applied. Simply put, the Latin American countries did not use the foreign borrowing to develop a resource base in tradable goods, especially exports, adequate for future debt servicing." In relation to this kind of charge of resource misallocation in the Latin American and other developing countries, a number of observations are in order. These are briefly stated below.

First, during the middle 1970s, when the Latin American and other newly industrialized countries (NICs) contracted their enormous debts, they were no more than following market signals that were particularly favorable. The real interest rates were negative or very low.

Second, as Fishlow's analysis of consumption functions indicates, the marginal propensity to save out of external borrowing was on the whole the same as, or greater than, domestic income. Fishlow (1987) notes: "At the margin, therefore, there was an expected substitution for domestic saving. But there seems to be no difference in this respect between Indonesia and Korea, on the one hand, and Brazil and Mexico, on the other."

Third, there was a marked increase in the rate of investment in the developing countries during the 1970s. Gross domestic investment as a proportion of GDP in these countries rose from 23.6% in 1973 to 26.6% in 1980. Moreover, this increase in investment was not just confined to the Asian countries, but was widespread in the South. The World Bank (1988) data indicate that for the group of heavily indebted countries, the comparable increase in investment was from 21.8% in 1973 to 25.2% in 1980. For the Sub-Saharan African countries the corresponding figures were 18.9% and 20.4% respectively.

Fourth, as far as the allocation of investment resources is concerned, it was not just Mexico or Brazil but also South Korea that used foreign borrowing in the 1970s to launch an ambitious programme of import substitution and development of heavy industries. Park observes with respect to South Korea: "A massive investment programme in these industries financed largely by foreign loans and central bank credit was put in effect in 1973 and pursued vigorously

until 1979. To the dismay of policy makers who had conceived this industrial restructuring, the development strategy ran into a host of financing, engineering, quality and market difficulties.”<sup>22</sup>

Fifth, although during the 1970s the Third World debt expanded very fast, the rate of growth of manufacturing exports from the South was faster than the growth of debt. The developing countries' exports of manufactures increased at a much higher rate in the 1970s than in the 1960s; in the 1970s the growth rate of these exports was 12% per annum (in constant 1978 prices) compared to 8.5% for total world trade in manufactures. In relation to the relative performance of Asian and Latin American countries, it is interesting to observe that Brazil's rate of growth of manufacturing exports (in value terms) during the 1970s was much the same as that of South Korea's while Mexico's and Argentina's were significantly higher than that of India's. (UNIDO, 1984, Table VII.4). Overall, in relation to the record of the NICs in the 1970s, the Yugoslav economist D. Avramovic rightly observed: “the newly industrializing borrowing countries have proven that they can absorb modern technology, organize efficient production, penetrate the international market at an extraordinary speed, manage their economies in a satisfactory manner with a few exceptions...”<sup>23</sup>

All these factors taken together strongly suggest that it was the extraordinary increase in interest rates which took place after 1979 and the other exogenous shocks discussed earlier that have been directly responsible for the economic and industrial crisis in the developing countries rather than their intrinsic supply side deficiencies in utilizing and allocating their resources.<sup>24</sup> It is however important to stress that although inefficient resource utilization in the 1970s is not in general the cause of the Third World's industrial setbacks in the 1980s, *more efficient* resource utilization will nevertheless be undoubtedly beneficial in the future. Indeed, as we shall see below, it will be a *sine qua non* for getting out of the crisis.

## VI. Industrial Policy in the South: the Orthodox Perspective

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<sup>22</sup> Quoted in Fishlow (1987). The reason why nevertheless South Korea did not subsequently succumb to the debt crisis and Brazil and Mexico did, has been discussed in Section IV above.

<sup>23</sup> Quoted in Singh (1984).

<sup>24</sup> The question of possible errors in macroeconomic policy management (e.g. the role of the exchange rate, the issue of capital flight) has not been discussed here. This is a large controversial subject in its own right, which will take us too far afield in relation to the central discussion of this paper. For an analysis of these issues see among others Fishlow (1987), Hughes and Singh (1988), Singh (1986a), Singh (1988), and Taylor (1988). In these contributions the orthodox view that inappropriate exchange rate management and related macroeconomic policy errors in the developing countries played a major role in the economic crisis of the 1980s is confronted and seriously challenged. Instead these authors point to the extraordinary size of the adjustments required in many of these nations as a consequence of the external shocks—far greater than anything suffered by the developed countries—and to the complexities of the political economy of macroeconomic management in the affected countries.

As a consequence of the balance of payments difficulties and acute foreign exchange constraints faced by the developing countries in the 1980s, a very large number of them have had to go to the IMF and the World Bank for balance of payments support and for adjustment assistance. These two international financial institutions<sup>25</sup> have imposed increasingly severe and detailed conditions with respect to the economic and industrial policy of developing countries seeking such assistance. Avramovic (1988) sums up the current situation as consisting of four layers of conditionality:

- (a) Demand conditionality pioneered by the IMF through their monetary approach to the balance of payments. This focuses on cutting spending, primarily that of the government, currency devaluation, raising interest rates, and trade liberalization. There are now also elements of supply conditionality, mainly in eliminating price controls.
- (b) Supply conditionality, pioneered by the World Bank, originally focussed on project (or micro) formulation and implementation, and dealing with pricing of products and services to be sold by the project, and its management. This was then extended to cover sectors, and now, with “structural adjustment lending” to the entire economy. The center of attention is the investment program, system of incentives, pricing, financial liberalization, and trade liberalization.
- (c) “Growth” conditionality, in application during the last year or so, focussed on giving free hand and incentives to the private sector of the economy, including “privatization” of government-owned enterprises as much as possible, rationalization of the rest, promotion of foreign direct investment, and again, trade liberalization.
- (d) Cumulative total of (a), (b) and (c), called “cross-conditionality,” where lending decisions of each agency depend on the borrower having met the loan conditions of some other agency. This is now in increasing use, and it involves private as well as official lenders. The breakdown in arrangements between a borrowing country and any one of these agencies—in particular the IMF and The World Bank—can have a “domino effect” in relation with all other agencies. The situation is still fluid: the number of instances of “cross-conditionality” is increasing, but is not yet clear how firmly committed to coordinated action individual lenders feel they are.

Many of these measures are highly controversial and there is a large literature on the efficacy and the validity of the specific parts of such programmes, e.g. currency devaluations, rise in real interest rates, monetary and fiscal targets.<sup>26</sup> However, in the context of this paper, this conditionality also reveals a particular approach to industrial policy. Central to this perspective are two elements:

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<sup>25</sup> In principle, the IMF is supposed to deal with short-term adjustment problems and the World Bank with the long-term questions of economic development. In practice, because of cross conditionality, the IMF’s own structural adjustment loans and the greater cooperation between the two institutions, the distinction has become much blurred. See further, Helleiner (1988).

<sup>26</sup> See among others Singh (1986b), Avramovic (1988), Taylor (1988) as well as the WIDER studies on economic adjustment for twenty developing countries.

- i. An increase in the role of free markets and private enterprise as far as possible and a diminution in that of the state. Hence measures such as privatization, deregulation, financial liberalization, changes in taxation and other incentive systems.
- ii. A closer integration with the world economy. Hence the emphasis on export promotion, import liberalization, bringing domestic prices in line with the world market prices through changes in the exchange rate, promotion of foreign investment.

Denying any philosophical or ideological proclivities, the IMF and the World Bank as well as many mainstream economists argue that they favour such a policy programme on the basis of its empirical validity and its proven record in promoting fast and “efficient” economic and industrial growth. Thus De La Rosiere (the former Managing Director of the IMF): “Advocacy of these policies is not a matter of theology. It is instead grounded in the lessons of actual country experience.”<sup>27</sup> Similarly, Balaasa et al. (1986) suggest: “The essential factors that give impetus...to the severity of the economic and social crisis of the 1980s was the pervasive and rapidly expanding role of the state in most of Latin America.”<sup>28</sup> The contrasting success of the East Asian NICs plays an essential role in the advocacy of the orthodox policy prescriptions; this success is ascribed to the ability of these countries in “getting the prices right” and to the closer integration with the world economy. However, both the theoretical arguments and the empirical evidence bearing on these issues are far more complex. Significantly, even the East Asian experience does not in fact lend much support to the IMF/World Bank views on how successful industrial development can best be achieved. Sachs in his recent paper has a most instructive fable which is worth repeating at some length:<sup>29</sup>

Let us begin with a country example. Country “X” pegged its currency to the dollar in 1950, and kept the nominal parity absolutely fixed for more than twenty years. During the first fifteen years of this period (until 1964), foreign exchange was strictly rationed by a government agency, and the currency was always overvalued. Purchasing power parity calculations using home and US consumer price indices show a 60% real appreciation in the 20-year period. A Foreign Exchange and Foreign Trade Control Law of 1949 required that exporters remit all earnings to the government within ten days, making the government the only legal source of foreign exchange, a privilege jealously guarded by the bureaucrats in charge of foreign exchange rationing. No explicit rules governed the distribution of foreign exchange. Bureaucrats allocated foreign exchange to favoured sectors and clearly gave attention to particular firms that they were interested in nurturing. Government bureaucrats often retired to those firms at the end of their official careers. Rationing was so tight that private individuals were not allowed any foreign exchange for tourism abroad between 1950 and 1964.

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<sup>27</sup> De La Rosiere (1986), page 308.

<sup>28</sup> Balaasa et al (1986), page 124. Quoted in Fishlow (1987).

<sup>29</sup> Sachs (1987), pp. 295-296.

Domestic capital markets were highly regulated and completely shut off from world capital markets. The government was the only sector with access to international borrowing and lending. Foreign direct investment was heavily circumscribed, with majority ownership by foreign firms both legally and administratively barred. During the early to mid-1950s, about a third of external funds for industrial investment originated in loans from government financial institutions, at preferential rates that varied across firms and industries. These state financial institutions remained an important source of cheap financing until the 1960s.

The country in question, as will be familiar to many, is Japan. But the description sounds like many countries in Latin America, complete with overvalued exchange rates, foreign exchange rationing, restrictions on foreign direct investment, government allocation of credit, and so on. Moreover, this policy framework was in place for much of the “rapid growth period” in Japan (conventionally dated as 1955-73), which may arguably be the most remarkable two decades of a country’s economic development in world history. I begin with this example to urge on the reader a humble and inductive state of mind regarding growth-oriented adjustment. The policies of “outward orientation” in Japan, and in East Asia generally, have not been modeled on a free market approach as is frequently asserted.

As for the East Asia NICs, there is a large body of evidence that shows that in countries like Taiwan and South Korea the state has played a large and highly interventionist role. In relation to South Korea, Amsden (1989) draws attention *inter alia* to the following crucial aspects of the government’s industrial policy:

- i. the use of long-term credit at negative real interest rates to foster particular industries;
- ii. the “heavy” subsidization and the “coercion” of exports;
- iii. the strict control over multi-national investment and foreign equity ownership of Korean industry;
- iv. a highly active state technology policy.

With respect to Taiwan, Sachs (1987) points out that the country is more heavily dependent on state-owned industry than probably any country in Latin America with the possible exception of Venezuela. During 1978 to 1980, state-owned industry accounted for nearly a third (32%) of domestic capital formation in Taiwan, compared with 19.6% in Argentina, 22.8% in Brazil and 29.4% in Mexico.

## **VI.1 State-Owned Enterprise**

Turning from the general role of the state in promoting and regulating industrial development to the specific case of state-owned enterprises, the IMF/World Bank industrial policy proposals favouring the privatization of such industrial and commercial enterprises are not based

on systematic empirical evidence. It is often claimed by World Bank publications<sup>30</sup> that the public enterprise sector in the developing countries is over-extended and that its performance has been poor. However Kirkpatrick's (1986) recent survey of the subject comes to the conclusion that there is no evidence to support the view that intra-country differences in overall economic growth can be explained by differences in the size of the public sector. More significantly, Kirkpatrick's careful consideration of the evidence on productivity performance of state-owned enterprises in a number of different developing countries suggests that "an unqualified assumption that public enterprise performance is 'unsatisfactory'" would be "injudicious."

Similarly, in relation to the Sub-Saharan African countries, Green (1985) notes: "on almost any criteria...their [the public sector enterprises] efficiency of performance varies widely (wildly indeed) among and within countries; almost no generalizations are valid in that respect." He points out that in Tanzania from the middle to late 1970s the large scale parastatal manufacturing enterprises had higher capacity utilization ratio and higher ratios of profits to output than the large private enterprises. He further reports that in 1983, analysis of several sub-sectors of manufacturing showed substantially higher ratios of average output value to foreign exchange for public than for private enterprises.

With respect to state-owned enterprises in the East Asian NICs Sachs (1987) concludes as follows: "The Asian experience does suggest however that successful development might be helped as much by raising the quality of public sector management as by privatizing public enterprise crisis or by liberalizing markets."<sup>31</sup>

## **VI.2 Import Liberalization and Export Promotion**

We next consider the IMF/World Bank policy proposals with respect to closer integration with the world economy. In addition to the promotion of foreign private investment, these proposals involve both import liberalization and export promotion. Import liberalization is supposed to make domestic industry much more efficient as well as promote exports. However both common sense and economic theory tell us that competition can be a spur to efficiency but it can also kill domestic industry. If domestic industry is in a weak state because of inadequate investment (as is the case in many developing countries today on account of their acute foreign

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<sup>30</sup> See the *World Development Reports* for 1983, 1987, and 1988. See also "The Berg Report on Sub-Saharan Africa," World Bank (1981).

<sup>31</sup> Sachs (1987), page 294. Even for the UK, where Mrs. Thatcher's privatization programme over the past ten years has won world-wide attention, Bishop and Kay (1988) found that on a number of different indicators, the performance of privatized enterprises during the 1980s has been no better than that of companies still under public ownership. They conclude that privatization was neither necessary nor sufficient for improvement in enterprise performance. Rather, Matthews and Kay suggest that the promotion of competition is a greater spur to enterprise efficiency than the transfer of ownership.

exchange constraints), precipitate import liberalization is likely to lead to deindustrialization. Moreover, in the short- to medium-term, such liberalization may also worsen the balance of payments, thus defeating the objectives of a stabilization programme.<sup>32</sup> Balaasa et al. (1986) have proposed for the Latin American economies that they should adopt a flat rate tariff of 10 to 20% over a five year period. Such a draconian programme of import liberalization was never adopted by Taiwan, South Korea, or Japan in the course of their highly successful industrialization. Evidence suggests that in these countries import liberalization was only implemented after successful export promotion had been achieved; furthermore, it was closely tailored to the strength of domestic industry.<sup>33</sup>

Advocacy of export promotion for the severely foreign exchange constrained economies of the South may appear non-controversial. There are however two issues that need further reflection: firstly, the method of promoting industrial exports; and secondly, the alternative of efficient import substitution. The World Bank puts primary emphasis on changes in the exchange rates as the main instrument for promoting exports. However, leaving aside the question of the efficacy of a devaluation for this purpose in normal times,<sup>34</sup> for the developing countries in the midst of an economic crisis, such a blunt weapon has the enormous disadvantage that it is likely to conflict with the requirements of stabilization of the economy. Stabilization may for example require a confidence building measure of a stable exchange rate rather than a fall in the exchange rate. Export promotion in these circumstances may be better achieved by selective

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<sup>32</sup> See also Sachs (1987).

<sup>33</sup> See further Sachs (1987), Lin (1985).

<sup>34</sup> On these issues see Kaldor (1978), Fishlow (1987), and Hughes and Singh (1988).

subsidies or the targeting of particular industries or firms by the government, as indeed was practiced in the past both by Japan and South Korea. However, such non-market methods are not approved of by the international financial institutions.

Turning to the second point, when the world economy and the world manufacturing trade are growing relatively slowly (see further below) and when there is increasing protectionism in the advanced countries in relation to Third World exports,<sup>35</sup> there is a fallacy of composition in the view that the developing countries, including important new entrants such as China, can all achieve a sufficiently high rate of expansion of manufacturing exports so as to be able to resume their long-term trend rates of overall economic growth.<sup>36</sup> In these circumstances, as Singer (1988) notes: “efficient import substitution may be as good if not a better alternative for many developing countries.”

## **VII. An Alternative Policy Framework for Industrial Development in the South in the 1990s**

### **VII.1 The Main Parameters**

Although the appropriate industrial policy for any individual developing country will depend on its particular circumstances, a realistic policy framework for the developing countries in the 1990s must, in my view, be based on the following main parameters:

1. Despite the setback to southern industry in the 1980s, there is a continuing social imperative for fast long-term industrial growth in the developing countries. As noted in Section III, the best estimates indicate that industry needs to expand at a long-term rate of 8 to 10% per annum if there is to be any reasonable chance of (a) providing employment to the South's burgeoning labour forces (increasing at an annual rate of about 3.5% per annum in countries like Mexico and Brazil); and (b) meeting the minimum “basic needs of the people” for food, shelter, health, and education over say a 20 year time-span. Thus it is socially necessary for the Third World's industrial revolution of 1960 to 1980, when industrial growth of more or less the required order was indeed taking place, to continue.
2. However, the fast growth of industry during 1960 to 1980 occurred in unusually propitious world economic circumstances. Up to 1973, the world economy enjoyed its “golden years” (1950-1973) of historically unprecedented growth of output, consumption, productivity and employment.<sup>37</sup> During this period, the volume of world trade in manufacturing expanded at a rate of about 10% per annum. Between 1973 and 1980, although the developed countries' economic growth was nearly halved compared with their 1950 to 1973 trend rate, the developing countries were able, by and large, to maintain their economic and industrial momentum mainly by their huge borrowings during the 1970s. This

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<sup>35</sup> See Chapter 2 of *World Development Report*, 1987 on this point.

<sup>36</sup> See Cline (1982) and Singh (1984).

<sup>37</sup> See Maddison (1982).

situation came to an end, as seen earlier, by the second oil price increase and the Volcker shock.

There are strong reasons to suggest that over the foreseeable future (say the next decade) the economies of the industrial countries and hence the world economy as a whole (as the OECD countries account for nearly 80% of the non-Communist world's GDP) will at best only be able to expand at their post-1973 long-term rate rather than that achieved during the Golden Age.<sup>38</sup> The slow growth of the world economy will have two significant implications for industrial policy in the developing countries. First, world trade and world demand for manufactures will expand at a slower rate than in the pre-1973 period. Secondly, the developing countries are unlikely to be able to recoup the terms of trade losses they have suffered over the last decade; even in the longer term, the relative commodity prices will continue to be weak.

3. As a consequence of these far-reaching changes in world economic conditions, a very large number of Third World countries, particularly in Latin America and Africa, are today faced not only with a short-term liquidity or a balance of payments problem but also with the necessity of long-term structural adjustment. Many countries are in fundamental structural disequilibrium in the sense that their economies are unable to generate sufficient exports to pay for the required imports at a rate of economic and industrial growth that will keep their per capita income constant, let alone one that will permit a steady rise in living standards. The correction of this disequilibrium requires major changes in the structure of national production, both agricultural and industrial.

## **VII.2 The Strategic Perspective on Industrial Policy in the 1990s**

Even in the industrially most underdeveloped Third World economies such as those of Sub-Saharan Africa, in the medium to long term industry will have to play a crucial role in the correction of the disequilibrium noted above. Two kinds of policy will need to be simultaneously pursued: (a) reducing the propensity to import, without impairing domestic productive capabilities; (b) enhancing the capacity to import through promotion of exports. As a consequence of the balance of payments crisis, as seen in Section IV, imports have been severely curtailed in the 1980s, particularly in the Latin American and Sub-Saharan African economies. However, this import compression has led to greatly reduced domestic production. What is required for the correction of the disequilibrium is a phased reduction over time in the import elasticity of production and hence major structural changes in the economy. Given the size of the structural disequilibrium in many of the developing economies, this efficient import substitution is at least as necessary as export promotion for future economic and industrial development in these countries.

More significantly, it must be appreciated that in the medium to long term, if the developing countries are to reach their socially necessary rates of growth in a slow-growing world

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<sup>38</sup> For a fuller discussion, see Glyn, Hughes, Lipietz, and Singh (1989).

economy, they will have to rely much more on domestic rather than world demand, on their own internal technological dynamism and on economic and technical cooperation amongst themselves. This does not mean that exports should be neglected; quite the contrary, in foreign exchange constrained economies they should be vigorously pursued through appropriate market (currency changes) or non-market (direct state assistance to particular firms or industries) methods, depending on the circumstances of a particular country. Moreover, an extension of migrants' remittances can also make a significant contribution to a country's foreign exchange earnings. Nevertheless, as argued in Singh (1984), the essential point is that with slow world economic growth, if the developing countries are to resume their golden years' growth path—their industrial revolution—the main dynamic will have to come increasingly from internal factors rather than from the external economy.

To illustrate with a specific example, consider industrial development in Mexico. During the 1960s (between 1960 and 1968), the Mexican manufacturing industry expanded at an impressive rate of nearly 9% per annum, with a rate of growth of productivity of over 3% per annum. A critical element in this successful industrial development was the low value of the import elasticity of manufacturing production—it was about 0.8.<sup>39</sup> However, towards the end of the oil boom years (1980-81), the value of this elasticity rose to 4 (i.e. whilst manufacturing production increased at a rate of about 6% per annum, the volume of imports rose by nearly 25%). This large increase in import elasticity not only contributed to the subsequent balance of payments problems, but there is evidence that it also harmed rather than assisted domestic manufacturing production. Since the crisis in 1982, the volume of Mexican imports has fallen sharply, but this has also led to a reduction in the rate of growth of manufacturing production from its long-term rate of 6 to 7% per annum to nearly zero over the period 1982 to 1988. Notwithstanding Mexico's oil resources and its success with non-oil exports in the 1980s, if the Mexican manufacturing industry is to re-attain its high long-term growth trajectory, the value of the import elasticity will have to come down to the level of the 1960s.<sup>40</sup> Singh (1986c) has argued that this would require *inter alia* a new technology policy and a purposive development over time of Mexico's capital goods industry. In capital goods production Mexico lags behind other semi-industrial countries such as India, South Korea, Brazil, or China. There is no reason either on the demand or the supply side why Mexico, through efficient import substitution, should not be able to further develop this crucial sector.<sup>41</sup> Turning to the strategic question of how "open" or how closely integrated with the world economy should a developing country's economy be, the answer clearly cannot simply be in terms of free trade and liberalization. Even modern neo-classical theory rejects this view: in a

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<sup>39</sup> See Brailosky (1981).

<sup>40</sup> See further Singh (1986c).

<sup>41</sup> See Singh (1986c).

world of imperfect competition, learning by doing and static and dynamic economies of scale (i.e. in the real world), the optimum level of trade for all countries is not free trade.<sup>42</sup> As argued in Chakravarty and Singh (1988) “openness” is a multi-dimensional concept; apart from trade, a country can be “open” or not so open with respect to financial and capital markets, in relation to technology, in science, culture, education, inward and outward migration. Moreover, a country can choose to be open in some directions, say trade, but not so open in others, such as foreign direct investment or financial markets. Chakravarty and Singh’s analysis suggests that there is no unique optimum form or degree of openness that holds true for all countries at all times. A number of factors affect the desirable nature of openness: the world configuration, the timing, the sequence, the past history of the economy, its stage of development. There may be serious irreversible losses if the wrong kind of openness is attempted or the timing and sequence are incorrect. The significance of the world configuration in this context cannot be exaggerated.

### VII.3 Policy Lessons from Past Industrial Development

Apart from the above general perspective on the medium and long-term industrial development in the 1990s, the developing countries must also learn from the successes and failures of their own industrial history over the last three decades as well as that of countries like Japan. The following lessons appears to be particularly relevant for the future:

1. Although it was noted earlier that privatization is neither a necessary nor a sufficient condition for improved performance, the efficiency of the state- owned industrial and commercial enterprises in many developing countries needs to be greatly enhanced if these countries are to achieve fast industrial growth. Aylen (1987) provides an interesting comparison (see Table 9 below) between two different models of public enterprises in developing countries, both producing steel. One is the Pohang Steel Company (POSCO) in South Korea and the other is the Steel Authority of India (SAIL).

**Table 9**

**Public Enterprises in Developing Economies:  
Organizational Models**

<b>Market Model</b>	<b>Bureaucratic Model</b>
Financial autonomy with emphasis on profitability.	Finances overlap with national budget. Losses accepted for social reasons.

<sup>42</sup> Krugman (1987).

Clear commercial and social	Confusion about objectives and objectives. political interference in decisions.
Operating independence.  concern with overall enterprise	Close scrutiny of input decisions (employment, investment) and attention to politically sensitive outputs (prices). Lack of efficiency.
Potential competition from domestic rivals and imports. market entry by potential	Tariff barriers and import licensing to limit competition. Legal restrictions prevent competitors.

Source: Aylen (1987)

POSCO represents the market model of organization while SAIL typifies the bureaucratic model. The contrast between the economic performance of the two countries could not be greater. POSCO is the most efficient steel producer in the world; it produced 467 tons of crude steel per man in 1986 compared with an average of 327 tons for Japan's five biggest steel producers. POSCO's efficiency advantage is passed on to its Korean customers. It charges its domestic steel consumers \$320 per ton—far less than the American or Japanese car makers who (according to POSCO) pay \$540 and \$430 respectively.<sup>43</sup> SAIL, by comparison, is grossly inefficient, with low productivity and high costs. Aylen suggests that "a significant part of the overmanning at SAIL is due to a superstructure of administrators absent at POSCO." Although cultural and other factors may explain some of the performance differences between POSCO and SAIL, the influence of organizational factors cannot be exaggerated.<sup>44</sup> Experience suggests that efficiency of public sector enterprises requires *inter alia* managerial autonomy, setting of clear economic targets, transparency of accountancy and, where possible, private sector competition.

2. The thwarted industrialization of Sub-Saharan African economies during the last decade has important lessons for the future.<sup>45</sup> These countries of course started, after their independence in the 1950s and early 1960s, at a much lower initial level of industrial and skill development, compared with the Asian and Latin American countries. The African governments were certainly right in their aim during the past two decades to attempt to change the structure of these economies by building up industry. However, the industries they established, although they may have been appropriate for the Golden Age, have turned out to be unsuitable for the new world economic conditions. The African economies diversified by moving from the production of mineral or agricultural commodities to the production of some manufactures. This reduced the

<sup>43</sup> The source of these data on POSCO is the *Economist* 14 May 1988.

<sup>44</sup> The Indian government is conscious of these problems and has in recent years been taking steps to improve the efficiency of the public sector enterprises. See Ahluwalia (1987).

<sup>45</sup> The analysis of the following paragraphs is based on Singh (1987).

imports of consumer goods, but overall dependence on manufactured imports increased. This was for two reasons: (a) the dependence on intermediate industrial imports did not decrease in most countries; and more importantly (b) capital goods' imports increased both as a consequence of the industrialization process itself and infrastructural development. As long as the world economy was expanding fast, foreign aid and other capital inflows were forthcoming, and equally importantly, the agricultural sector was functioning adequately, this pace of industrial and economic development was sustainable. However, once all these conditions changed simultaneously in the middle to late 1970s, the crisis was inevitable.

There were serious shortcomings in the model of economic development followed in Sub-Saharan Africa during the Golden Age, which were pointed out by observers at the time and which have become even more glaring in retrospect. In relation to industrial development, the most important of these were the lack of inter-sectoral linkages and in particular appropriate linkages with agriculture. As Gulahti and Sekhar (1981) note, African agriculture uses hardly any tools and implements locally manufactured by modern African industry. The main reason for this is that by and large African agriculture employs traditional technology, which does not use modern tools, or there are heavily mechanized pockets that use imported tractors and other heavy agricultural machinery. A more gradual and phased mechanization of agriculture as a whole will not only help improve agricultural productivity but also aid sustainable industrial development. The local production of simpler modern agricultural tools and implements will promote small-scale industrial development, which in turn will increase industrial skills and employment. Foreign aid and private foreign capital have played a leading role in establishing industry in Sub-Saharan African countries during the last two decades. Unfortunately, however, the African governments have tended to accept from the donors any industrial projects that the latter were willing to provide, regardless of linkages with other industries and suitability for the current state of the country's industrial development. In choosing industrial investment projects African countries must in future pay close and serious attention to the inter-industry and the agriculture-industry linkages and to the viability of such projects in an uncertain world economic environment.

3. Turning to the experience of the "large" semi-industrial countries, there is reason to believe that at the present world conjuncture, external liberalization for many of these countries is not just far from being the best policy but may in fact harm their industrial and economic development. Nevertheless there may be gains from internal liberalization, e.g. promotion of vigorous internal competition. Large countries have the advantage that they can substitute "domestic competition" for "external competition" without incurring the heavy penalties that external competition may impose on a foreign exchange constrained economy. In a recent paper on India's new industrial strategy, Singh and Ghosh (1988) have argued that the external liberalization policy that the Indian government has embarked on in recent years with the

encouragement of the World Bank carries with it a serious danger of leading to an unsustainable debt burden, economic failure, and low growth of output and employment. Instead of further import liberalization and a greater integration with the world economy, Singh and Ghosh propose an alternative policy of more internal competition, greater internal technological development and a reduction in the propensity to import capital goods.

4. There are some important lessons for small industrial countries as well from the experience of the last quarter century. Small countries must necessarily rely on trade and specialization in order to achieve industrial development. There have therefore been a number of schemes for the establishment of common markets of contiguous countries to promote these aims. However, these integration schemes have not been conspicuously successful to date. The main reason is the large difference in the level of development of the various countries; in a common market with internal free trade, the more developed regions or countries have a tendency to develop even further without commensurate development in the less developed member countries (Kaldor, 1978). Nevertheless, industrialization in smaller developing countries does require much more intra-developing country trade; if it is planned, this is more likely to aid the development of all participating countries than free trade. Thus, with the widely varying conditions of industrial development in the small countries, for integration schemes to be successful, what is needed is not so much the creation of a common market as the coordination of trading, industrial and indeed macroeconomic policies of the participating countries. As the history of the development of the European Economic Community shows—from its initial beginnings in the early 1950s with six countries participating in the production of only steel and coal to its present state of wide ranging economic integration among twelve countries—such economic cooperation can only occur with political will and over time. In view of the very large possible gains from economic and technical cooperation, the small developing countries, despite all the difficulties they have experienced in the past, should therefore persist with their endeavors in this direction.

### **VIII. Summary and Conclusion**

This paper has surveyed the state of industry in the South in the 1980s in a long-term perspective. It has been argued here that the industrial crisis in the developing countries during this decade has been caused overwhelmingly by world market forces. The superior performance of the Asian countries in the 1980s is not due to their greater openness, but happened because they were less subject to interest rate, demand, and capital supply shocks. The Sub-Saharan African countries, which have a rudimentary level of industrial development and are mainly commodity exporters, have been subject to far greater terms of trade shocks. They have also suffered disproportionately from other external factors—drought and war.

It is also suggested here that the abrupt interruption in the 1980s of the industrial revolution, which was taking place in the countries of the South during the previous two decades, cannot be explained in terms of microeconomic or supply side inefficiencies or an *ex ante* misallocation of resources. Nevertheless, the paper argues that although inefficient resource utilization is not the cause of the crisis, more efficient allocation and employment of resources will be necessary for the southern industries to get out of the crisis.

The paper points to serious flaws in the industrial policy proposals of the international financial institutions—privatization, deregulation, liberalization, and closer integration with the world economy. The World Bank, the IMF and many mainstream economists often appeal to the industrial success of the East Asian NICs to support their policy programme. The paper suggests that the proper reading of the Japanese and East Asian experience lends scant support to the extensive liberalization policies currently recommended by the Bretton Woods institutions.

An alternative perspective on industrial policy for the developing countries is set out for the 1990s. This is predicated on the following postulates: (i) there is a compelling social imperative for the southern industries to expand at a long-run rate of 8% or more per annum—the kind of rate actually achieved during 1960 to 1980; (ii) the world economy during the next decade will grow at its slow post-1973 trend rate rather than the rate that obtained during the Golden Years 1950 to 1973. There is therefore a daunting agenda before the industrial policy makers, managers, and workers in the Third World. The paper outlines some of the essential elements of this agenda.

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**TABLE 7**

**Incremental Capital Output Ratios in World Market Economies at 1975 Prices**

	<b>1960-65</b>	<b>1965-70</b>	<b>1970-75</b>	<b>1975-80</b>	<b>1960-70</b>	<b>1970-80</b>
World market economies	4.1	4.7	7.1	6.4	4.4	6.7
Developed economies	4.3	5.1	8.3	6.7	4.7	7.4
Developing countries	3.2	2.9	3.8	5.4	3.0	4.6
Developed economies						
North America	4.1	6.9	7.9	5.7	5.4	6.6
Africa, Asia, and Oceania	3.3	3.1	8.1	7.0	3.2	7.5
Europe	4.8	5.2	8.8	7.6	5.0	8.1
Major industrial economies	4.2	5.2	8.4	6.4	4.7	7.2
Other developed economies	4.4	5.0	7.8	8.8	4.8	8.2
European Economic Community	4.9	5.2	9.2	7.3	5.0	8.1
Developing countries						
Latin America and the Caribbean	3.5	3.4	4.1	5.5	3.5	4.9
Africa	2.7	2.5	6.2	4.8	2.6	5.2
West Asia	1.6	1.7	2.0	10.7	1.6	4.5
Asia and the Pacific	4.5	3.3	4.1	4.1	3.7	4.1
High-income	2.8	2.6	3.6	6.1	2.7	4.8
Medium-income	2.8	3.3	3.8	4.4	3.1	4.2
Low-income	6.1	3.5	4.9	4.6	4.3	4.7
Least developed	4.1	6.1	5.2	4.0	5.1	4.4
Capital surplus energy exporting	0.9	1.0	1.9	13.3	1.0	5.2
Other net energy exporting	2.8	3.0	4.1	4.5	2.9	4.4
Net energy importing	4.2	3.5	4.2	5.1	3.8	4.7
Petroleum exporting	1.9	2.0	3.2	6.0	2.0	4.7
Newly industrialized	3.7	2.7	2.9	4.4	3.1	3.7
Agricultural product exporters	4.8	3.8	5.2	5.7	4.2	5.5
Mineral product exporters	2.8	3.7	7.1	6.3	3.3	6.6

Source: U.N. Reproduced from Raj (1984).