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EXPORT PROMOTION POLICIES IN DEVELOPING  
 COUNTRIES <sup>★</sup>/

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 exclusively their responsibility and do not necessarily coincide  
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1. The first part of the document discusses the importance of maintaining accurate records of all transactions and activities. It emphasizes that this is essential for ensuring transparency and accountability in the organization's operations.

2. The second part of the document outlines the various methods and tools used to collect and analyze data. It highlights the need for consistent and reliable data collection processes to support informed decision-making.

3. The third part of the document focuses on the role of technology in modern data management. It discusses how advanced software solutions can streamline data collection, storage, and analysis, leading to more efficient and accurate results.

4. The fourth part of the document addresses the challenges associated with data management, such as data quality, security, and privacy. It provides strategies to mitigate these risks and ensure that data is used responsibly and ethically.

5. The fifth part of the document concludes by summarizing the key findings and recommendations. It stresses the importance of ongoing monitoring and evaluation to ensure that data management practices remain effective and up-to-date.

## INTRODUCTION

A suitable strategy for the promotion of non-traditional exports can help to overcome some of the most serious problems of developing economies, such as excessive fluctuations in export income, possible deterioration of the terms of trade, smallness of the domestic market with its consequent unfavourable effect on the efficiency of industrial activities, and chronic shortage of external resources.

In the middle of the last decade, some Latin American countries began to apply aggressive outward-looking development strategies involving policies aimed at stimulating non-traditional exports. In some of these strategies, a certain change in mentality was discernible in the sense that foreign markets were now considered as an important variable in the design of new investment projects. This explains, even though only partially, why Latin America's exports no longer consist only of primary commodities but are now beginning to be made up to an appreciable extent of manufactures. Thus, industrial goods amounted to 13 per cent of the total sales of the region to the rest of the world in 1974: three times their share in 1950.

After the initial impulse, doubts have arisen about the cost of such policies and the significance of the benefits obtained. Furthermore, experience has shown the developing countries that the international markets for certain products suffer from defects which make it difficult to secure a major increase in exports on conditions which are beneficial and profitable to the exporting country. These considerations indicate that the development of exports must not be based on the proliferation of every kind of incentive without taking into account the repercussions that this can have on the rest of the economy, nor should it consist solely of the mere manipulation of exchange policy.

A strategy designed to contribute to the integral development of the national economy calls for a more elaborate approach to export promotion policy. It is in this context that public policies in general and those aimed at promoting sales abroad in particular must

/be situated.

be situated. They must be based on an examination of the role to be played by exports in the national economy, the objectives to which exports are to be subordinated, and the most effective tools and mechanisms for achieving this.

Chapter I of the present study examines the objectives to which the development of exports must be subordinated. Chapter II analyses the three categories in which we have grouped policies for the promotion of non-traditional exports: equalizing-compensation policies; negotiation policies; and over-compensation policies. The consequences of such promotion for national development, however, depend primarily on the instruments used and the manner in which they are employed. Just as in other areas of economic policy, there is a wide range of tools and action mechanisms which can be used to promote exports.

The selection of the particular set of these instruments to be used and the extent to which they are to be employed will be determined by the objectives pursued, by the nature of the external markets aimed at, by the degree of autonomy as regards the use of specific mechanisms and by the repercussions which they may have on the rest of the national economy. In this study, these instruments are not described and examined in an abstract manner. On the contrary, the inevitable preselection of emphasis involved in any analysis will be placed within the framework, as far as possible, of the type of specific problems characterizing the Latin American countries and the consideration of the form most often assumed by export policies in the region.

The various instruments can be grouped, according to the bodies which are involved in their design and application, into internal and external instruments. Among the first category are exchange, import, fiscal and financial policies, which affect the conditions of production and consumption of exportable goods. These are considered in Chapter III. The other series of policies, which act within the external framework in which the exports are carried out, concern marketing policies and policies which seek, through bilateral or

/multilateral negotiations,

multilateral negotiations, to achieve more stable and speedy access by national exports to foreign markets. These matters are dealt with in Chapter IV. The study concludes with some general recommendations for the design of a policy in keeping with a global national development strategy.

## I. TARGETS OF THE POLICY

Many developing countries, including the Latin American countries, have made intensive efforts during the last few decades to substitute imports. In recent years, a critical view of this has become more widespread which maintains that this process should have given more attention to considerations of the efficient allocation of resources and should therefore have assumed a more selective nature, promoting greater vertical integration in certain sectors. The criticisms of the form and intensity assumed by import substitution arose simultaneously with observation of the fact that the continued advance of this process within the limits of national markets was running into increasing limitations.<sup>1/</sup> The combination of these two circumstances has gradually increased the concern to promote the growth of exports.

It would therefore appear that there is a very clear distinction to be drawn between import substitution and export promotion. In reality, however, this is so only in certain circumstances, depending on the policy instruments used. Thus, a substitution policy operating under excessive protection cuts off the national market from the external market and discriminates against production for export by leading to over-valued exchange rates and by giving exports using imported inputs a negative level of effective protection.

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<sup>1/</sup> See, for example, CEPAL, "Some conclusions on integration, industrialization and economic development in Latin America", Economic Bulletin for Latin America, Vol. 19, Nos. 1 and 2, pp. 65 and 66. This paper recognizes that "Criticism is quite justifiably levelled at the ... poor degree of efficiency of many industrial activities that have only been able to expand thanks to strong and indiscriminate protection". It goes on to say, however, that "this does not mean, however, that the pendulum should now be allowed to swing to the opposite extreme of ignoring the obvious progress that has been made in industrialization and development ... thus allowing countries to start exporting manufactures".



Import substitution, however, often constitutes a prior step to the development of new exports of manufactures for which the domestic market serves as a supporting base.<sup>1/</sup> This reduces the uncertainty experienced by domestic producers when venturing into new markets, and this is particularly important in the case of newly-established activities and exports of manufactures which are not based on the exploitation of high-productivity national resources.

Integration processes expand the field in which import substitution can be carried on, one of the main means of securing this at the regional level consisting of the expansion of the exports of each member country to the markets of the other participating nations. These exports, directed towards markets with a degree of development similar to that of the exporting country, can constitute an intermediate stage of learning and improvement for the subsequent pursuit of markets - such as those of the industrialized countries - which are more difficult to penetrate but which are also much wider.

The growth of exports, just like import substitution before it, is not an objective in itself. Consequently, exports should be promoted to the extent that they contribute to national development and to the achievement of economic strategy targets. Because of the wide range of products which are capable of being exported, there may be some uncertainty about defining the objective of the policy. Thus, the policy can be aimed at total exports or merely non-traditional exports, or minor exports, or manufactures, or products with some more specific characteristics. In the final analysis, the category or characteristics selected will depend on the objectives pursued.

Changes in the level and composition of exports can have numerous effects on the national economy. Thus, for example, they can affect the balance-of-payments position and its stability, they

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<sup>1/</sup> It should be borne in mind, however, that in certain cases some changes in design and quality must be made to domestic products because of differences in consumption habits between the domestic and external markets.

can have different levels of impact in different sectors of production, and they can affect the fiscal budget, the level of employment and income distribution. The capacity of export policy to secure a given effect at each of these levels is very disparate, however. While the effect on the balance of payments can be direct and intense, the effect on income distribution will be of a more indirect and gradual nature.

It will be gathered from the foregoing that the export policy should be aimed at achieving those objectives where it has greatest influence. This does not mean that its other repercussions should be ignored, however. Even though such aspects as better income distribution and balancing of the budget are not primary objectives of an export development policy, in a developing country they should nevertheless condition the selection of the tools and mechanisms to be used in such a policy.<sup>1/</sup>

There are four objectives to which an export policy can contribute significantly: efficiency in overcoming external restrictions, reduction of instability arising from the export sector, improvement of the terms of trade, and increasing the contribution of manufacturing to national development.

1. Efficiency in overcoming external restrictions

It is well known that the shortage of external resources required to cover the imports vitally needed for the country's growth and for satisfying basic consumption is one of the most serious problems faced by the developing countries. Basically, these resources can be obtained in three ways: by generating greater exports, by intensifying the process of import substitution, or by receiving net inflows of foreign

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<sup>1/</sup> The greater a country's difficulty in achieving other objectives, the more the freedom of action for using a particular instrument to comply with a specific objective must be subject to strict conditions. The budgetary situation and income distribution are particularly difficult areas. Generally speaking, this aspect of the use of policy instruments is not considered in traditional economic policy theory.

capital through an increase in external indebtedness or new foreign investment. If there is a growing deficit on the real part of the external sector (exports and imports of goods and services), however, this cannot be compensated indefinitely through inflows of foreign capital. In order to maintain their independence of action, countries must therefore obtain the necessary external resources for their development by generating new foreign exchange income through increased exports and/or by freeing greater resources through import substitution.

An external sector strategy which aims to maximize the growth of national income should allocate resources in such a way that, when evaluated at social prices, the cost in terms of real resources of generating new foreign exchange income through greater exports is similar to that of freeing additional foreign exchange resources by substituting exports with national products. This is the classic condition for efficiency in the allocation of resources, which seeks to solve the external imbalance as effectively as possible.

A factor which will have a crucial influence on determining the emphasis to be given to either of these two ways of improving the availability of foreign exchange is the significance assumed in new investments or in the expansion of existing investments by economies of scale, which give rise to an increasing need to expand exports as the industrialization process proceeds, especially if the national economy is small in size.<sup>1/</sup>

Another important aspect is the degree of accessibility of foreign markets. It should not be overlooked that import substitution provides a protected market which cannot be interfered with by the actions of other countries, whereas integration and trade agreements provide a broader market than the domestic one and thus promote the exports of each participating country in a context of regional import

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<sup>1/</sup> Another way of expressing this is to say that substitution for the domestic market of a wider range of imported products generates growing social costs because of the greater importance assumed by economies of scale. See a short discussion on this subject in Bhagwati and Krueger, "Exchange control, liberalization and economic development", American Economic Review, May 1973.

substitution with negotiated access. This expanded market, in its turn, can facilitate a subsequent movement towards production for third countries, provided the instruments used in it do not adversely affect the position of those exporting to the rest of the world. It is not correct, however, to visualize the markets of third countries as being full of imperfections and the integrationist markets as being perfect. The forces which give rise to imperfections in the former are also present, although somewhat reduced by negotiations, in the latter.

The name given to the category of exports to be promoted or preferentially developed is no more than a semantic simplification. In many countries, traditional exports were made up of primary commodities of mining or agricultural origin which now show poor marginal profitability (although they may show high average profitability) which show great instability and dependence on variables outside the national decision-making process, and which face inelastic demand. It is for this reason that, although there are traditional exports which have desirable characteristics and whose production should be promoted, the term "non-traditional exports" has frequently been used as a synonym of the exports which should be promoted. This is obviously valid only as first approximation.

When designing an export promotion policy, however, it is necessary to be more selective in defining the category of exports to be encouraged, in the light of the objectives sought and the priority given to them. If the objective is to reduce the instability arising in the exporting sector, then promotion should be directed preferentially towards exports of products, or groups of products, with small income variance and destined for markets where there is stable access. If emphasis is to be placed on diversification, then "minor" exports are of interest. If the aim pursued is to try to avoid a deterioration in the terms of trade, priority should be given to exports whose demand has a high price and income elasticity. If what is sought is to increase the contribution made by the industrial sector to the economy, then promotion should concentrate on exports of

/semi-manufactures

semi-manufactures and manufactures. Finally, if the objective is to generate foreign exchange income at the lowest cost in domestic resources, then exports with the greatest social profitability are the adequate target.

An integrated view of social profitability or of the contribution made to national development must include all the examples mentioned in the preceding paragraph. Since each objective is not being pursued per se, but in the light of its contribution to national development, the intensity with which they are pursued must be determined by the priorities of the other goals. Consideration of the influences which each exerts on the other is one of the aspects that must play a decisive role in the design of the policies to be applied.

## 2. Reduction of instability of exports

One of the most striking features of the external sector of many developing countries is the instability of their export income, which can lead to both political and economic difficulties.

On the one hand, the balance-of-payments crises often caused by fluctuations in export income, with all their implications for the proper supply of essential products and for the level of domestic economic activity, represent a source of political instability. On the other hand, the instability of the export sector has represented a substantial economic cost for the developing countries,<sup>1/</sup> since it has prevented the establishment of a stable trend of capital formation; it has hindered the normal process of planning both at the central level and at the level of productive activities; it has led to the failure of many attempts to rationalize foreign trade; it has hindered the operation of monetary and fiscal policies, and it has given rise to great difficulties in domestic mechanisms for adjusting to such fluctuations, very often giving an impulse to domestic inflation.

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<sup>1/</sup> The literature on this subject contains extensive discussion of the benefits and costs associated with such instability. An up-to-date discussion of these arguments may be found in C. Diaz-Alejandro, "Trade policies and economic development", in P. Kenen (ed.), International Trade and Finance, Cambridge University Press, Cambridge, 1975.

The economic costs of instability manifest themselves at three different levels: directly at the levels of the exporting and producing enterprise and of the balance of payments, and indirectly through the transmission to the domestic economy of the adjustments required by the external payments situation.<sup>1/</sup>

In order to tackle the problems generated by instability there are two possible approaches: the first is to seek ways of reducing their cost, while the second is to tackle directly their causes. These approaches are complementary, and the best possible combination would be one whereby the marginal cost of each policy is comparable to the benefit associated with the reduction of instability. The level of operation of export sector stabilizing policies will depend not only on their implementation cost, but also on the preferences of the community as regards risks and uncertainty. In this respect it can safely be maintained that countries are risk averters and that the developing nations are frequently faced with practical difficulties in applying systems which will enable them to defend themselves against such fluctuations.

Instability of income may be due to changes in a country's supply or in the demand for its principal export product.<sup>2/</sup> In the first case, the variation in the volume placed on the international market will be of the opposite sign to the change in price, thus giving rise to a compensatory effect as regards the value of exports.<sup>3/</sup> In

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<sup>1/</sup> An interesting historical study is given in J. Levin, The export economies: their pattern of development in historical perspective, Harvard University Press, 1960.

<sup>2/</sup> The demand encountered by a country for a main export product is what has been called "excess demand", meaning that it is the difference between world demand and the supply made available by other countries exporting the same product.

<sup>3/</sup> The compensation will be insufficient and income will fall if the demand has a price elasticity which is greater than unity; the opposite occurs when the demand is inelastic. A demand with price elasticity equal to unity means that variations in the volume exported do not lead to any changes in export income.

the second case, which arises when there is a change in world demand or in the supply from competing countries, the volume exported and the price move in the same direction, thus giving rise to a double destabilizing effect on income. More often than not, the Latin American countries face crises due to falls in the demand for their products, so we will concentrate our analysis on this type of instability.

The cost of export income instability may be reduced through international reserve policies and through mechanisms for short-term external financing: the latter solution may involve both the use of the international finance market and the establishment by governments and multilateral institutions of compensation funds and financial safety nets.<sup>1/</sup> This means that the economic authorities, using their foreign currency reserves, apply a compensatory policy which prevents the price fluctuations from affecting the conditions in which the rest of exporting and importing activities take place. In this way it is possible to reduce the transmission into the economy of the fluctuations in the balance-of-payments position. Even so, however, this compensatory policy may cause instability in the monetary and fiscal sector. Thus, for example, an increase in external prices increases export reimbursements, and insofar as the sector does not belong to the State or is not suitably controlled, the increase in reserves will be accompanied by monetary expansion. Consequently, unless the monetary authorities can promptly control the creation of means of payments originating from other sources, it is desirable that the reserve compensatory policy should be carried out in combination with policies aimed at stabilization of export income. This calls for a system of taxes and subsidies or compulsory savings and credits which

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<sup>1/</sup> See, for example, JUNAC, "Notas sobre un fondo común de reservas para el Pacto Andino", CMC/III/dt/7, November 1974, and CEPAL, Possible features of a financial safety net for Latin America, Santiago, July 1975.

concentrates in the hands of the treasury or the monetary authorities the responsibility for compensating businessmen for fluctuations in the prices (in national currency) of the products they export.<sup>1/</sup>

The maintenance of international reserves has a cost which is represented by the difference between the social profitability of the use of such resources in the national economy and the income which would be obtained if the country invested these resources with a sufficient degree of liquidity in the international capital market. Compensation funds and financial safety nets are equivalent, conceptually, to the collective maintenance of reserves, and they can substantially reduce the cost of this. Furthermore, the establishment of common reserve funds may also help the participating countries to improve their conditions of access to the international capital market, since the use of this mechanism would strengthen their credit worthiness and thus remove one of the main obstacles to greater use by them of such markets.

The vulnerability of the export sector can be reduced basically through the diversification of products and markets, and this process can be promoted through the adoption of suitable domestic policies. The first of these aims calls for the preferential promotion of the export of those goods which provide the least unstable income.<sup>2/</sup> The second of these aims calls for the granting of stimuli to exports directed to new markets. A third alternative, which unavoidably

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<sup>1/</sup> The economic significance of export income stabilization also depends on the form of organization and ownership of the producing enterprises, which can range from small domestic producers to big foreign-owned firms.

<sup>2/</sup> In some cases, the diversification of the products exported by a country might actually result in greater concentration for Latin America, as might occur, for example, if some countries decided to include coffee, sugar or copper in their new exports. This is not of great importance, however, since the region's sales to the rest of the world display considerable diversification and the instability of their average prices is appreciably less than that of the exports of the countries taken separately.



involves the participation of other countries, is that of stabilizing international prices through the regulation of markets by producers and/or consumers.<sup>1/</sup>

It has been observed that the prices of primary commodities suffer from greater fluctuations than those of manufactures. This instability is due both to fluctuations in demand, as a result of the economic cycles in the industrial countries (as in the case of mineral products), and to abrupt changes in supply (as in the case of agricultural products). The price fluctuations are amplified by the characteristic inelasticity of supply and demand of primary commodities. Thus, the fluctuations in the prices of the main export products not only directly create difficulties in the development of the branches of production affected - an effect which has to be taken into account by businessmen when calculating profits - but are also transmitted, mainly through their repercussions on the balance of payments, to all national activities connected with the external sector. These negative effects must therefore be taken into account when comparing the cost of obtaining greater foreign exchange income through increased investment in traditional exports with the cost of securing the same objective through the promotion of new lines of production and sales to the exterior.

Consequently, going beyond the market profitability, it is necessary to evaluate the cost and viability of these methods as means of reducing instability, so as to determine, on the basis of this information, the desirable degree of diversification. The market profitability of those products whose prices show the smallest fluctuations and even of those groups of products whose prices fluctuate

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<sup>1/</sup> A detailed list of recent proposals for market stabilization is to be found in UNCTAD, An integrated programme for commodities: A common fund for the financing of commodity stocks: amounts, terms and prospective sources of finance, TD/B/C.1/184, June 1975. In view of the well-known shortcomings in the international marketing of primary commodities, price stabilization could enable the net income of the exporting countries to be increased without this representing an additional burden for consumers.

in varying proportions should in principle be corrected by increasing the effective protection which they enjoy, so as to reflect in this manner their social profitability. Thus, selection of the blend of exported products can be compared conceptually to the search for the best possible type of investment portfolio, taking into account both the profitability and the risk of exportable goods.

Generally speaking, the most suitable category for this analysis is that constituted by exports which show the relatively most stable markets. In a first approximation, these can be indentified as being different from primary commodities.<sup>1/</sup> It may be noted, however, that it is likely that any diversification in the external trade of a country whose principal exports have a price showing a high degree of variation will tend to reduce the instability of the export price index, since the fluctuations of the new products placed on the world market will not be identical with each other nor similar to those affecting the main exports.<sup>2/</sup>

The diversification of markets will also help to reduce instability in the export sector. The political fragmentation of the world into sovereign States which reserve for themselves, within quite wide margins, the right to intervene in the control of their foreign trade means that international markets - which are nothing but the domestic markets of other countries - frequently suffer from imperfect or uncertain accessibility. Inasmuch as some of the reasons for the adoption of protectionist measures in a particular country are independent of those adopted in another country, the diversification of markets will reduce

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<sup>1/</sup> Nevertheless, a higher degree of processing of primary commodities will tend to make the export price more stable.

<sup>2/</sup> If the fluctuations in the prices of the new exports are identical with those of the traditional products, then the degree of instability will not change. If they show a similar variance, but a different sequence, then the instability will diminish, even though there may still be a positive correlation between them. If this is of negative sign, the most likely result is that instability will diminish, unless the variance in the new exports prove to be appreciably greater than those of the traditional ones.

the risk faced by the export sector as a whole and will give rise to an external economy which may not be completely internalized by the export enterprise, thus requiring the corrective action of the State.

The diversification of products and markets also helps to reduce the danger of unforeseen deterioration in the price of a major export and to increase the degree of independence with regard to the pressures which may be exerted by enterprises or governments of a particular country.

The degree and security of access to international markets therefore constitutes a key factor in the selection of the export promotion mechanisms to be used and the type of external markets towards which the efforts to sell national products are to be directed. An example of exports enjoying negotiated access is that of exports directed to countries which are associated in an integration process.

### 3. Improvement of the terms of trade

Increasing exports of primary commodities may, for a particular country and in a particular moment, represent the cheapest way of generating new external resources. The fact that primary commodities are "major" exports is a clear indication of the degree of comparative market advantages which they have had so far.<sup>1/</sup>

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<sup>1/</sup> These advantages have often been enjoyed only partially by the country which owns the natural resource in question, since a considerable part of the economic advantage has been appropriated by the transnational enterprise exploiting the resource. In this context, therefore there would be two alternative ways of measuring the terms of trade: one which considers the prices of the goods at the moment they pass through the customs post, and another which measures the income earned by nationals of the country. The recovery of control over natural resources or the establishment of stricter or more rational manners of treating foreign investment make possible the improvement of the terms of trade, as quantified in the light of the second criterion.

However, if the country (or a group of exporting countries which co-ordinate their politics in this respect), has some degree of monopoly power in the international market - i.e., if its "major" export product enjoys a demand which does not have infinite elasticity - the maximization of the benefits which can be obtained may perhaps call for the restriction of supply with the object of securing an improvement in the terms of trade. Similarly, in a dynamic context, the concept of "immiserizing growth" <sup>1/</sup> indicates that in some cases the fact of making new investments in a product for which there is an inelastic external demand may, as a result of the intensity of its negative impact on the terms of trade, lead to a lower level of well-being than that initially enjoyed.<sup>2/</sup>

Under the title of "optimum tariff argument", this possibility has received great emphasis in the pure theory of international trade, but it has been practically ignored by some specialists as an explanation of the changes in the terms of trade as between primary commodities and manufactures. The recent example of the oil-exporting countries, however, which have - at least in the short run - substantially increased the resources received for their main export product by taking advantage of the inelasticity of demand and control of supply, has brought out the perils and opportunities involved in these rigidities of the system. Perils for those exporting countries which are not capable of co-ordinating their actions and exercising a minimum control over their supply, thus leading, as new producers enter the market to a substantial deterioration in export prices. Opportunities for those countries which, fully conscious of their latent power in the

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<sup>1/</sup> See J. Bhagwati, "Immiserizing growth: a geometric note", Review of Economic Studies, Vol. 25, 1958.

<sup>2/</sup> It should be noted that it is also possible that there may be some degree of under-investment in the exploitation of primary resources. This could occur when the decisions on production and investment are taken by transnational enterprises whose global interests, which cover diversified goods and markets, do not coincide with those of the countries where they operate. After a process of nationalization, therefore, it may be necessary to make new investments in these products.

commodity markets, are capable of uniting their political will and the technical capacity to apply it, in a unilateral or negotiated form as the case may be, with the objective of increasing their share of the benefits generated by international trade.<sup>1/</sup>

The foregoing argument in no way signifies any rejection of the importance of exports of primary commodities, which will long continue to be the main source of external resources of the developing countries and will therefore call for priority attention from the economic authorities. Rather, since this argument aims to point out the undesirability of concentrating investment resources solely on the "major" export branch, it is an argument in favour of the diversification of exports.

The categories of exports which should be promoted in keeping with these objectives are those whose prices, for the country concerned or for a group of countries acting in co-ordination, are not significantly affected by the amounts sold. The elasticity of the (excess) demand encountered by these exports will depend, among other variables, on the elasticity of world demand for the product and the percentage of total world trade represented by the production of the country or group of countries in question. It will therefore most probably be the "minor" exports which will encounter prices which are not affected by the level of sales.<sup>2/</sup> These exports may include

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<sup>1/</sup> A theoretical analysis of the forms which might be assumed by the commodity trade in order that this might constitute one of the mechanisms for redistribution of the benefits generated by international trade is to be found in J. Piñera, "World income redistribution through trade", doctoral thesis, Harvard University, 1974.

<sup>2/</sup> There are exceptions, which correspond to minor exports based on natural resources peculiar to the region. The marketing is often so imperfect, however, that the policy of the exporting country, rather than consisting of any attempt to regulate the volume of sales, must consist of intervening in the export process through the establishment of new marketing channels or minimum export prices.

products of industrial, agricultural or mining origin, always provided that they do not constitute a high proportion of the respective international transactions.

4. Increased contribution by the industrial sector to development

Industrialization has constituted a major objective of the development strategies of most of the Latin American countries. In trade policy, import substitution played an active role in past decades. The progress which has been made in this respect, and also the recognition of the increasing importance of economies of scale, give rise to the need to seek broader markets in order to continue industrialization. In addition to the economic arguments in favour of the development of manufacturing, the theoretical literature has produced studies based on the hypothesis that the under-developed nations are seeking industrialization as an objective per se.<sup>1/</sup> The expansion of exports of manufactures can play a positive role in both these contexts.

Various economic arguments can be adduced to justify the promotion of particular industrial activities (including agro-industries) in the developing countries, insofar as certain desirable characteristics of their production processes, such as for example the creation of technologies which can subsequently be disseminated and the absorption of unemployment, are present to a greater degree than in other sectors of the economy. Such characteristics frequently constitute "externalities" which are not fully reflected by the system of market prices. This leads to the need to correct the signals given, in order to eliminate such distortions. The strength of the incentives must therefore depend on the size of the gap between social and market values.

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<sup>1/</sup> Two very well-known articles in this respect are those of C. Cooper and B. Masell, "Towards a general theory of customs unions for developing countries", Journal of Political Economy, 1965, and H. Johnson, "An economic theory of protectionism, tariff bargaining and the formation of customs unions", Journal of Political Economy, 1965.

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Furthermore, the recent history of the economic development of the Latin American countries suggests that the public authorities tend to favour a higher level of industrial production than is warranted by the indications of the market. It is probable that in many cases, this is not a non-economic bias but an intuitive awareness that greater industrialization can contribute in various ways to more rapid economic development. It is difficult to distinguish between the two aspects, but there is no doubt that the more objectively the contribution of the sector is viewed, the more efficient the policy directed towards its development can be.

Accepting, for the purpose of the analysis, that such a preference exists for a level of industrialization beyond that which can be supported by economic arguments, it is evident that exports can make this course less costly. Because of the substantial economies of scale involved in many industrial processes (particularly in those on which this preference tends to be based), a model oriented towards the production of manufactures for external markets, both in the region and in third countries, will have a lower cost than that of industrial development of a substitutive nature oriented exclusively towards satisfying domestic demand.

In various Latin American countries there is serious under-utilization of the installed capacity in the manufacturing sector, partly as a result of a set of distortions which prevent it being utilized in a more efficient manner and of the limited size of the domestic market.<sup>1/</sup> The seriousness of this phenomenon becomes even more obvious if the concept of multiple-shift working is included in

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<sup>1/</sup> The Center for Latin American Development Studies of the University of Boston is carrying out a systematic study at both the theoretical and the empirical levels on the problem of the utilization of installed capacity, and the initial conclusions confirm this statement. See D. Schydrowsky, "Capital utilization, growth, employment and price stabilization", CLADS, University of Boston, October 1975.

the definition of installed capacity.<sup>1/</sup> If it is attempted to increase its utilization solely by the method of expanding domestic demand, two major limitations are encountered. Firstly, it causes an increase in import requirements which can only be satisfied if policies are adopted at the same time to divert domestic expenditure from other imports towards the purchase of national substitutes, and if greater exports are promoted, some based on a more intensive use of the existing installed capacity. Secondly, the size of the idle capacity in the various industrial sectors is very heterogeneous; in the face of the difficulties of adjusting the structure of demand to that of installed capacity with precision, exports facilitate the distribution of the production of the surplus sectors and thus diminish the imbalances between supply and demand. It is thus possible to design a strategy for the development of industrial exports which would use the excess installed capacity as one of its primary pivots. The incentives should be graduated in accordance with the degree of under-utilization, so as to avoid expansion of capacity in sectors which are not socially viable for the country. In other words, incentives should promote the utilization but not the expansion of the installed capacity, because the latter depends on factors of a different nature.

Exports of semimanufactures are the relevant category for analysis in this case. Exports of agricultural and mining origin, which although they may be minor or non-traditional exports do not represent industrial production and do not derive from activities involving high levels of under-utilization of installed capacity, are thus excluded. It should be noted once again that the conceptual

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<sup>1/</sup> The use of multiple shifts entails fewer difficulties in large corporations than in family firms, and it is more economic in activities where the cost of capital represents a higher percentage of the gross value of production. Furthermore, the introduction of multiple shifts makes it possible to absorb a higher volume of employment with the same equipment, thus increasing the labour capital ratio. In some cases it also permits expansions of the installed capacity which would otherwise not be viable.



frontiers tend to be vague. Thus, just as there is no clear dividing line between substitution and promotion, neither is there one between sectors. The development of agro-industry or of the processing of mineral resources will generate domestic demand for the basic products; this will not occur, however, if the mechanisms of promotion encourage industrial production based mainly on imported components. The industrialization strategy therefore needs to be developed in accordance with the stage reached by the national economy, its imbalances and the supply of resources available to it.

## II. CATEGORIES OF POLICIES

In this chapter we will group the policies for promoting non-traditional exports into three categories according to the global purposes which are pursued. They are termed here as policies of equalizing-compensation, negotiation and over-compensation. The first seek to compensate for the discrimination against the non-traditional exports of the developing countries which derives from an excessive emphasis on import substitution oriented exclusively towards the national context, and also from the distortions caused by unsuitable economic policies and the imbalances which afflict the markets of these countries. The compensatory policies aim to treat these exports in such a way as to put them on a level with the other sectors of the economy, and they will thus be termed policies of equalizing-compensation. The policies of negotiation, for their part, operate on the conditions of access to the domestic markets of other nations, which are variables which the country cannot directly manipulate in an unilateral manner in accordance with its own objectives, but which can be a subject of negotiation between States. Lastly, the policies of over-compensation aim to establish preferential treatment for non-traditional exports by giving them more favourable treatment than that granted to the other sectors of the economy.

### 1. Policies of equalizing-compensation

For the efficient allocation of the scant resources which a country possesses, policies are required by means of which the social cost, in real resources, of generating foreign currency

/through exports

through exports can be made equal to that of releasing foreign exchange through import substitution. This formula allows various interpretations, however, with very varying implications for the formulation of the corresponding economic policies. The interpretations can be classified in three groups. One of these maintains that the optimum results are attained with free trade which involves an overall rate of exchange (including taxes and subsidies, if any) which is similar for each export and import. A second approach takes into account the instability of the international markets, particularly of traditional exports. A third interpretation, which is more elaborate and forms part of the theory of development, attempts to make allowance for the various imbalances which characterize the developing economies in the formulation of policies of substitution and promotion. The three approaches are considered below.

For various reasons, the Latin American countries have followed a policy of import substitution at the national level 1/ which has provided the activities involved in this process with high effective protection.2/ The range of policies employed reduced the demand for imports and eventually made possible the maintenance of a rate of exchange which was lower than that which would have prevailed without such a policy, which in fact has discriminated against exportable goods 3/ and import substitutes which receive low tariff protection.4/

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1/ See CEPAL, "Políticas de comercio exterior en América Latina: origen, objetivos y perspectivas", E/CEPAL/L.117, April 1975.

2/ See National Bureau of Economic Research, Foreign trade régimes and economic development (in the press), volumes on Colombia, Brazil and Chile, prepared by C. Díaz-Alejandro, A. Fishlow and J. Behrman, respectively.

3/ This discrimination tends to have more effect on the supply of minor exports. The corresponding elasticity tends to be greater when the percentage of production destined for the external market is lower.

4/ It should be noted that this lower rate of exchange also had the effect of extracting quasi-rents from the export of raw materials. Where this is developed through foreign investment, it produces a redistribution of income from foreigners to nationals; otherwise, it produces an effect of domestic redistribution.

/Consequently, when

Consequently, when formulating foreign trade policies the interaction between these aspects cannot be ignored: protection of the import substitution sector means discrimination against the exporter.<sup>1/</sup> Furthermore, the tariffs levied on the inputs used by the exporting activities and the higher price of the national inputs which are protected by high tariffs affect the costs of production and create negative effective protection for these activities.

The discrimination referred to has meant that the resources procured by the sector have been of a sub-optimum level,<sup>2/</sup> making the generation of industrial exports more difficult and producing what has been called the "illusion of industrial inefficiency".<sup>3/</sup> To some extent the industrial sector seems to have been "inefficient" because of the protectionist and exchange policies which have been in force; however, with a favourable rate of exchange some branches of manufacturing activity could be in a position to expand their exports.

It could be risky to end the analysis at this point. A superficial view would provide grounds for maintaining that the recommendation which emerges from the analysis is that a trade policy without State intervention should be pursued by the developing countries,

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<sup>1/</sup> According to the Lerner theorem of symmetry, a uniform tax on imports has the same long-term effect on the allocation of resources as a tax on exports. It should be borne in mind that in the real world of n goods, the distinction between import substitution goods and exportable goods is less precise, as there are products which can possess both characteristics. The distinction is clear in the case of the segmentation of markets: that is, when imports substitution operates exclusively for the domestic market and with very high protection, in combination with exports which are not very diversified and are based on primary products with a low level of processing.

<sup>2/</sup> Consideration of the studies on the effective protection given to various categories of exports confirms this statement. See B. Balassa and associates, The Structure of Protection in Developing Countries, John Hopkins Press, 1971.

<sup>3/</sup> See D. Schydrowsky, "Latin American trade policies in the 1970s: a prospective appraisal", Quarterly Journal of Economics, May 1972.

through the unilateral elimination of the controls which the respective governments apply to their trade exchanges.<sup>1/</sup> However, all that can strictly be deduced so far is that the policies considered have discriminated against the expansion of exports. To make policy recommendations it is necessary to take the analysis further.

Although the preceding argument should be taken into account in devising an export policy, it is of limited scope, because it only covers the compensation of discrimination arising out of a policy of import substitution, without going into the origin of that policy. As was pointed out at the beginning of this section, however, in the real world there are other sources of discrimination originating both in the instability of the international markets and in the imbalances and distortions of the developing economies. Consequently, a broad concept of equalizing-compensation would require the establishment of mechanisms to neutralize the effects of these distortions.

Our analysis here concentrates on "second-best" considerations. This is because some distortions (such as those associated with external economies or dynamic external factors) disappear only with development; others are linked with the conduct of foreign countries or decision-making units (as in the case of oligopolistic or unstable foreign markets, for example), while others can only be partially removed (as occurs with unemployment in some economies). If the State has difficulty in securing new fiscal resources it must take this restriction into account in the combination of subsidies and tariffs it selects. It is only when this limitation does not exist that subsidies constitute the first-best alternative.

With regard to unstable external markets, an adequate strategy should include, in addition to an exchange policy guided by the medium-term trends rather than the short-term balance of payments

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<sup>1/</sup> An alternative which appears to be more protectionist, but whose effects are similar to those of a policy of free trade, is to apply a tariff at a single rate on all imports and a subsidy of equal proportions on each export item.

situation, measures aimed at favouring those products which, because of their lesser degree of instability, do not provoke adverse external factors for the rest of the economy; such measures would thus promote a greater diversification of exports. One aspect of such a policy, by way of example, could be to apply a higher overall rate of exchange to minor exports than to traditional exports.<sup>1/</sup>

With regard to domestic disequilibria, the policy of equalizing-compensation required the use of incentives linked to the nature of the production processes, regardless of whether these are aimed at the domestic or the external market. In this case, the compensation must be linked with factors such as labour absorption and the generation of external economies.<sup>2/</sup> Thus, compensation, rather than representing a global incentive to all exports, should vary in accordance with the characteristics of the corresponding production processes. In other words, the costs and benefits have to be evaluated at social prices. There is therefore no need for a categorical choice between exports and the substitution of imports; instead efforts should be made to attain the optimum level and structure of the resources which should flow towards production destined for each of the markets.

The subject of transport is another element of the analysis which is of great importance for the developing nations' trade in non-traditional items. The transport routes and price systems are conditioned by the traditional patterns of trade, and this becomes an artificial obstacle to the development of new lines of exports, particularly towards other developing countries, which the export policy must aim to remove. The inadequacy of transport services

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<sup>1/</sup> Various alternative ways of applying an exchange tax on major exports are discussed in E. Tironi and R. French-Davis, eds., El cobre en el desarrollo nacional, Ediciones Nueva Universidad, 1974, pp. 227-232.

<sup>2/</sup> In activities which involve economies of scale, the compensation referred to would more often tend to favour production for the external markets, leading then to a fall in average costs.

is very marked not only between nations in distant continents but also within the same region.

In sum, the policy of equalizing-compensation is based on a neutral approach according to which minor exports should receive preferential treatment under some policies, because otherwise the discrimination hurting would persist. Thus the policy of equalizing-compensation entails eliminating negative discrimination, but it does not involve granting favourable treatment.

## 2. Policies of negotiation

The framework within which the local enterprises carry out their exporting activities is determined by the economic policies of the importing countries and the behaviour of the economic agents which play a part in world trade, particularly the transnational enterprises.

As has already been pointed out, the external markets are no more than the domestic markets of the importing countries. As a result, it is not surprising that the conditions prevailing for various products and markets vary greatly according to the domestic policies of each buyer country, the degree of competition between importers, and the nature of the product involved. These conditions determine the degree of accessibility of each product to each market.

Markets can be classified, according to the form of access to them, as competitive, government-influenced, transnational-dominated, and negotiated. The nature of the conditions of access has implications for the formulation of policies since these conditions affect the intensity, speed and direction of the response of exports to the policy instruments. This list shows that, in the case of a number of products, State intervention may be required to facilitate the access of national exports to external markets.

The wide heterogeneity of the external markets encourages the concentration of sales in those which are best known to the exporters, so that there remains scope to improve the negotiating capacity and secure more favourable sales conditions for the country. In this

/sphere there

sphere there are three levels of centralized action: firstly, obtaining information on external markets and circulating it among current and potential producers; secondly, making national products known in external markets, and thirdly, identifying the areas for the concentration of these efforts.

The three levels are interrelated. In order to make progress at the first two levels, however, it is to some extent necessary to make a pre-selection of markets and products on which to concentrate the efforts of securing and disseminating information. Similarly, negotiations with foreign governments and enterprises also call for pre-selection. Because of the wide range of alternatives, some specialization in terms of markets and goods is called for in all these areas of action. One of the criteria which should be considered is that of diversification in both directions in order to promote stable growth of the value of exports and greater autonomy in the face of phenomena of external origin.

The external framework referred to has some characteristics which can adversely affect the non-traditional exports of the developing countries. The industrialized nations maintain tariff and non-tariff restrictions which hamper the access of manufactures from the rest of the world to their markets, and the device of graduated tariffs, with nominal rates which rise in line with the degree of manufacture, provides considerable effective protection to the domestic producers who operate in sectors which compete with the exports of the developing countries.<sup>1/</sup> Moreover, although the multilateral negotiations carried out in GATT have led to non-discriminatory tariff reductions, these have favoured goods which

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<sup>1/</sup> Empirical studies show that there is a (partial) negative correlation between the tariff system of the United States and the structure of its imports of manufactures from the developing countries. Furthermore, a positive correlation between tariff levels and labour-intensiveness has been found in the tariff structures of the United States and the European Economic Community. See M. Rahman, Exports of manufactures from developing countries, Rotterdam University Press, 1973, pp. 39-44.



are mostly traded among the industrialized nations. The average level of the nominal tariffs which these nations impose on the type of goods imported from less developed areas is almost twice as high as the level corresponding to their imports as a whole, while the effective tariffs are often double the nominal ones.<sup>1/</sup> Furthermore, when sensitive sectors of the economies of these countries see their interests affected, they press for the rules against export subsidies to be applied and, alleging the existence of such subsidies or of dumping, try to have compensatory tariffs or some other kind of restrictions imposed on imports. Finally, when faced with balance-of-payments crises, these nations have resorted to protectionist measures which, although concentrated on certain products, generate uncertainty and increase the risks run by the exporters in the developing countries.

Furthermore, some international markets are dominated by a few transnational enterprises which collect quasi-rents in the process of distribution and marketing and exercise their oligopolistic power to the detriment of the exporters of the developing countries. Although it is probable that the lessening of obstacles of governmental origin to imports leads to greater international specialization and increases trade flows, the measure can prove unfavourable for the developing nations if the increased trade mainly takes place between branches of the same corporation or group, without adequate regulation on the part of the host governments.<sup>2/</sup>

Broadly speaking, it could be said that there are two forces in the international markets which tend to act in favour of their improvement - namely, the reduction of tariff restrictions in the developed countries and the emergence of new transnational corporations which compete with those already in existence - and two

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<sup>1/</sup> See B. Balassa, Trade liberalization among industrial countries: objectives and alternatives, McGraw-Hill Book Co., 1967, p. 56.

<sup>2/</sup> See C. Vaitsos, Intercountry income distribution and transnational enterprises, Clarendon Press, Oxford, 1974.

forces which increase their segmentation, namely the increasing importance of trade between branches of transnational enterprises and the persistence of non-tariff restrictions in the industrialized countries.

Although it is difficult for individual exporters to change this situation, States are in a position to negotiate more liberal conditions of access; to advocate systems of tariff preferences; to establish marketing enterprises jointly with other countries; to negotiate entry into certain markets by assuring the supply of scarce raw materials in return, or, lastly, to reach agreements providing for negotiated access, the most comprehensive examples of which are the processes of economic integration.

In a world where power politics are also important in economic transactions, policies need to make use of all the negotiating capacity of a country - or group of countries which are in some way associated - in order to create the most favourable external framework for its exports. Strictly speaking, the measures included in this category also tend towards equalizing-compensation. However, they do not affect the conditions and costs of production or the income earned per dollar of exports: instead they influence the volume of sales abroad and the conditions of prices and time scales. The cost of the State is entirely limited to that incurred during the process of negotiation.<sup>1/</sup>

### 3. Policies of over-compensation

The arguments in favour of providing incentives for non-traditional exports which go beyond equalizing-compensation and do not constitute a deliberate utilization of the national negotiating power in order to improve the external framework are either based on non-economic considerations, or constitute erroneous arguments, or form part of strategies aimed at achieving economic development through the creation of certain imbalances.

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<sup>1/</sup> Negotiation may imply lower fiscal income as a result of tariff concessions.

As regards the first type of argument, if the authorities have a "preference" for a greater degree of industrialization, disregarding the economic considerations already set forth, an additional subsidy may be established for all manufacturing production, including that destined for the external market. One particular aspect of non-economic "preferences" is that frequently seen when, with the aim of developing certain products, subsidies or exemptions are established which are sufficiently high to ensure that such products are manufactured.

Recently, within this same line of thinking, export promotion as such has acquired a status analogous to the indiscriminate substitution of imports. The equivalent of the absolute protection provided through quantitative restrictions or prohibitive tariffs on substitutable imports, is the proliferation of export incentives of all kinds. When this occurs, the danger arises that the lack of selectivity and moderation of a policy of this nature may lead to an inefficient diversion of resources towards exports, through their over-promotion, and may often result in high fiscal costs, as well as regressive redistribution, a meagre contribution to employment, and even transfers of income to foreign-owned exporting enterprises.

Another line of argument in favour of the over-compensation of exports aims at bringing about an artificial increase in the competitiveness of national production by subsidizing the actual costs which the country incurs. In order to justify the application of such subsidies it is argued inter alia that: (i) transport costs to the place of destination are high because of the distance between markets; (ii) other countries subsidize their exports of the same products, and (iii) the importing nations apply tariff restrictions which reduce the possibility of competing within their markets. The nature of each of these three cases needs to be carefully considered. In the first example, a distinction must be drawn between artificially high costs which can be reduced through an active transport policy and the argument of "incipient transport and marketing channels", which falls within the category of compensation policies, as was

/explained in

explained in the relevant section, whereas the high costs caused by the difficulty of reaching the markets of destination really do represent a genuine outlay of currency which increases the CIF cost (and reduces the FOB income).1/

A similar analysis can be made of the arguments relating to the export subsidies and import taxes applied by other countries. The essential point is whether these can be removed through some type of negotiation (bilateral or international) or whether they really are permanent. If they are likely to remain in force for a prolonged period, regardless of the policies of negotiation which are attempted, the granting of subsidies to national exporters to offset the effects of the actions of other nations will improve their competitive position, albeit at the expense of the fiscal budget and at some cost to the country. Thus, except in situations which are clearly transitory or in the case of production processes or goods which have some positive characteristics which the market prices do not reflect (the case of equalizing-compensation, there is no justification, from the point of view of contributing to national development, for granting subsidies aimed at relieving the exporter of costs which in fact constitute a real burden for the economy of the country.

The third group of arguments are more difficult to classify. They are based on the theories of "unbalanced development",2/ which lay stress on the inertia of the system, and their proponents recommend that financial over-compensations should be granted in order to attract resources towards the exporting sector more rapidly and intensively. This can indeed make possible a greater dynamism of exports, but at the cost of creating quasi-rents or capital gains for the exporting enterprises, including those of foreign origin

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1/ It is nevertheless obvious that it is always easier to produce for the domestic market. The costs of transport and international marketing constitute a natural protection for import substitution and a disadvantage to exports which does not need to be compensated.

2/ See A. Hirschman, The strategy of economic development, New Haven, Yale University Press, 1958.

which operate in the sector. The alternative is to spend the resources in excess of those required for equalizing-compensation on the promotion of exports through direct measures such as investment in marketing enterprises and in those producing exportable goods.

4. The importance of distinguishing between compensation and over-compensation

Various export policy instruments can be used both to compensate and to over-compensate. In this respect, there are no specific instruments which are exclusively associated with a particular category, since these categories are not identified by the mechanisms which are used in each case, but by the degree to which they are used compared with the initial discrimination existing against non-traditional exports.

The distinction we are making is relevant in terms of the political economics of the process of export promotion, in both the national and the international spheres. In the first of these spheres, the realization that a real devaluation of the rate of exchange and the use of other instruments to encourage exports do not constitute within certain limits, an unjustified subsidy, but merely the termination of negative discrimination, will reduce the level of resistance to these policies.

At the international level, the acceptance of the concept of equalizing-compensation policies would weaken the argument of some industrialized nations that the fact that the developing countries grant subsidies to their exports justifies the application of compensatory tariffs on these products in the markets of destination. Thus the concept of dumping should be reconsidered, taking into account the discrimination which exists against non-traditional exports, so that policies entailing compensatory subsidies do not constitute "unfair competition", but merely represent the neutralization of the repercussions of other economic policies and of the distortions in the markets of the developing countries on their exports. The

GATT rules and the new United States Trade Act contain clauses which provide for the imposition of compensatory duties on subsidized exports, including those from developing countries. It should be stressed once again that in these countries there is a much greater initial bias against exports than in the industrialized nations, so that a certain level of subsidy is justified if it is not possible to eliminate the sources of discrimination. One of the aims of the policy of negotiation is thus to secure the acceptance of the distinction between justified and unjustified subsidies in the appropriate world forums.

/III. DOMESTIC

### III. DOMESTIC INSTRUMENTS TO PROMOTE EXPORTS

Domestic promotion policies can be grouped in four categories: foreign-exchange, import, fiscal and financial policies. They comprise various instruments with which the national government can directly affect the costs or incomes of exporters. We shall examine the common effects shared by different mechanisms, as well as the differences among them. In our analysis of each category of instruments, we shall distinguish between "global" and "differentiated" effects on exports. Because any subsidy or duty is expressed in monetary terms it can also be expressed in a foreign exchange equivalent. Consequently, the analysis will examine this common component of various instruments, but it will be focused on the specific effects of each instrument in other respects. In particular, they differ in their influence on the composition of production costs, on the degree of integration into the national economy and on the origin or destination of the financial resources mobilized with each instrument.

#### 1. Foreign exchange policy

Management of the exchange rate is the most global and neutral mechanism to affect the conditions of production and sale of exports.<sup>1/</sup> Nevertheless, its effects will differ according to the precise form in which it is done.

Let us consider first a static context, with a single exchange rate applied to all foreign trade operations. In these conditions, a change in its level will affect in a similar proportion the market price of all exports expressed in the domestic currency. The same would be true of national value added, measured in the same form.<sup>2/</sup>

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<sup>1/</sup> Because of its resemblance to systems of subsidies or differential taxation, the use of multiple exchange rates is included in the section on fiscal policy.

<sup>2/</sup> It is well known that the concept of "value added", without further qualification, is imprecise. It may mean: (a) value added in the transformation of a product; (b) value added in a company; (c) value added in the country on imported components; (d) gross or net values; and (e) at social or market prices. (Cont'd.)

Since the sale price and cost of imported components will tend to vary in the same percentage with an alteration in the exchange rate, the difference between the two, i.e., national value added at market prices, will vary in an identical proportion. On the other hand, if there are different exchange rates for exports and imports, a change which applies only to the former will also cause a similar variation in the prices of all exports, but will tend to affect national value added at market prices in inverse proportion to the domestic component of the exports goods. In other words, if the exchange rate for imports remains constant a rise in the exchange rate for exports will improve the relative position of goods with a high proportion of imported components, thus increasing the protection they really receive.

A subsidy which is proportional to the value of sales abroad discriminates in the same way.<sup>1/</sup> Differentiation in exchange rates among capital goods and flows and their services also leads to discrimination between different exports, according to the composition of their liabilities. One aspect of particular practical importance in the case of foreign participation in the ownership of exporting industries is the influence of foreign exchange policy on the level of integration of such companies in the national economy and on the volume of profits tapped by foreign capital.<sup>2/</sup>

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<sup>2/</sup> (Cont'd.) Normally when using this concept we are referring to the value added in the country, at domestic market prices, as the relevant variable for the exporter, and at external prices as the variable of social and balance-of-payments interest. Of course, serious measurement problems remain, such as (a) what the external price is, and (b) how to detect the "indirect" use of imported inputs.

<sup>1/</sup> A customs drawback system, up to the equivalent of a percentage of the value of exports, would have a similar effect.

<sup>2/</sup> See, respectively, Ffrench-Davis and Tironi (ed.) El cobre en el desarrollo nacional, Ediciones Nueva Universidad, 1974, pp. 227-232, and R. Ffrench-Davis, "Dependencia, subdesarrollo y política cambiaria", Trimestre Económico, 146, 1970.



Once the static context is abandoned, other implications of alternative foreign exchange policies appear. The main one concerns their stability, particularly in view of the widespread inflation in many developing countries and the fluctuating prices of their exports. Both (i) discontinuous adjustments of the nominal exchange rate in an inflationary situation and (ii) modifications which periodically follow the fluctuations of export earnings, cause irregular variations in the real exchange rate, which causes instability in the price ratios of foreign and domestic goods, with the ensuing uncertainty and disruptions in the domestic economy and the flow of exports. Both types of foreign exchange adjustments also tend to have a greater impact on new exports, made by companies whose markets are less diversified and which have greater difficulty in gaining access to the credit system. As a result, instability of the foreign exchange policy, while affecting all exports, has a bias against non-traditional exports.<sup>1/</sup>

It is therefore desirable both that the exchange rate should change continuously and simultaneously with the path of inflation,<sup>2/</sup> and also that it should be guided by the trend shown by the balance-of-payments projections, so as to prevent short-term fluctuations in the terms of trade being carried over into the national economy. A foreign-exchange policy which combines these two features has been called a programmed exchange-rate policy.<sup>3/</sup>

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<sup>1/</sup> The bias also affects domestically-owned companies in comparison with transnational corporations. The latter, because of the diversity of markets (geographic, product and financial) in which they operate can protect themselves better against foreign exchange risks, and bring forward or put off capital inputs or remittances in each subsidiary, while having rapid access to financial markets.

<sup>2/</sup> Besides avoiding uncertainty, this reduces the possibilities of destabilizing short-term flows, which result from speculation in the foreign-exchange market.

<sup>3/</sup> An account of the first foreign exchange experience of this kind in Latin America, in Chile in 1965, may be found in R. Ffrench-Davis, Políticas económicas en Chile: 1952-1970, Ediciones Nueva Universidad, 1973, chapter IV.

The alternative of allowing the exchange rate to be determined by the free play of the supply and demand for currency is not suitable for developing economies for various reasons.

In the first place, they are characterized by the concentration of exports in few products and by the great instability of the incomes stemming from the sale of exports abroad. The price of the currency would fluctuate too much, since it cannot be expected that, given the amount of financial resources needed, the private intermediaries should be able to cushion these fluctuations. The ups and downs create uncertainty and risks of substantial foreign exchange losses for those who operate in foreign currency, which cannot be reduced because of the absence of forward exchange markets.

Secondly, the few products which account for the majority of exports are in the hands of the State or of foreign investors, particularly in the case of mining resources. In the first case, the State would be a supplier of foreign exchange with oligopolistic features and would therefore exercise, willingly or not, a determining influence on the level of the exchange rate. In the second case, once again there would not be a competitive market; in addition, it may occur that the foreign investors have a supply of foreign exchange with a negative slope, which will lend its form to total supply, arriving in some cases at situations of unstable equilibrium. This may happen if the foreign investor provides foreign exchange only to pay production costs in local currency and his taxes, so that at a higher exchange rate he will return (supply) less foreign exchange and vice-versa.

Thirdly, the dominant position of the State in external financing operations (contracting and payment of external debt) means that the market is not atomistic and therefore very sensitive to the course of the external debt service, whose amount usually varies greatly over time.

Finally, the lack of private operators with the financial capacity and the desire to bear risks hinders the creation of an efficient forward exchange market. The lack of timely and correct

/information, and

information, and the economies of scale characteristic of such markets, creates further difficulties. National exporters and importers therefore have to seek coverage abroad for foreign exchange risks if they need it, which may be costly. Arguments of this kind show the undesirability of an exchange market without State intervention, and support the adoption of a policy which systematically manages the exchange rate.

Even when the foreign exchange policy indirectly affects the structure of exports, according to the reaction of the supply of each exportable good in response to changes in the price ratios, it provides an across-the-board incentive for the production of exportable goods. In this sense, the level of the exchange rate and the way in which it is managed constitute the overall framework for the policies of a selective nature. The three following sections are devoted to the study of the instruments which selectively affect either the incomes or the costs of exporters.

## 2. Import policy

Imported capital goods and inputs are used in the production of exportable goods. The terms on which they are imported therefore affect the conditions of production of the exports. The general level of import restriction and the treatment of the imported components of exports also affect the market equilibrium exchange rate.

There are countless forms of import control, and we shall therefore only study one instrument which directly affects import costs, and another which does so according to the volume of imports: examples of these are a tariff and a quota respectively.

### Tariff policy

The application of a tariff on imports - like a high multiple exchange rate, prior deposits or import taxes - raises production costs in proportion to the incidence of the imported component within total costs. In the case of inputs, it raises them directly; in the case of capital goods, its effect falls on depreciation costs and the cost

/of capital.

of capital. The counterpart of the higher production costs of activities which use imported components is a rise in the customs revenue of the public sector.<sup>1/</sup>

The rise in production costs, at market prices, affects the allocation of resources at two different levels: within each activity and among activities, also known as intra- and interindustrial effects, respectively.

With regard to intra-industrial effects, the change in the cost of imported components may affect the form in which the good is produced in the activity concerned. To the extent that viable technological alternatives exist, the tariff tends to encourage the substitution of the imported components by domestic inputs in capital goods, thus raising national value added: i.e., the part of the total value of the specific production in question, at external prices, which is generated in the country. Likewise, it alters relative prices in favour of labour in a degree which will depend on the proportion of equipment and machinery of external origin. Therefore, when it is technologically possible to substitute between labour and capital, the application of the tariff will tend to promote the absorption of labour.

In the second place, besides what occurs in the form of production within each company, the tariff increase will tend to raise the production cost of exportables, thus encouraging a decline in exports. The consequent disincentive to the production of goods

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<sup>1/</sup> This is true of revenue per unit imported. If the tariff is new, total revenue rises; in the case of an increase in the tariff rate, revenue will rise to the extent that the tariff elasticity of imports is less than one. As is well known, by definition this coefficient is notably lower than the price elasticity (due to the fact that the tariff is only a fraction of the price). Consequently, there is a wide range in which the first may be inelastic and the second elastic. This implies that with a rise in tariff rates, customs revenue will increase, while current expenditure on imports and monetary absorption fall.

which use intermediate goods subject to customs duties will be accompanied by the promotion of activities which are not intensive in imported components and capital goods.

Consequently, if it is at all possible to adjust the structure of production - a possibility which increases as the period of analysis lengthens - the tariff has allocation effects within each activity and among different activities.<sup>1/</sup> It should be stressed that the changes in the proportion of use of factors seem to be greater through changes in the relative importance of each activity than through substitution within each activity.

With the change in the emphasis of the development policies of a number of countries from import substitution to export promotion, it has frequently occurred that exemption from customs levies has been established in the interests of exports.<sup>2/</sup> It is argued that the imposition of import duties on imported inputs and capital goods weakens the competitive capacity of national exports. This argument is generally valid, but it calls for at least three major qualifications.

(a) First, when a certain level of protection and disequilibrium remains in the external sector of the economy, the exchange rate in the country will probably be below the shadow or social optimum rate. If this is so, besides weakening the discrimination against the export sector, total exemption from customs duties for inputs and capital goods used in the export sector entails an unjustified subsidy to the use of imported components and therefore the opposite of protection for the domestic industry for such goods.

Second, when there is no possibility of domestic production of substitutes for the input or capital good in question, total exemption from import duties together with an effective exchange rate below the

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<sup>1/</sup> Empirical estimates of substitution elasticities usually include both kinds of effect at once because they usually concern groups or branches of activity. As a result, they overestimate substitution elasticity within each activity.

<sup>2/</sup> During the process of import substitution exemptions were also very frequent, but their scope appears to have been less general.

shadow rate reduces the discrimination against such exports. This does not cause changes in the proportion of use of national and imported inputs in each product in particular, but it discriminates in favour of exports which are more intensive in imported inputs. If there is domestic production of substitutes for these inputs, and the existing level of protection is considered "desirable", exemption represents a removal of protection to some extent (in respect of the desired level) for the domestic industry of those inputs and, in the case of capital goods, an incentive to greater mechanization of the exporting activities at the expense of labour absorption. If the existing tariff is higher than the "desirable" level, a partial exemption should be applied which provides the total protection desired, taking into account the level of tariff protection and the exchange rate.

(c) Third, exemption from customs duties raises the problem of how to determine which inputs are actually used in the production of exports, when the latter are produced by the same plant which supplies the domestic market. From an administrative point of view, it is extremely difficult to exercise effective and prompt control. Fraudulent operations or an artificial division of the productive activity according to the market supplied, are therefore frequent.

An attempt has been made to solve this problem by establishing duty-free zones for the installation of companies which use the imported equipment and inputs to produce goods for export. Production and marketing operations are carried out in zones exclusively devoted to this purpose, which facilitates control over the destination of duty-free imports. Obviously this scheme solves one problem but creates or accentuates another. The zone becomes economically isolated from the other domestic productive activities. Sometimes imports to the zone are even exempted from the regimes of prior authorization and deposit, and from the payment of internal taxes.<sup>1/</sup>

<sup>1/</sup> This raises a serious problem when the tax on transactions, whether on turnover or the value added, is applied according to destination. Exemption from this tax for imports to the duty-free zone amounts to the application of a special lower exchange rate for such operations.

The companies situated in the zone limit themselves to returning foreign currency for the payment of goods, taxes on income and wages to domestic labour, while retaining the rest of the value of their exports abroad.<sup>1/</sup>

If the sale of part of the production on the domestic market were authorized, there would be unfair competition with domestic production which pays normal taxes and duties. To avoid this it would be necessary to require the payment of the customs duties for the imported components involved in the transaction. This would reintroduce, to some extent, the problem of control. It is therefore preferable that if duty-free zones are to be established, despite their undesirability for national development, the zone should be isolated to the greatest possible degree from the national market surrounding it.

The consequence of exemptions is that a single good is produced in different conditions: in one case, more integrated into the domestic market; in the other, more integrated into the external economy, with greater access to and use of imported inputs and equipment. This consequence is seen more clearly in the case of the duty-free zones, which lead to a kind of disintegration of the domestic market, in that the imports and production of the zone occur with different prices and regulations from those of the country in which it is situated. The policy of customs exemptions for exporters therefore tends to foster economic dualism, with the development of enclaves rather than activities closely incorporated into the domestic industry.<sup>2/</sup> It would be preferable for the country to establish a level and

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<sup>1/</sup> Some exports pay a gross rate of exchange (including customs duties) for their imports which is lower than the rate which would obtain in a hypothetical free-trade situation: however, at the same time the price in domestic currency which they receive for their sales is also lower than the free-trade price. The net result of the two situations is less exports and higher average intensity of use of imported components.

<sup>2/</sup> Sub-contracting industries are an example of this type of mechanism.

structure of protection considered "desirable" in the light of solid economic and social arguments, and to apply the corresponding duty without discrimination to all imports of every item, whatever the sector or area of destination. In this way the economy will move towards a situation in which the costs in real resources, evaluated at social prices, of generating and releasing foreign currency will be uniform in all the regions and productive sectors. In addition, the higher customs revenue obtained through the elimination of the exemptions can be used directly to expand the productive investment in those areas. This system seems more effective from the standpoint of the economic integration of the country, the permanent development of the regions which are benefited, and the distribution of the benefits which are generated.

We have studied the effects on exports of the import régime applied to the inputs and capital goods used in the production of exportable goods. Tariff policy can also be used to promote exports, in a more indirect manner, by taxing imports of the exportable good. In a competitive market, the duty would be redundant, and have no allocative or distributive effects. However, in oligopolistic conditions the higher duty will increase the monopolistic power of the producer of the exportable goods, since it allows him to raise his sale price in the domestic market. This may enable the producer who covers, with the price of his exports, the corresponding marginal costs but not average production costs, to finance his total operation through the higher price charged in the domestic market. This higher price in turn tends to be accompanied by the reduction of domestic supply, thus increasing the exportable balance.

As a result, in this case, exports may grow for two reasons: firstly, by allowing an industry to be installed or retained which would not finance itself in a competitive market; secondly, by redistributing sales from the domestic to the external market. In either case it may be said that the domestic user implicitly subsidizes the growth of exports, through the higher price he pays. Nonetheless, the mechanism does not serve to promote the growth of

/installed capacity



installed capacity or a greater use of it to supply the external sector, unless the State specifically conditions the maintenance of the higher price upon greater production.

### Quantitative restrictions

The use of import quotas creates a somewhat different situation. In the theoretical literature it is usually assumed that the importer of intermediate goods is a different person from the user. In this case, the imposition of a quantitative restriction will mean that the importer tends to charge a scarcity price above his costs, appropriating a surcharge for himself. There is thus a symmetry in the allocative effects of quotas and tariffs, but assymetry in the distributive effects, with capital gains for the importer in the first case and customs revenue in the second.

However, the results are different when the user and importer are one and the same person, as is frequently the case in practice, especially in the case of the larger companies. In this case the producer can appropriate for himself the possible capital gains, by selling a smaller volume of production at a higher price on the domestic market as a result of the restriction in the supply of imported inputs.<sup>1/</sup>

The sale of part of the production abroad involves further considerations. In the first place, the volume of sales will probably affect the domestic market price while not affecting the external prices, or only to a lesser degree. Therefore, in response to a restriction in the supply of imported inputs which causes a fall in production, it would be more desirable for the producer to restrict his sales in the domestic market.<sup>2/</sup>

<sup>1/</sup> So as not to stretch out the analysis unnecessarily, we will abstain from adding other considerations such as the level of competition in the domestic market. Thus the above argument is not of general validity, even though in our opinion it holds good for the most usual situations.

<sup>2/</sup> It is assumed that the domestic price is initially equal to the FOB export price. It may happen that because of price controls the domestic price is lower, or vice-versa in monopolistic positions.

/Secondly, in

Secondly, in some cases producers are obliged to give preference to the supply for the domestic market, so that it would be exports which were harmed by the quota. Thirdly, quantitative restrictions are usually established in periods of balance-of-payments difficulties and when exchange rates are undervalued. Thus, imports are cheap but total export earnings are also reduced. In these circumstances, with excess domestic demand for imported goods the producer will prefer to sell in the domestic market at the expense of his exports.<sup>1/</sup> In the case of "dispensable" products it has often happened that, with the aim of encouraging exports, they are exempted from the restrictions, and the total demand for them is supplied by imports.<sup>2/</sup> As a result of situations of this kind, export promotion mechanisms have been created which include the importation of inputs without quantitative restrictions, thus enabling producers to exploit the installed capacity which remains unutilized because of the shortage of imported inputs for the domestic market. In general, the allocative effects of the application of quantitative restrictions on imports intended for the domestic market tend to be similar to those of a tariff on the same goods.

Finally, quotas are sometimes used to restrict exports of primary products, in order to encourage their export at a higher level of processing.<sup>3/</sup> The allocative effects of export quotas are similar to those of a tax on shipments and tend to generate a domestic price below the FOB export value of the article in question. It is interesting to note that on some occasions some exports have been the object both of quotas, which can be imposed not only by the exporting country but also by the importing country, and simultaneously

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<sup>1/</sup> In other words, in these conditions there are less chances of having to face competition from the imported substitute for the final good.

<sup>2/</sup> Here once again the problem arises of the division of markets.

<sup>3/</sup> The allocative and redistributive role of export quotas, particularly in the case of unstable markets, is discussed in R. French-Davis, "Export quotas under market instability", American Journal of Agricultural Economics, September 1968.

of subsidies. If the quota has any effect (effective quota), the subsidy plays an exclusively redistributive role on behalf of the exporter, for whom it generates quasi-rents.

3. Fiscal policy.

Fiscal policy may comprise a number of levies and subsidies in respect of the production or marketing of export goods.

The levies consist of various special taxes on exports which have already been eliminated in general by many countries. However, two important taxes on major exports remain: those established to tap quasi-rents from the exploitation of natural resources (particularly if done by foreign companies), and those designed to restrict supply so as to wield monopolistic power in the international market. In addition, exports are sometimes subjected to the payment of a tax on behalf of entities which promote sales abroad and to the payment of commissions linked to the formalities of licensing, shipment, or return of foreign currency. Inasmuch as these taxes are offset by the services actually received, they do not constitute a tax proper, but rather a further component of production costs.

The situation with regard to incentives is more diversified and, therefore, complex. They include such instruments as subsidies, exemptions, tax rebates, special additions to costs, and incentives for the use of certain inputs or services.

Subsidies in proportion to the value of exports have a similar effect to the existence of a higher exchange rate.<sup>1/</sup> As it will be recalled, they may be subsidies on the gross value or on the value added of exports.<sup>2/</sup> Furthermore, they may be free of income tax; in this case, a particular percentage of subsidy constitutes a greater

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<sup>1/</sup> If the subsidy is also granted directly to national carriers, the export subsidy must be paid on the FOB value to avoid a double subsidy.

<sup>2/</sup> It should also be recalled that it is a question of value added to the imported component; i.e., inflow minus direct and indirect remittances.

incentive than an exchange-rate adjustment of the same rate. An incentive to value added, which is also counted as taxable income, is the most neutral mechanism to encourage exports. On the other hand, an incentive calculated on the gross value discriminates in favour of the activities which use a high proportion of imported components, and all the more so if it is accompanied by exemption from import duties; in turn, exemptions which are not counted as taxable income discriminate in favour of the activities subject to higher rates of profit tax. Both forms of discrimination between different exports are implicit and, frequently, unwanted; this is a consequence of the specific form in which promotion instruments are used. Alternatively, a deliberately discriminatory export promotion system may be chosen, by establishing, for example, different rates according to the use of factors, the maturity of the producing company, and/or the ownership of the capital.

Exemptions release the exporter from the payment of taxes on transactions and on payments for capital and labour. The fact that only that part of production intended for export enjoys this privilege once again raises the problems of control and dualism: it is necessary to identify separately the inputs, equipment and staff used in the production of the export goods and those intended for the domestic market.<sup>1/</sup> Because of the implicit nature of the system, the economic authorities frequently do not possess information on the fiscal cost of such exemptions.

Tax rebates play the same role as exemptions in that they also reduce the costs incurred by exporters. However, to mitigate the difficulties involved in identifying the taxable goods and factors

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<sup>1/</sup> Obviously as the economies become more complex it becomes increasingly difficult to identify the destination or origin of inputs: the growing use of "domestic" inputs usually brings an indirect use of imported components employed in the production of those inputs. The difficulty in identifying the latter tends to create a situation in which the incentive is only to the direct use of imported inputs, while indirect imported inputs remain subject to the régime of import substitution.

/which will

which will be incorporated in articles intended for export, they are subjected to normal taxation. The exporter receives back the taxes he has paid only once the goods have been sold abroad. In any event it is then necessary to estimate the amount to be returned. If the taxes actually paid are returned, the system is the same as one of exemptions, except for the financial cost of the waiting-period between the payment of the taxes and their actual return.<sup>1/</sup>

A special case of tax rebate is the system of value-added tax according to destination (or user country). In this system, imports pay not only the tariff but also the rate of tax corresponding to the equivalent domestic good; in turn, exports are exempted from the payment of value-added tax.<sup>2/</sup> To facilitate fiscal control, the tax is paid on each sales transaction and returned in the case of sales abroad. In contrast with the system of taxation according to origin, this system amounts to raising the total exchange rate (legal rate adjusted by taxes and subsidies) of imports and exports, by a percentage equal to the average rate of the value-added tax. As a result, with a change in the system of indirect taxation it will be necessary to alter the exchange rate to maintain the balance of external trade.

There are two varieties of incentives consisting in the authorization to make special additions to costs. First, rapid depreciation which enables the producer of exportables to reduce artificially his taxable income. The mechanism discriminates in favour of products with a high proportion of depreciable assets and which are subject to higher rates of taxation. Secondly, in order to promote exports permission is sometimes given to include as costs during the accounting period in which they are incurred certain

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<sup>1/</sup> They are sometimes returned in non-liquid financial instruments whose present value is below par.

<sup>2/</sup> In a system of payment according to origin, imports are not subject to the tax, while domestic production pays the tax, without subsequent rebates, irrespective of whether it is intended for the domestic market or export.

/investment expenses

investment expenses such as market research, initial advertising to place products in a new market, organization costs of marketing companies, and the installation of business premises.<sup>1/</sup> By allowing costs to be charged in advance, both types of incentives defer the payment of income taxes, with the ensuing financial benefit for the exporter.

Permission to over-depreciate and to impute specific costs for a higher amount than was actually paid also fall within this category of special cost increases. This amounts to, first, establishing that a proportion of profits is not taxable and, secondly, encouraging the expansion of the activities connected with the incentive. While it is doubtful that it is desirable to encourage some of its characteristics, such as the intensification of the use of depreciable assets, others may effectively help to remove the obstacles facing the exports of manufactures of the developing countries. The absorption of labour and the generation of external economies have already been mentioned in this regard.

Finally, fiscal incentives include preferential tariffs for the use of some inputs or services provided by the public sector. The obvious examples are the use of energy and land transport services for exports. Besides constituting implicit incentives, these tend to have undesirable effects: discrimination in favour of energy-intensive activities and under-estimation of the real transport costs.<sup>2/</sup> As in all the other cases of discrimination, it should be asked why the same amount of resources is not spent in promoting production with specifically desirable characteristics, i.e., why not discriminate in a different way, instead of using incentives with undesirable secondary effects.

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1/ I. Gal-Edd, "Tax incentives for export", Journal of World Trade Law, Vol. 5, No 3, May/June 1971.

2/ It is interesting to note that both energy and rail transport tend to be capital intensive.

4. Financial policy

The composition and volume of exports are influenced by both the terms of access to financial resources and the rate of interest paid for them.<sup>1/</sup>

The producers of the developing countries usually encounter difficulties in obtaining credit to support their economic activities. For a number of reasons, and particularly the inadequate management of certain economic policies, the capital markets of the developing countries are usually limited, reluctant to finance operations which appear risky, imperfect, and in inflationary economies usually operate at negative real interest rates.<sup>2/</sup> The opening up of new external markets is particularly affected by this situation. The risk involved in the creation of new export lines seems greater than that of financing production for the domestic market. This risky image is created by the uncertainty about how the products of developing countries will be received, ignorance about the trustworthiness of the foreign importers, the instability of the regulations for the importing of goods and the return of foreign currency in the purchasing countries and the risk of foreign exchange losses. This problem becomes more serious in the case of financing trade among developing countries. Furthermore, access to credit resources abroad is likewise more limited for exporters in developing countries, particularly if they face balance-of-payments difficulties. As a result, the creation of a system of preferential access to credit is frequently a priority component of a programme to promote non-traditional exports.

Credit facilities may be devoted to different stages of the activities which culminate in exports: the financing of production

<sup>1/</sup> For a study of the problem and policy proposals, see UNCTAD, "Report of the expert group on export credits as a means of promoting exports from developing countries", TD/B/552, June 1975 and the International Trade Centre, Export financing, UNCTAD-GATT, Geneva, 1974.

<sup>2/</sup> A study which stresses the impact of the imperfections of the capital market on the economic growth of the developing countries may be found in R. McKinnon, Money and Capital in Economic Development, Brookings Institute, Washington, 1973.

expenditure and the financing of credit sales to the foreign importer, which correspond to pre-shipment and post-shipment financing respectively. In the first case, normally called pre-shipment credit, the indiscriminate granting of preferential access to credit for any exports will tend to accentuate the shortage of resources for the remaining activities. There are therefore grounds for a selective approach. Two possible selection criteria, for example, are to grant preferential access only to exports produced by domestic companies and to "new" production for a specific length of time. In rationed capital markets, which is typically the situation of the developing countries, this measure may be an important incentive, whose effectiveness will increase with the level of imperfection of the financial system.

The second type of credit line, usually called post-shipment credit, answers a problem of a different kind. In the first place, it is designed to tackle one aspect of the lack of competition in international markets, namely, that in order to place specific products abroad the exporter must grant medium- and long-term credit.<sup>1/</sup> This is of great importance in the marketing of manufactures. Since it is practically impossible for the exporter to finance the credit with his own capital, he must have suitable credit lines for the standard periods in the international markets for those products.<sup>2/</sup> In addition, the granting of credit to the importer, whether covered by the exporter or by a domestic financial institution, affects the balance of payments, particularly in the period when the system is established. Credit to the importer represents a lag in the return of foreign currency until the loan is paid off. Consequently it represents a "capital outflow"

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<sup>1/</sup> If the market were relatively perfect, there would be no difference between cash down or credit sales, since in the first case the purchaser's financial needs would be covered by a third-party credit.

<sup>2/</sup> For example, an exporter with annual sales for a value of 100, with 10 per cent down and 9 annual payments, needs an increasing volume of capital until the ninth year of operation. In the ninth year, the credit balance amounts to 4.5 times annual exports, a level which is maintained from then onwards.



so long as there is any credit balance. The intensity of the initial effects may be weakened by limiting the opening of credits only to the growth of exports. In this way the capital outflow occurs in combination with a real growth of exports.<sup>1/</sup>

The nature of post-shipment financing means that it is not enough to establish a credit line for exports, but that it may also be necessary for the country to seek sources of refinancing abroad.

At another level, the creation of export insurance will weaken resistance to the financing of the production of exportables. The insurance may cover the commercial risk of bankruptcy of the importer or, more ambitiously, the risk of economic or political disturbances in the purchasing country which prevent the debtor from paying his debts. The insurance reduces the risk for the exporter, increases his access to financing and, probably, diminishes the cost of refinancing in international markets.

Until now we have discussed the facilities of access to credit, i.e., the volume and length of credit. A third aspect is the rate of interest applied to the exporter. Its role is clearly different. While pre-shipment credits with preferential access tend to remove an artificial obstacle to the development of the external sector, the practice of applying subsidized interest rates works towards reducing the cost of a scarce resource: capital in most developing countries. It does stimulate exports, but only according to the intensity with which credit is used: it favours the activities with a lengthy production cycle, and the companies with a high proportion of current liabilities. It is doubtful whether these features can be the goals of the export promotion policy. As a result, once again from the standpoint of policy options, the resources used

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<sup>1/</sup> It should be borne in mind that greater exports will tend to entail a growth of imports of inputs, which are usually paid off over relatively short periods.

in the interest-rate subsidy can be used to promote exports according to other characteristics than the degree of use of credit.<sup>1/</sup>

Preferential interest rates for the financing of credit sales also represent a subsidy to the exporter, covered by the government or an international institution operating on concessionary terms. For a specific percentage discount in respect of the normal rate, the subsidy will increase according to the length of the credit. The system will therefore discriminate in favour of the exports with longer credit periods. Obviously this will encourage exporters to try to obtain the longest possible credits and to pass them on to the importer, obtaining in exchange a better price or a more rapid sale.<sup>2/</sup> One alternative is to grant post-shipment credits at "normal" rates, and to provide instead incentives related to other features of the exportable goods.

Financing facilities may be channelled by mechanisms other than credit. One mean in quite frequent use is the advance purchase of the export income, where the exporter receives the domestic currency before the foreign currency is paid. Frequently the conversion to the domestic currency is made at the exchange rate in force at the time of the operation, thus eliminating the foreign exchange risk for the exporter. A discount may also be made corresponding to the interest which possession of the funds in advance represents. In this case the operation is an ordinary forward purchase of foreign currency. Alternatively, if a discount is not made, receiving the funds in advance may be considered an interest-free loan, which is equivalent

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<sup>1/</sup> The use of export credit subsidies also extends to various financing operations for the domestic market. In practice, the subsidies, rather than having an allocative effect, tend to have a regressive effect in distribution, by constituting capital gains or quasi-rents. See R. Ffrench-Davis, Políticas económicas, op. cit., Appendix VI.

<sup>2/</sup> In international markets there are a number of prevailing standards for the length of credits and interest. However, these are ranges rather than single terms. The exporter's option may fall within these margins without the national credit institution being able to exercise effective control.

to a real rate of exchange higher than the legal one; the higher rate corresponds to the real cost of the money during the in-between period. When the period is common to all operations, and relatively short so that it is used in full by all exporters, the system is neutral. When the system is extended to importers (advance payment of the foreign currency), it becomes an export credit mechanism which is self-financed by foreign trade. The periods over which the system operates usually range from 60 to 120 days, and they may therefore constitute a good palliative for pre-shipment financing needs.

#### IV. MARKETING, ACCESS AND NEGOTIATION POLICIES

##### 1. General aspects of the policy

The promotion instruments reviewed in the previous chapter can be used to influence production costs and their structure, the distribution of the profits obtained, income from the return of foreign exchange, and export credit conditions. In a world in which not all markets are perfect and information of actual or potential opportunities of placing new exports is scarce and costly, the marketing policy adopted is another mechanism which can have an appreciable effect on the volume, stability and prices achieved for non-traditional exports of developing countries.

Marketing policy should cover much more than the organization of the marketing of export commodities. In many cases, decisive, systematic and continuing action is required on the part of the governments of developing countries to improve their access to external markets. It should be noted that, in view of the wide range of products and markets that may be considered, a selective policy will be required. The method of selecting a priori the exportable commodities whose marketing is to be promoted differentiates marketing policy from the policies analysed in the preceding chapter.

The role of compensatory policies is to correct market distortions and disequilibria and, in general, to promote all exports whose production processes have certain characteristics, or those with certain repercussions on the rest of the economy. On the contrary, and owing to the direct nature of the action to eliminate shortcomings in communication and transport media and to negotiate conditions of access to external markets, these policies must necessarily be selective. Such selectivity may relate to areas in which the action to improve transport facilities is concentrated, to regions towards which the search for and dissemination of information on exportable offers is mainly directed, or to products on which the use of the country's capacity to negotiate more satisfactory conditions of access to other countries' markets is centred.

/Marketing comprises

Marketing comprises action at the external and the internal level. External action aims at modifying the existing conditions of access for domestic products to international markets, and internal action at transmitting the relevant information to exporters and producers and organizing the sales systems.

Another important aspect is who are responsible for the marketing of exports. They may be transnational corporations, national production enterprises or firms specializing in marketing which are constituted by associations of producers of any type. The best form of organization will depend on the kind of external market and the type of producers.

Another fact about marketing policy is that it generally involves substantial economies of scale. Marketing activity is intensive in terms of information, and the collection, processing and transmission of data permits appreciable economies of scale. On the other hand, marketing activities also present some external features which may not easily be internalized by the agent effecting the marketing operation. Thus an individual exporter opening up new markets and creating a certain image of the product or of the country may incur costs which will generate profits that can be appropriated by other exporters following the path opened up by him.

Lastly, some thought should be given to the problem which inadequate information on available markets means to the exporter. The widely different nature of these markets makes it easier for him to concentrate on those with which he is already familiar, thus reducing the possibility of improving his bargaining capacity and obtaining more favourable selling conditions.

There are three levels of centralized action in this field. The first, consists of obtaining information on external markets and making it available to present and potential producers; the second, of transmitting information about domestic products to external markets; and the third, of identifying areas for the concentration of these lines of action.

/The three

The three levels are interrelated. To a certain extent, however, progress at the first two levels requires a pre-selection of markets and products upon which to concentrate the efforts to obtain and provide information. Such a pre-selection is also necessary for negotiations with governments and foreign enterprises. Owing to the many alternative possibilities, a certain specialization in terms of markets and goods is required in all these spheres of action. One approach which should be considered is diversification in both senses in order to promote a steady rise in the value of exports.

Information on markets must be systematically organized through the establishment of a system of commercial information.<sup>1/</sup> In addition, the establishment of commercial offices abroad, visits by commercial missions and participation in fairs may be suitable mechanisms for making domestic products known abroad. There is some risk, however, that they may be converted into sporadic bureaucratic action with no lasting effects. If they are to be effective, an organization is required to programme these activities, carry them out regularly, seek mechanisms that will be an effective link between the producer-seller and the buyer, and maintain a system of control and periodical rectification.

As noted earlier, external markets are merely the domestic markets of importing countries. It is not surprising, therefore, that the conditions ruling for different products and markets vary widely, according to the internal policy of the importing country, the degree of competition between importers and the nature of the product concerned. These conditions determine the degree of accessibility of each individual product to each market.

When the market for a product is completely competitive, both the national exporter and the foreign importer face an infinitely elastic supply and demand for the product concerned, so that the levels of their sales and purchases do not affect the price of the product. In other words, they are sellers and buyers in an atomistic market.

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<sup>1/</sup> This system can also provide information for a more effective control of declared export prices.

In competitive markets, the limitations on the volume exported are imposed not by external demand but by the exporter's costs. Consequently, the national producer will export a quantity determined solely by his marginal production costs and domestic demand. There are no problems of access to markets as such, but only of production and marketing.

Clearly, this international demand can be affected by the government of the importing country. The levying of an import tax on the product concerned means a lower price for the exporter. Quantitative restrictions imposed by the importing country may also reduce the volume of sales below the level which the exporter may desire. Although the international market for a product may initially be competitive and of fairly easy access, it may so happen that as exports of the product to a specific country grow rapidly and substantially, protectionist pressures are created in that country, particularly if imports come to represent a high proportion of the domestic supply of the product concerned.

Non-competitive markets may be grouped in three categories, according to the form of access to them:

- (a) markets with access controlled by governments;
- (b) markets with access dominated by transnational corporations;
- (c) markets with negotiated access.

Each of these categories has implications for the design of policies, inasmuch as they affect the intensity, length of time and direction of the response of exports to policy instruments.

This enumeration shows that, for a number of goods, State intervention may be required to facilitate the access of a country's exports to external markets. This may take the form of action to improve the conditions of access within each category, or to transfer the marketing of a specific product from one category to another.

The rest of the chapter analyses the characteristics of marketing policies, access and negotiation in each category of market.

2. Markets with access controlled by governments

Access to many markets is controlled by the governments of importing countries through a great many mechanisms aimed at restricting imports. In the developed countries these restrictions as a rule have a protectionist rather than a fiscal function. That is to say, the aim is to protect the domestic producer against foreign competition rather than to choose import restrictions calculated to maximize fiscal income. These countries' tax systems are sufficiently advanced to be able to obtain fiscal resources through other tax mechanisms with a more appropriate base for the policy objectives concerned (for example, personal income, company profits, etc.).

In the developed countries, protectionism is upheld by two forces: certain labour groups, and those sectors manufacturing labour-intensive products which regard imports from the rest of the world as a threat to their existence. A theory of international trade maintains that the main source of comparative advantages in a country is the relative availability of factors and that protectionism, by restricting trade, raises the relative price of the scarce factor in the country.<sup>1/</sup> In the developed countries, capital (both material and human) is plentiful and labour is scarce. Consequently, imports tend to compensate for the labour shortage and to lower the real wages of the workers compared with a situation without trade. The other protectionist motive or force is represented by those labour-intensive sectors (for example, textiles, footwear, etc.) which see their existence threatened by cheap imports by virtue of the lower real wages paid in other parts of the world.

It must be stressed that the theory of international trade merely affirms that a country as a whole stands to gain from trade, but not all the sectors in the country will necessarily profit. What it does assert is that those who gain from the opening up of trade could

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<sup>1/</sup> This is the well-known Heckscher-Ohlin theory, which has given rise to the Stolper-Samuelson theorem regarding the effect of protectionism on relative factor prices.



compensate others for their losses and still be better off with trade than without it. That is why it is understandable, and even quite legitimate, for the sectors affected by imports from developing countries to oppose an increase in trade and to adopt protectionist attitudes to the extent that no action is taken to improve the mechanisms for reducing adjustment costs and compensating for losses in those sectors. If the developing countries' exports to industrialized nations are to expand, it is essential that the latter should perfect what has been called adjustment assistance, i.e., compensation to the sectors affected by such trade so that they can channel the production factors into other activities. There would thus be less opposition on the part of producers in those countries to the liberalization of trade in items competing with exports from developing countries. This would ultimately amount to the internal redistribution of costs and benefits of the larger volume of trade, so that the country's total gain would also bring benefits, though not necessarily equal, to all the sectors affected.

It should be noted that protectionism in developed countries is taking on new forms. Thus, tariff barriers are diminishing in importance, since the GATT rounds of negotiations achieved substantial tariff reductions in the post-war period. Consequently, tariff barriers in the developed countries are low and tending to decline as a result of the multilateral negotiations conducted within the context of GATT. It is noted, however, that these reductions have been much greater in the case of trade items of interest to the developed countries. On the other hand, the actual protection of the domestic producer does not necessarily diminish with the reductions in the nominal tariffs; it depends also on what happens as regards the tariffs for his inputs.

There has, however, been an increase in non-tariff barriers, either of a quantitative nature (quotas) or in the form of artificial obstacles to the entry of foreign products, such as voluntary agreements restricting exports (textiles, etc.) and health measures over and above

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what may be justifiable with respect to agricultural commodities. Furthermore, there would seem to be a systematic bias in these non-tariff barriers against exports from developing countries.<sup>1/</sup>

One of the restrictive mechanisms which is most potentially dangerous for developing countries consists of countervailing and anti-dumping tariffs imposed in the event that the importing country considers that exports from developing countries are being "subsidized" so that they can be sold on external markets at lower prices than those ruling in the domestic market.<sup>2/</sup> As noted earlier, the disequilibria and distortions prevailing in the developing countries have led to discrimination against their exports. It is often impossible to eliminate such discrimination at the source, and it is then necessary to adopt countervailing policies aimed, through incentives of a different kind, at neutralizing the disincentives prevailing in the markets of these countries. That is why it is necessary to revise or redefine the concepts of "unfair" subsidies and dumping in the light of the situation of the developing countries, so that they will be less vulnerable to the indiscriminate use of this protectionist mechanism by the industrialized countries.<sup>3/</sup>

The preferential systems of the developed countries constitute a special form of access. In fact, one of the demands put forward at the United Nations Conference on Trade and Development in 1964 was, after much discussion, accepted by the developed countries, which have

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<sup>1/</sup> See I. Walter, "Non-tariff barriers and the export performance of developing economies", American Economic Review, Vol. LXI, No 2, May 1971. See also R.E. Baldwin, Non-tariff Distortions of International Trade, (Brookings Institution, Washington, 1970).

<sup>2/</sup> See the Report of the UNCTAD secretariat, Anti-dumping and countervailing duties and the problem of export subsidization in developing countries (TD/B/C.2/147), 30 April 1975.

<sup>3/</sup> The United States Secretary of State recently affirmed in Nairobi that his country believed that a code to regulate the use of countervailing duties against export subsidies should recognize the special conditions confronting the developing countries. Statement by Henry A. Kissinger at the fourth session of the United Nations Conference on Trade and Development, 6 May 1976.

instituted generalized systems of preference. These provide for the reduction, and in some cases the elimination, of import tariffs for certain products from developing countries, while keeping them in force for imports of the same products from other industrialized countries. This gives the exports of developing countries a preferential margin equal to the original tariff less the preferential tariff applicable to them, which makes it possible to obtain higher prices and to expand their exports. For this margin to be effectively enjoyed by the exporting countries rather than by importers or marketing agencies in the developed countries, some mechanisms should be considered with a view to counteracting the monopsonistic power of distribution and marketing agencies in importing countries. In some cases the governments of the developed countries themselves help to keep this margin in the hands of their importers by granting them the necessary permits to use the preferential system where this is subject to quotas. Actually, few generalized systems of preferences permit the entry of any quantity of imports at the preferential tariff levels; most of them impose some form of quantitative limitation on imports covered by this system.<sup>1/</sup>

A preferential system of access limited to certain developing countries is that established between the countries of the European Economic Community and the African, Asian and Caribbean countries grouped together under the Lomé Convention. This Convention permits preferential access for products imported by the Community only from these countries, thus constituting a vertical block of preferences which is contrary to the UNCTAD principle of generalized non-discriminatory preferences.

It should be noted that when multilateral negotiations lead to reductions in most-favoured-nation tariffs for those products in respect of which preferences are being granted, the preferential margin

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<sup>1/</sup> See J. Piñera, "América Latina y el Sistema Generalizado de Preferencias de los Estados Unidos", Cuadernos de Economía, XII Year, No 35, April 1975.

shrinks. One of the most useful courses for the developing countries to adopt would seem to be to secure the inclusion of a larger number of products in the preferential systems to compensate for the inevitable reduction of the preferential margin, rather than to oppose the multilateral tariff reductions.<sup>1/</sup>

Lastly, it is pointed out that it is not only the developed countries that impose restrictions on imports, but some developing countries also have a degree of protection which hinders the growth of trade between countries at that economic level. Since these tariffs and other protectionist measures were designed with the object of providing protection against imports from developed countries, there being no possibilities of vigorous trade between developing countries at the time they were imposed, their maintenance is conducive to fairly inflexible trade patterns. This is yet another barrier to the expansion of trade between these countries, together with others such as the fact that transport systems are geared to trade in a north-south direction, and the lack of mechanisms providing information on the market conditions prevailing in these countries. Therefore, in order to overcome this situation of initial discrimination against trade within the southern hemisphere, some consideration might be given to the study of a system of tariff preferences between developing countries.

There is one case in which the intervention of the government of the exporting country is advisable and, without involving negotiations with enterprises and governments, would improve the position of the exporting country. That is when the individual exporters of a product, which may well represent a low export value, confront as a group an external demand which is not completely elastic. If these exporters

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<sup>1/</sup> It should be noted that it is more advantageous for countries according preferences to grant a certain level of "aid" through small preferential margins in a large number of products than through large preferential margins in only a few products. This conclusion is derived from the application of the second-best theory. See, in this respect, R. McCulloch and J. Piñera, "El comercio como ayuda: las preferencias arancelarias para países en desarrollo", Cuadernos de Economía, XIII Year, No 39, August 1976.

are competitive in the domestic market, it would be in the country's interest to establish some kind of alliance vis-à-vis foreign buyers. This could take the form of an association of exporters of the product concerned who would follow a co-ordinated price policy. If this is difficult owing to the number of exporters involved, or to problems concerning their association, the economic authority could establish minimum export prices and impose "optimum" taxes on sales abroad with the object of obtaining, in the first case for the exporters and in the second for the State, the potential monopolistic income from this market. This action is even more urgent where external buyers join forces to depress prices and obtain the whole monopolistic profit.

3. Markets with access dominated by transnational corporations

The flourishing of transnational corporations has a number of implications for the export trade of developing countries. Three aspects may be noted: the increase in the number of transnational corporations, the expansion of trade between the parent firms and their subsidiaries, and the importance which international sub-contracting has assumed in the last few years.

Buyer markets are more imperfect, i.e., more oligopsonistic, the smaller the number of enterprises operating in them and the closer the explicit or implicit alliance among them, and that is why the increase in the number of transnational corporations operating in a specific product leads to more competitive markets. This benefits the exporting developing countries which can thus keep for themselves a larger proportion of the price prevailing in the developed country, without reductions in their profits in the form of quasi-rents obtained by these enterprises.

A large proportion of the developing countries' exports are, however, effected by subsidiaries of transnational corporations. If transactions between the different units of a single enterprise were effected at competitive or "arms-length" prices, the profits would be obtained in the place where they were actually generated, thus giving the developing country the chance to obtain part of the profit by virtue

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of the rules prevailing for the treatment of foreign investment. As noted earlier,<sup>1/</sup> however, the transfer prices which these enterprises establish for their internal transactions may be very different from the competitive prices, with the object of minimizing the payment of taxes, tariffs, etc., and thus maximizing their net profit.

It is in their interests to over-invoice imports and under-invoice exports, thus transferring the profit to the parent company or to other subsidiaries where tax rates are lower. Consequently, the profits generally appear in countries with low or non-existent tax rates instead of in those where the goods are produced. Another artificial obstacle to exports from developing countries takes the form of export restrictions which are included in licences and patents and which the parent companies tend to impose on their subsidiaries as a means of segmenting the markets.

It may therefore be necessary for the State to intervene by fixing the prices of transactions between enterprises, or by not permitting foreign investment in export sectors when such restrictions exist.

International sub-contracting is another interesting aspect of the activity of transnational corporations. The tariff systems of several developed countries envisage cases where the tariff is applicable only to the value added abroad to inputs originating in the final user country. Therefore, some transnational corporations find it convenient to locate production activities in countries where labour is cheap, importing practically all the inputs and exporting the product to the parent company. Lastly, international sub-contracting means the disappearance of the marketing function for the developing country. This may be desirable when the developing country concerned lacks the experience and ability to purchase marketing services in the international markets, so that instead of being an exporter it is merely a sub-contractor. As noted earlier, the marketing operation involves substantial economies of scale and, therefore, it may not suit the developing

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<sup>1/</sup> See, in particular, C. Vaitos, op. cit.

country to assume the responsibility of marketing all the products it exports. However, exports become dependent on a demand deriving from the transnational corporation, whose decisions may suddenly change, creating a serious problem of employment and adjustment.<sup>1/</sup> Therefore, an evaluation of the cost-benefit ratio of sub-contracting is necessary in each individual case.<sup>2/</sup>

There is relatively little a country can do on its own to prevent the performance of transnational corporations from reducing the profits it obtains from exports of manufactures. However, exporting countries can jointly, at the regional, sub-regional or third world level and at the appropriate forums, negotiate the preparation of an international code of conduct for transnational corporations which will uniformly regulate their performance so that their presence in exporting sectors will bring benefits to all the parties concerned. At a different level of action, steps can be taken to promote the establishment of multinational enterprises among a group of developing countries, which, through the support of their various members, would be in a position to enter sections of the market formerly controlled by transnational corporations.

#### 4. Markets with negotiated access

The instability and non-competitive nature of some international markets makes it necessary to take direct action aimed at modifying the conditions of access for non-traditional exports of developing countries. The possibilities for action vary widely, depending on the nature of the external market.

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<sup>1/</sup> See M. Sharpston, "International sub-contracting", Oxford Economic Papers, Vol. 27, No 1, March 1975, and T. Morrison, "International sub-contracting: Improved prospects in manufactured exports for small and very poor LDC's", World development, Vol. 4, No 4, 1976.

<sup>2/</sup> See W. Koenig, "Towards an evaluation of internacional sub-contracting activities in developing countries: Interim Report upon completion of field work on 'Maquiladoras en México'", CEPAL, September 1975.

The restraints which the industrialized countries impose on their imports was discussed in section 2 and mention was made of the negotiations within the context of GATT and UNCTAD's efforts to improve the position of exports from developing countries. When government restraints are eased in a market oligopolically dominated by transnational corporations, the results achieved through the liberalization of world trade represent only a potential improvement. Therefore, in order to obtain these potential benefits for themselves the developing countries must exercise their negotiating powers. As noted in the previous section, this may take the form of measures such as joint action by a group of countries to regulate the operation of transnational corporations and co-ordinate their relations with them, or the establishment of multinational enterprises among developing countries which could compete with the transnational corporations on a fairly equal footing. In addition, the possibility should be explored of concluding agreements whereby adequate access may be obtained to the developed countries' markets in exchange for according guaranteed access to the sources of raw materials in developing countries.

As the quest for markets for new exports shifts to other countries which are also in process of development, the feasibility of achieving successful results increases. A vein is being opened here which has been virtually unexploited, in spite of its long existence as a government concern and its prominent place in literature.<sup>1/</sup> Reciprocal trade between developing countries still absorbs only a fraction of their total trade. The systematic expansion of trade between developing countries can be brought about in two ways: through economic integration processes and by virtue of specialization agreements.

An economic integration mechanism constitutes a generalized negotiation directed at the reciprocal opening of markets among the member countries. Without going into details that are already familiar,

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<sup>1/</sup> See J. Bhagwati, "Trade liberalization among LDC's, trade theory and GATT rules", in J.N. Wolfe, Value, Capital and Growth: Essays in Honour of J.R. Hicks, Edinburgh University Press, 1968.



the integration process may be based exclusively on the liberalization of reciprocal trade or it may also extend to the programming of investment on a region-wide scale.

The elimination of reciprocal trade barriers is generally accompanied by the establishment of a common external tariff. The presence of a barrier to imports from third countries and the absence of customs duties and charges on internal trade determine a margin of preference for the region's production. The establishment of preference margins for import substitution at the level of the expanded market also determines the protection to be enjoyed by each country's exports to other member countries. The regional exporter can sell his production at a price exceeding the international price by a margin equal to the external tariff. Therefore, the common external tariff determines the type and level of collective protection which will be accorded to reciprocal exports, i.e., the same instrument determines similar support at the same time for import substitution and for export promotion, both at the regional level.<sup>1/</sup>

An important conclusion may be drawn from these considerations. In formulating the tariff policy of a common market, the system of incentives to exports to the region concerned is also affected. This fact should be borne in mind in devising monetary incentives to these exports; otherwise, it would lead to a duplication of advantages, to the extent of making it more attractive to produce for member countries than for the domestic market.

Specialization or production agreements are a more ambitious form of integration which complements trade policy. Their essential characteristic is that they assign some type of advantage to each member country so that it will develop specific economic activities. In this way the decision as to where to produce does not depend on the market. These systems have been developed in the integration process of developing countries with two key objectives. First, they

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<sup>1/</sup> It is pointed out, however, that this tariff also provides a disincentive to exports to the rest of the world.

constitute one of the mechanisms for ensuring a fair distribution of the benefits among the member countries and preventing any market trend towards a geographical polarization of industrial production.<sup>1/</sup> They are also designed to programme the investment that is required by markets larger than the domestic market and which will take advantage of the economies of scale thanks to the existence of the expanded market. Through such programming it is possible to prevent the duplication of investment, make better use of the dynamic external economies generated by the simultaneous development of technologically associated activities, and provide a more clearly-defined field of investment opportunities for potential producers.

Specialization agreements could also be concluded at two other important levels. First, they could be designed to seek specialization among enterprises that have expanded under excessive national protection. Frequently, this has meant extensive diversification of products within each firm. Rather than an indiscriminate liberalization of reciprocal trade, integration could entail a scaled reduction of trade barriers accompanied by industrial specialization agreements which will guide the selection of the types of products on which each country will concentrate its expansion efforts, and those on which it will give ground to other member countries. Undoubtedly, the two types of production agreements can be implemented not only among the members of a formal integration process but also with countries outside it.

A second category of production specialization agreements could be implemented outside the context of formal integration processes. They would, however, be similar to those described above, involving the utilization of economies of scale based on the reciprocal opening

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<sup>1/</sup> See references to this question in C. Díaz-Alejandro, "The Andean Common Market: gestation and outlook" in Eckaus and Rosenstain-Rodan, Analysis of Development Problems, North-Holland, 1973; R. French-Davis, "El Pacto Andino: un modelo original de integración", Trimestre Económico, April-June 1976; and P. Robson, Economic Integration, Penguin Readings, London, 1971.

of markets for production whose location is decided collectively or at a supra-national level. Two examples are connected with the production of raw materials. When an industrialized country wishes to make sure of a stable supply of a certain primary good which it may lack, the supplier country could seek to conclude an agreement covering the opening of that country's market to manufactured products based on those raw materials.

The other example is connected with the manufacture of intermediate and capital goods for the production of raw materials. The developing countries exports of raw materials account for a high proportion of total world output. For this very reason they are the main consumers of a wide range of inputs and capital goods. There is therefore a demand for such manufactured goods in these countries which would normally enable them to take advantage of economies of scale. Although this may be difficult to achieve, it would seem feasible for the raw materials producing countries to seek agreements aimed both at regulating the markets for and governing the production of intermediate goods. In a second phase, the initiation of the production of these goods would hold out possibilities of developing and incorporating technological advances better suited to the characteristics of the developing countries.

/FINAL CONSIDERATIONS

## FINAL CONSIDERATIONS

An adequate strategy for the promotion of non-traditional exports could help to solve some of the most serious problems of the developing economies. Its results, however, would depend decisively on the instruments employed and the form and intensity of their use. As in other areas of economic policy, there is a wide range of promotion instruments and mechanisms from which to choose. The choice of the mix used, and the intensity with which they are operated, would be determined by the objectives pursued, the nature of the external markets, the degree of freedom to have recourse to one or another of those instruments, and the impact they might have on the rest of the national economy.

According to the units participating in their design and implementation, they can be divided into internal and external instruments. The former include exchange, import, fiscal and financial policies, which affect the conditions of production and consumption of exportable goods. The latter, which act on the external framework within which goods are exported, comprise marketing and other policies which, through bilateral or multilateral negotiation, seek to achieve easier access for national exports to foreign markets, including integration agreements among developing countries.

Domestic policy instruments can be used to compensate or over-compensate. In this respect, the categories are identified not by the mechanisms used in each case, but by the degree to which they are operated, compared with the initial discrimination existing against non-traditional exports. Therefore, one instrument used too intensively converts an equalizing-compensation policy into an over-compensation policy. Moreover, it is not enough merely to graduate the intensity with which a specific export is promoted. The manner of compensation is equally important. The same incentive to the gross value of production can be provided in different ways, which have different effects on the level and structure of the value added generated in the country.

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It should be a matter of primary concern that the promotion policy should be implemented in a manner which is consistent with other goals of public policy, such as those connected with industrial development and employment. This involves efforts to make substitution and promotion policies, among others, compatible with each other. It is often suggested that there is a distinct cleavage between these policies. In actual fact, however, that is so only in certain circumstances, as explained earlier.

The argument developed here points to the fact that it is necessary to discriminate deliberately between different items, since in practice the divergencies between the social and private values related with the nature of the production processes are not uniform in all activities. Preferential treatment must consist, where feasible, in the direct elimination of the elements generating that heterogeneity; otherwise, they must be compensated for, either by means of subsidies and direct taxes or through the use of trade policy. In the latter case, the general recommendation is that the profile of tariff protection should be similar to that of the incentives to exports. Nevertheless, considering the fiscal restrictions with which the governments of developing countries are usually faced, it would seem advisable for the average level of the latter to be somewhat lower. In the last analysis, trade policy should not discriminate in the case of one good, whatever the market to which it is destined, except on account of the heterogeneous nature of the imperfections of the external markets, and the shortage of fiscal resources.

In a world with imperfect markets in which information on actual or potential opportunities of placing new exports is scarce and costly, the trade policy adopted can have an appreciable effect on the volume, stability and price obtained. However, "marketing" policy should comprise much more than the organization of the sale of export products. In many cases it is essential that the governments of developing countries should take decisive, systematic and continuing action to improve the access to external markets. Owing to the

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marked heterogeneity which characterizes them, the strategy implemented in this connexion should be selective in terms of products and of the geographical markets in which the negotiating and marketing action is concentrated.

It is necessary to close this article with a warning. In the past there was a trend in favour of import substitution which, owing to the failure to consider the costs of the process, culminated in over-protection for some products at the expense of others, and in the inefficient use of foreign trade instruments and mechanisms. What must be pointed out now are the dangers of over-promotion of exports. Their optimum development must be pursued as an integral part of a national development strategy, rather than as a mere attempt to expand them. It is not enough to affirm simply that exports must be promoted; it is necessary also to define the objectives sought and the structure, frequency, duration and level of the indirect incentives and direct mechanisms that will be used. This involves an attempt to evaluate, quantitatively or qualitatively, the costs and benefits of each policy option in terms of national development.