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Some Lessons of the Development Decade

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## Some Lessons of the Development Decade 1/

The 1960's began with the label "the development decade," a term that symbolized widely held expectations that the economic performance of the less developed countries would be greatly improved in this period. This paper examines some of the ideas about development policies that were influential at the beginning of the decade in the context of subsequent experience in Asia.

A good statement of some of the widespread ideas of that period is found in a paper on "Foreign Trade Problems in Planned Economic Development," delivered by an official of the Economic Commission for Asia and the Far East (ECAFE) at a conference of the International Economics Association early in 1960. It said:

> "Insofar as an underveloped country is seriously intent on improving its level of economic performance, there can be no reliance on a spontaneous process of economic growth.
>
> "Only planned economic development can hope to achieve a rate of growth that is politically acceptable and capable of commanding popular enthusiasm and support."2/

The author said that effective planning would involve controls over foreign trade "designed to make the most of a given capacity to import." By this he meant that the developing countries would have to impose restrictions on imports in order to stimulate the development of domestic industries. The time had definitely passed, he said, when countries could achieve adequate rates of growth by relying on their capacity to expand exports.

This echoed the official position of ECAFE, which said:

> "The momentum provided by the expansion in the export industries will be too small to bring about an adequate increase in total output. Rising exports are unlikely to play a leading role in the development process of most countries in the region."3/

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1/ Remarks before the International Economists Club, Washington, D. C. December 19, 1969.
2/ H. Kitamura, "Foreign Trade Problems in Planned Economic Development," in Economic Development with Special Reference to East Asia, edited by Kenneth Berrill, St. Martins, New York, 1964, p. 202.
3/ Economic Survey of Asia and the Far East, 1959, ECAFE, Bangkok, 1960, p. 101.

The answer to the dilemma of the developing countries, according to ECAFE, was to embark on a policy of import substitution.

Gloomy Outlook for Exports

The ECAFE position was buttressed by a study which examined the growth of the exports of the primary producing countries in Asia over the previous three decades and projected their probable growth over the following two decades. The study reached some very pessimistic conclusions.

It was estimated that from 1955 to 1975, some developing countries in Asia might be able to expand export earnings by 75 per cent, but most would not be able to increase their exports more than 50 per cent over this two-decade period.4/

This pessimistic view of export prospects for the developing countries was rather widely accepted. It was argued that the long-term trends showed a very slow rate of growth for exports of primary commodities, and explanations were advanced to show why this had been true in the past and why it would continue in the future. Technological changes were reducing the demand for raw materials. Synthetic products were rapidly displacing natural commodities such as cotton and wool, rubber and even metals. The demand for foodstuffs was relatively inelastic in the high-income countries. This meant that the food exporting countries were doomed to relatively slow rates of export expansion. Commodity prices had been trending downward since the Korean War boom, and some feared that this downward trend might continue over the next two decades.

The export performance of the developing countries in the 1950's no doubt had much to do with creating the climate that produced this pessimistic trend of thought.

From 1950 to 1960, exports of Asia, excluding Japan and Communist China, grew by only 16 per cent.5/ Pakistan and Indonesia exported less in 1960 than they had in 1950. The only country in the area, except Japan, that equaled the world average increase in exports in this period was Taiwan, which had a rise of 108 per cent, compared with a world average increase of 102 per cent.

Japan, of course, was a major exception. Japanese exports had risen nearly fourfold in this period. This suggested to some analysts that exports could be expanded at a rapid rate if countries would adopt policies designed to encourage this, as the Japanese had done. I pointed

4/ Kitamura, op. cit., p. 207.
5/ These are the countries listed under "Other Asia," in the table of World Trade Values published in the IMF's "International Financial Statistics." I will hereafter refer to these countries as "Other Asia."

out in an unpublished comment on the ECAFE Economic Survey for 1959 that the Japanese experience was instructive not only from the point of view of short-run experience, but also in looking back over the preceding three decades. In 1928, 40 per cent of Japanese exports had consisted of primary products, chiefly raw silk. Japanese success in adapting to changing technological and demand patterns seemed to me to indicate how mistaken it was to assume that export patterns and export capacity were determined independently of the policies of the exporting country.

However, the general tendency was to regard the Japanese experience at inapplicable to other developing countries Even the experience of Taiwan did not impress those who were inclined to view the future darkly. Although Taiwan had doubled exports from 1950 to 1960, achieving an annual rate of export growth of 7.6 per cent, the paper the ECAFE official read at the 1960 IEA conference took a dim view of Taiwan's prospects. The author discussed an econometric study that had shown that Taiwan should aim for a rate of economic growth of 6.3 per cent a year. It said this would require expanding exports at the rate of 15 per cent a year. "Can we seriously count on such a high rate of growth of exports nowadays?" he asked.6/

The answer was obviously supposed to be "no."

Export Growth Since 1960

However, as the table below shows, from 1960 to 1968, Taiwan expanded its exports at the rate of 22 per cent a year! Korea did even better. It expanded exports in this period by nearly 50 per cent a year.

In the thirteen years since 1955, "Other Asia" has increased its exports at an average rate of 3.6 per cent a year. If this is continued through 1975, these countries, as a group, will have achieved a total expansion of their exports of 103 per cent over the 1955 level. This compares rather favorably with the 75 per cent increase which ECAFE thought only the most favored countries might hope to achieve over this two-decade period.

In addition to Korea and Taiwan, the countries that had already expanded exports by more than 75 per cent since 1955 were Hong Kong, with nearly a threefold increase, the Philippines and Cambodia, which have more than doubled their exports, Thailand, which has nearly doubled its exports, and Pakistan, with an 80 per cent increase. India and Malaysia had rates of increase that, if continued, would give them more than a 75 per cent expansion by 1975.

6/ Kitamura, op. cit., p. 199 n.

## Asian Exports

| Country | Millions of dollars 1950 | 1955 | 1958 | 1960 | 1968 | Percentage Change 1960/1950 | 1968/1955 | 1968/1958 | 1968/1960 |
|---|---|---|---|---|---|---|---|---|---|
| Brunei | 67 | 99 | 106 | 88 | n.a. | 31 | n.a. | n.a. | n.a. |
| Burma | 139 | 227 | 195 | 226 | 111 | 63 | -51 | -43 | -51 |
| Cambodia | 1/ | 42 | 56 | 70 | 89 | n.a. | 112 | 59 | 27 |
| Ceylon | 328 | 407 | 359 | 385 | 342 | 17 | -16 | -5 | -11 |
| China | 79 | 123 | 156 | 164 | 802 | 108 | 552 | 414 | 389 |
| Hong Kong | 650 | 443 | 523 | 689 | 1,744 | 6 | 294 | 234 | 153 |
| India | 1,146 | 276 | 1,221 | 1,331 | 1,753 | 16 | 37 | 44 | 32 |
| Korea | n.a. | 18 | 16 | 33 | 455 | n.a. | 2,428 | 2,744 | 1,279 |
| Indonesia | 800 | 946 | 755 | 840 | 689 | 5 | -27 | -9 | -18 |
| Laos | 1/ | 1 | 1 | 1 | 1 | n.a. | 0 | 0 | 0 |
| Malaysia 2/ | 1,004 | 964 | 809 | 1,189 | 1,343 | 18 | 39 | 66 | 13 |
| Pakistan | 489 | 401 | 302 | 393 | 720 | -20 | 80 | 138 | 83 |
| Philippines | 331 | 401 | 493 | 560 | 848 | 69 | 112 | 72 | 51 |
| Singapore | 1,006 | 1,101 | 1,026 | 1,136 | 1,271 | 13 | 15 | 24 | 12 |
| Thailand | 304 | 335 | 309 | 408 | 660 | 34 | 97 | 114 | 62 |
| Vietnam | 79 1/ | 69 | 55 | 86 | 12 | n.a. | -83 | -78 | -86 |
| Other | 100 | 130 | 110 | 140 | 200 | 40 | 54 | 82 | 43 |
| "Other Asia" | 6,520 | 6,986 | 6,495 | 7,740 | 11,110 | 19 | 59 | 71 | 44 |
| Japan | 820 | 2,011 | 2,877 | 4,055 | 12,973 | 395 | 545 | 351 | 220 |

1/ All Indochina included under Vietnam.
2/ Includes Sabah and Sarawak.

SOURCE: IMF *International Financial Statistics*.

The export performance of the Asian countries has brought the basic assumption of the pessimists into serious question. The most obvious lesson to be learned from the experience is that past trends are frequently a poor guide to future performance. Burma was one of the better export performers in the 1950's, but it was one of the worst in the 1960's. On the other hand, the export outlook for Korea was considered so bleak in the late 1950's that ECAFE did not even bother to include Korea in its long-term projections for export growth for the area. But Korea has been far and away the outstanding performer in this decade.

This lesson is also applicable to price trends. Some thought that commodity prices might go on declining for twenty years, and ECAFE thought they would probably at best hold their own. Actually commodity prices ended their decline in 1962 and have since turned upward. The strengthening of commodity prices since 1962 has been quite general and the increases apply not only to a number of foodstuffs but also to some products that were supposed to be in serious trouble because of competition from synthetic substitutes.

While the favorable turn in commodity prices partly explains why Asian exports have done better than many analysts believed possible, this is by no means the whole story.

Perhaps the most serious error of the pessimists was the assumption that the developing countries would have great difficulty in expanding nontraditional exports significantly. This was exemplified by the views of an Indian expert writing in the "Economic Journal" of September 1959, who assessed India's export prospects as follows:

> "The trend of the conventional exports is stagnant. It is believed that the demands are of relatively low elasticity. Their long-term growths in receipts are expected to be low, whatever prices may be charged. On the other hand, no conceivable multiplication of the newer dynamic exports can be great enough during the next ten or fifteen years to produce anything but a declining ratio of exports to national income."7/

And, according to ECAFE, India's prospects for expanding exports of manufactured products were good compared with other countries in the region.

It is interesting to note that the sensational export performance of Korea and Taiwan has been almost entirely the result of the development of new export products. In 1968, at least three-fourths of Korea's exports of $455 million consisted of goods that Korea did not export at all ten years earlier.

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7/ S. J. Patel, "Export Prospects and Economic Growth: India," Economic Journal, September 1959, pp. 490-506.

The picture is much the same for Taiwan. In 1958, about 70 per cent of Taiwan's exports consisted of sugar and rice. In 1968, exports of these two commodities accounted for a mere 7 per cent of Taiwan's total export earnings of $802 million. Three-fourths of Taiwan's exports in 1968 consisted of goods which accounted for no more than 8 per cent of exports ten years earlier.

However, not all the good performers made their gains from the expansion of new manufactured goods exports.

Thailand, for example, has increased exports at the rate of 6.2 per cent a year since 1960, largely by expanding traditional exports and developing new agricultural products that have found good markets abroad. These include corn, kenaf and tapioca products, which together accounted for over a fifth of Thailand's export earnings in 1968, compared with practically zero ten years earlier. As a result, rice, rubber and tin accounted for only half of Thailand's export earnings in 1968, compared with 70 per cent in 1958.

Pakistan provides a good lesson in what can be done with export incentives. The decline in export earnings that made Pakistan the worst performer in Asia in the 1950's was reversed by the adoption of export incentives in the early 1960's. Exports of raw cotton, which had fallen sharply, have since risen, but a push was given to other exports also. Manufactured jute products surged ahead of both raw cotton and raw jute to become Pakistan's largest single export in 1968.

Malaysia, while not one of the countries with a high rate of export growth, has demonstrated that export earnings can be increased even in the face of what might be considered a catastrophic fall in the price of the main export commodity, rubber. Rubber prices have fallen more than 50 per cent since 1960, but Malaysia's earnings from rubber exports fell less than twenty-per cent, thanks to a rise in volume. Other exports, notably wood, have been developed, and Malaysia has been able to record some increase in exports in spite of the fall in the price of rubber.

A few Asian countries have managed to reduce their export earnings substantially since 1955. These are Ceylon (-16%), Indonesia (-27%), Burma (-51%) and Vietnam (-83%). However, the experience of these countries gives no support to the theories of those who contended a decade ago that the export outlook was bleak for the primary producing countries.

It would be more correct to say that these countries have done poorly in the export field in large part because they tended to follow the advice of the pessimists--those who said that the developing countries could not count on exports expanding rapidly enough to support the rates of economic growth they desired.

Even in the case of Vietnam, the poor export performance is not solely attributable to the war. Policies that inhibited exports have also played a role.

## Ceylon's Experiment with Import-Substitution

The advice was to turn inward and develop import-substitution industries. The ECAFE representative at the 1960 IEA conference in Japan spelled this out, saying.

> ". . .all unnecessary imports, including luxury goods, (must) be cut out and goods imported (must) be replaced, if possible, by domestic production. The import substitution becomes necessary if a drastic reduction in consumption is to be avoided, but this is under the present conditions possible only with a certain degree of government encouragement and protection. . . .The government intervention in trade flows constitutes, therefore, one of the indispensable instruments for the policy of resource allocation."8/

This same analyst held up Ceylon as an example of a country that was planning its development properly. The Ceylonese had worked out a ten-year plan. One of its features was that it allocated 26 per cent of total investment to the development of industry and power and only 9 per cent to the main export crops.

Some thought that it was economically unwise to divert resources away from those areas of production in which the country enjoyed a relatively high degree of efficiency. But those who were convinced that the time had passed when countries could enjoy an adequate rate of growth by heeding comparative advantage argued that Ceylon, and other similar countries, were headed for trouble if something drastic was not done to change the pattern of exports and production. They argued that only by following a policy of import substitution of manufactured consumer goods and food could these countries develop at a reasonably rapid rate and narrow the income gap between themselves and the developed countries.9/ The

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8/ Kitamura, op. cit., p. 209.
9/ Survey for Asia and the Far East 1959, p. 104.

expectation was that the decision to invest in what appeared to be uneconomic industries would be validated over time because of the indirect as well as the direct benefits that would ensue and because of changes in supply and demand for various goods over the longer run.10/

What the proponents of this policy failed to consider adequately was the impact of the policy they advocated on export capabilities. They envisioned import substitution running in tandem with export expansion. They thought exports would grow at about the same rate as in the past, or a little faster, even though the major part of investment was being concentrated on industries that admittedly had no prospect of contributing to the export growth.

Ceylon was held up as an example of a country that was going to prove the wisdom of this policy in 1960. Ceylonese experience, however, has proved its folly.

Ceylon was not one of the more dynamic exporting countries in the 1950's. In that decade her exports grew by only 1.6 per cent a year. It was certainly desirable that something be done to speed up growth in the future.

However, the policy prescriptions that have been followed, contrary to expectations, have moved Ceylon's export trends in the opposite direction. Ceylon's exports have declined by more than 11 per cent since 1960. Since the import-substitution industries depend heavily on imported supplies, the failure of export earnings to expand caused serious problems for these industries. A 1968 survey showed that over half of the value of manufacturing production in Ceylon consisted of the value of the raw material inputs, and two-thirds of the raw materials had to be imported. In basic metals over two-thirds of the value of the output consisted of imported materials utilized by the industry.

The Central Bank of Ceylon has provided a candid statement of the dilemma that Ceylon found itself in, saying:

> A larger volume of imports of intermediate and investment goods was required to sustain the program of import substitution in particular and economic development in general. But the exchange reserve position especially in 1964 and 1965 did not permit of even a moderately liberal importation of these goods thus causing a further fall in domestic production.11/

10/ Kitamura, op. cit., p. 207.
11/ Annual Report of the Central Bank of Ceylon, 1968, p. 20.

The bank went on to say that one of the principal factors that had inhibited growth in the manufacturing sector prior to 1968 had been the inadequacy of raw materials due to import restrictions. It noted that because of this many establishments had been working well below full capacity.12/

Ceylon has been temporarily rescued from this dilemma by the infusion of a substantial amount of foreign aid, permitting some liberalization of imports in 1968. However, there is no sign of progress toward a fundamental solution of the problem created by the over-concentration of resources in industries which push up import demand while neglecting the development of the efficient sectors which might earn foreign exchange.

In contrast with the countries that have done well, such as Korea, Taiwan and Thailand, Ceylon is just as dependent on three export items today as it was ten years ago. Tea, rubber and coconut products accounted for nearly 90 per cent of export earnings in 1968, about the same ratio as in 1958. Far from solving the problem of slow export growth, import substitution has made it worse.

White Elephants are Hard to Kill

This is a common problem for countries that have gone in heavily for import-substitution policies. Those who advocated these policies ten years ago were not entirely unaware of the danger. The ECAFE representative at the IEA meeting in 1960 noted that in some cases indiscriminate and excessive protection would shelter and promote inefficiency. His advice was for governments to avoid this by being "flexible and adaptable to changing conditions."13/

This is not very specific advice. Few countries have been able to show flexibility and adaptability once they have invested large sums in inefficient, uncompetitive industries that employ large numbers of people and are highly visible. For example, Ceylon has two sugar mills, both owned by the government, which have from their establishment several years ago operated well below capacity because they lack an "adequate and regular supply of cane for crushing."14/ The government-owned textile corporation's mills have operated well below capacity since its establishment in 1958. In the last four years its earnings on investment, even with protection, have ranged from 1.3 per cent to 3 per cent a year, not a princely return.15/ Adaptability and flexibility would probably mean abadoning the sugar mills and drastically shaking up the textile operations, if not liquidating them. But this is easier said than done.

12/ Ibid. p. 29.
13/ Kitamura, op. cit., p. 210.
14/ Central Bank of Ceylon, Annual Report, 1968, p. 90.
15/ Ibid., pp. 78-79.

One of the most important lessons to be learned from the experience of the last decade is that import substitution policies are not the remedy for slow export expansion that many believed them to be. On the contrary, they may, as in the case of Ceylon, worsen the export performance and seriously reduce productivity in the economy.

A second lesson is that it is easier to avoid creating inefficient industries than it is to get rid of them once they are created. This is especially true when the industries are publicly owned and operated.

These are lessons that have cost countries like Ceylon a heavy price. Unfortunately it is the peasants and the workers that will have to pay this price, as Milovan Djilas pointed out in his perceptive book, The New Class, published in 1957. He said:

> Planning takes very little account of the needs of world markets or the production of other countries. Partly as a result of this. . .governments take too little account of natural conditions affecting production. They often construct industrial plants without having sufficient raw materials available for them and almost never pay attention to the level of prices and production. They produce some products at several times the production cost in other countries. At the same time, industries of above average productivity are neglected. Entire new industries are being developed even though world markets are surfeited with the items they will produce. The working people will have to pay for all this. . .16/

## The Decline of Central Planning

Djilas, while not a professional economist, had been a perceptive observer of the consequences of import-substitution policies, which were an important ingredient of central planning. Unfortunately, his and other similar warnings were not heeded. Central planning became almost obligatory for the countries that wanted to obtain American aid in the early 1960's, and we saw a lot of the kind of planning that Djilas described--planning for production that took little account of demand and supply in world markets, that did not give adequate attention to the problem of obtaining needed materials and supplies from abroad, that gave little weight to prices, costs and efficiency. India was the example that was held up for others to follow. India was going to show the less developed world how to "take off."

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16/ Djilas, Milovan, The New Class, Praeger, New York, 1957, p. 121.

Not everyone was enthusiastic about the Indian model. Professor P. T. Bauer published a critique of our aid to India in 1960 in which he made the following criticisms of the Indian Third Five-Year Plan:

1. Provides for excessive expenditure on heavy industry regardless of cost and prospective.

2. Provides for too little expenditure on agriculture in the face of the manifestly urgent need to increase agricultural productivity.

3. Imposes severe restrictions or complete bans on the supply of imported and even domestic consumer goods in the face of an urgent need to raise living standards and provide an incentive for agricultural production.

4. Restricts expansion of efficient industrial capacity and subsidizes inefficient production and distribution.

5. Excludes private Indian and foreign investment from a wide range of industrial and commercial activity despite an urgent need to encourage such activity in the most efficient way.17/

Subsequent developments have proven the validity of Bauer's criticisms. While India's exports have not fared as badly as Ceylon's, the country encountered very similar problems because of the overly ambitious investment program of the Third Five-Year plan, which contributed little to export expansion. The neglect of agriculture proved to be disastrous. Grain production fell in 1963 and 1964, and food shortages caused critical problems. Large food imports became necessary. The industrial plants, like those in Ceylon, found themselves short of supplies and also short of demand for their products in many cases. They had to operate at far below capacity. Shocking discoveries were made with respect to the inefficiency of the public enterprises, which had absorbed so much of the investment. An inquiry ordered by the Ministry of Finance into the operations of the public sector industries reportedly found only one being run efficiently and making a profit. The enterprises run by the states were said to be in even worse condition. One of the worst was a bicycle plant run by the Mysore Government which in a three-year period managed to turn out only 322 bicycles, 2 per cent of its installed capacity. The cost per bicycle was $460.18/

The high hopes that were placed on Indian-style economic planning were badly disappointed. Another valuable lesson of the past

17/ P. T. Bauer, United States Aid and Indian Economic Development, American Enterprise Institute, 1960.
18/ A. D. Shroff, On Planning and Finance in India, Lalvani, Bombay, 1966, pp. 278-81.

decade is that it is not true that "only planned economic development can hope to achieve a rate of growth that is politically acceptable and capable of commanding popular enthusiasm and support."

It is respectable today to encourage the developing countries to learn from the examples of countries like Japan, Taiwan, Korea, Hong Kong, Thailand and even Pakistan. We cannot say that these countries have in all cases been rigid followers of the policies that derive from the law of comparative advantage. Except for Hong Kong, none of them have followed a policy of free trade. But at least they have avoided stacking the deck against the most productive and efficient sectors of their economies. They have given the export sector a chance to thrive. They did not determine in advance, by some recondite formula, what ought to be produced over the next five or ten years and force investment into a rigid pattern. They did not cut themselves off from world markets, and they did not ignore supply and demand, prices and costs.

Perhaps the most important lesson of the development decade is that the law of comparative advantage was not repealed after all. The road to economic growth lies in increasing productivity. It is impossible in a complex and rapidly changing world for the economist to advise a government precisely how all the resources available in even as simple an economy as that of Ceylon can be most efficiently allocated. It is even greater folly to presume that we can foresee what the most efficient allocation overall will be far in the future.

One of the lessons of the 1960's was perhaps that Winston Churchill was right when he said, "It is a mistake to look too far ahead. Only one link in the chain of destiny can be handled at a time."