

PROMOTION OF MANUFACTURED EXPORTS IN DEVELOPING COUNTRIES

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INTRODUCTION

THE 1970s saw many developing countries emerge as exporters to bring on significant changes in the outlook for manufactures in world trade. The trend first appeared in the 1960s when the East Asian countries now called NICs entered the market for light manufactures in the industrialized markets, particularly those of the United States and Europe. By 1980 more developing countries were following the NIC lead and becoming exporters, and thus the NICs, and semi-NICs were expanding their export lines to more sophisticated goods.

The change underscores the fact that developing countries no longer constitute a monolithic "South," and are broken down into several categories: the high-income oil exporters, the upper-middle-income, the lower-middle-income, and the low-income countries; with the rapidly growing exporting countries fitting into the second and third categories.

Although exporters are still limited in number, their success has very important ramifications. One is the change wrought on theories of economic development. Up to the mid-1960s, mainstream thinking focused on factors of industrialization that the developing countries lacked. The success of the NICs, however, shifted theoretical emphasis toward identifying the factors positive to development and toward empirical analyses of the development process. One of the first positive factors to be examined was "outward-looking policy." Another highly praised factor was "export-led growth," which created virtuous circles of export and investment and gave the budding economies an ability to improve their adjustment capabilities. Those capabilities allowed the emerging economies to demonstrate surprising resilience against the external shocks, the ensuing turbulence in the world economy, and the general disruption of the growth process caused by the two oil price hikes of the 1970s. By the mid-1980s, these countries had greatly improved their relative position.

Many internal and external factors contribute to successful export-led growth. But the prerequisites that are critical to the above context are those policy packages that enable rapid industrialization and fast export growth simultaneously.

This paper summarizes the results of the IDE Research Project "Export-led Growth in World Recession," directed by I. Yamazawa [14]. An earlier version of this paper was presented at an international symposium on "North-South Manufactures Trade: Factors for Recent Development," held at the Institute of Developing Economies, Tokyo, March 23-24, 1988.

This paper focuses on the link between industrialization and trade policy to address those issues.

Section I briefly looks at the performance of eleven successful developing countries; Section II examines their policies for promoting exports of manufactures; Section III compares policy packages for industrialization and export promotion in two semi-NICs, Thailand and Malaysia; and Section IV sums up and gives tentative conclusions.

I. EXPORT AND GROWTH PERFORMANCE IN ELEVEN COUNTRIES

A brief overview of export-led growth in some fast growing countries would be in order here. Chosen for this purpose are the eleven manufacture-exporters of the Republic of Korea, Taiwan, Hong Kong, Singapore, Thailand, Malaysia, Philippines, Indonesia, India, Brazil, and Mexico. A few developing countries could be added to the list, but these eleven exported more than 80 per cent of the manufactures from the Third World in 1983 and provide an adequate basis for examination.

Exports by the eleven expanded very rapidly: at a combined rate of 25.8 per cent per annum in the 1970s, figures that compare very favorably with the 20.8 per cent world average.¹ In the early 1980s, when world recession depressed the nominal value of world trade, the eleven still managed to maintain a 5.6 per cent positive export growth. This faster-than-average expansion drove up their relative share of world export from 5.4 per cent in 1970 to 9.9 per cent in 1980 and then to 11.7 per cent in 1984, when their total exports were valued at 223 billion dollars.

Growth in manufactured exports led export expansion at 28.2 per cent in 1970–80 and 7.5 per cent in 1980–83, higher than that for all commodities; again faster than the 1970–80 world average of 18.9 per cent and the 1980–83 average of –1.5 per cent, with a larger margin than for all commodities. The eleven's share in this category thus rose from a mere 3.6 per cent in 1970 to 7.6 per cent in 1980 and 9.8 per cent in 1983. By 1983, the developing countries were shipping 10.9 per cent of all exported manufactures. The eleven's predominance among the LDCs is underscored by the fact that they exported more than 80 per cent of the LDC total.

Export composition also underwent great changes. Table I shows that the share of manufactures rose continually from 34 per cent in 1965 to 55 per cent in 1983. The eleven however, show considerable differences in level and speed of export industrialization. The export industrialization rate is calculated by dividing manufactured exports by total exports. That calculation will give the Asian NICs a 90 per cent export industrialization rate, the highest for 1980. It can be safely said, therefore, that the Asian NICs had completely industrialized their export structures by that time. The exception here is Singapore, but that is attributable mainly to a classification in which, for one thing, Singapore's exports

¹ Nominal values.

TABLE I
SHARE OF THE ELEVEN LDCs IN WORLD EXPORT OF MANUFACTURES

	1965	1970	1975	1980	1983
Korea	0.1	0.3	0.8	1.4	2.0
Thailand	0.04	0.1	0.1	0.2	0.2
Philippines	0.04	0.04	0.1	0.2	0.2
Malaysia	0.3	0.2	0.2	0.3	0.4
Indonesia	—	0.01	0.04	0.1	0.2
India	0.8	0.5	0.4	0.4	0.5
Brazil	0.1	0.2	0.5	0.7	0.9
Mexico	0.2	0.2	0.2	0.2	0.3
Taiwan	0.2	0.5	0.8	1.5	2.1
Hong Kong	0.9	1.2	1.1	1.6	1.9
Singapore	0.3	0.2	0.5	0.9	1.2
Subtotal	3.0	3.6	4.7	7.6	9.8
Japan	7.1	9.0	10.4	11.0	13.1
U.S.A.	16.6	15.2	14.3	13.1	12.7
EC (9)	46.5	45.3	45.8	45.1	39.8
LDC Total	5.5	6.5	7.0	9.6	12.1
World Total	100.0	100.0	100.0	100.0	100.0

Sources: AID-XT (IDE trade data retrieval system based on the United Nations, *Commodity Trade Statistics*, Series D; OECD, *Statistics of Foreign Trade*, Series C, *Trade by Commodities*; and the Republic of China, Taiwan, Inspectorate General of Customs, *The Trade of China; Taiwan District*); United Nations, *International Trade Statistical Yearbook*, various issues.

Note: Manufactures are goods listed under SITC 5 to 8. For these eleven countries, SITC 9 is added.

include reexport, and for another, includes exports of refined oil to neighboring countries—a large proportion of Singaporean export—in the primary product category.

India industrialized its export at the next highest rate: close to 50 per cent in 1965. However, that rise was slow for the next fifteen years at 10 per cent. Rate of growth in manufactured exports for 1970–80 was 15.3 per cent, well below the world average. Another country moving slower than the world average was Mexico. During the sharp rises in total export earnings that are attributable mainly to rises in the price of oil, the relatively stagnant increases in the export of manufactures forced the Mexican export industrialization rate down from 40 per cent in 1970 to 15 per cent in 1980.

Malaysian export industrialization went ahead at a steady 30 per cent for the entire period, but for reasons different than those for Mexico. Initially, most of the manufactures that Malaysia exported were tin, which is most often classified as a primary commodity. Tin's proportion in exports began to decline around 1970, with other manufactures taking up the slack. The decline in tin and rise in other manufactures was still keeping the overall rate stable in 1983.

The export industrialization rates for Thailand, the Philippines, and Brazil rose rapidly from under 10 per cent in 1965 to 40 per cent in 1980. The Philippines'

rate went to above 50 per cent in 1982, but Thailand's and Brazil's went down slightly. Thailand's growth in export manufactures was actually negative at -2.9 per cent, the only one of the eleven to experience such low growth. Here, too, however, the problem is compounded by classification, for exports of processed food—a primary commodity when classified by trade, but a manufacture when classified by industry—actually expanded steadily.

The last country to look at is Indonesia, whose export industrialization rate is the lowest of the eleven throughout the period. The rate of expansion, however, was very rapid at almost 70 per cent per year, the highest for the group. Even during the 1980-83 world recession, Indonesia expanded its manufactured exports at 29 per cent per annum, which is noteworthy for its sharp contrast with the zero growth in total exports. Indonesia benefited much in the 1970s from its position as a major oil producer, and steady export industrialization can be clearly observed even during recession. The momentum of that expansion seems to have intensified in the 1980s.

What causes such different performances in manufactured exports? The main reasons are factor endowment, size of the domestic market, and the level of industrialization already achieved. Without much in the way of natural resources, the NICs embarked upon export industrialization by taking advantage of the 1960s' expansion in world trade and using abundant labor to produce light manufactures. The small markets domestically available provided an additional incentive for the orientation toward exports. The ASEAN countries stand in contrast, because they relied on adequate natural resources and exports of primary commodities to finance industrialization during the period. Mexico, Brazil, and India all had abundant resources and large domestic markets and were consequently not very keen on industrializing exports. Resources and market size undoubtedly affect the level and pace of export industrialization in each of the eleven, and is responsible for the differences between them and the other developing nations.

Policies to promote manufactured exports in these countries, or more precisely, interconnected policies to promote industrialization and export, were a contributing factor. In spite of the large amount of criticism of the import substitution that is behind protection, none of the eleven, with the possible exception of Hong Kong and Singapore, succeeded without a deliberate industrialization policy. That policy very often was, and still is, accompanied by tariff and non-tariff protection, with significant causal factors for distortion. One of the most important outcomes of these industrialization policies was their discrimination against export sectors.² It is for that reason that active export promotion is deemed necessary to neutralize or at least partially compensate for that discrimination.

Compensating for one kind of distortion with another is not good policy. The best solution, theoretically, is to remove all distortion. In practice, however, such a policy could severely damage already established industries, and, in turn, lead to an erosion of capital stocks and, more importantly, a decline in industrial

² Little et al. [6] were among the first to make such critiques. The cost of protection has been frequently pointed out as large by Balassa [3] and the World Bank [13], among others. This paper agrees with them on basic points, but has a slightly different view on longer-term effects of industrial promotion.

employment. Employment promotion has been, and still is, a major objective of industrialization. Countries with dense, rapidly growing populations can ill afford employment shrinkage in their manufacturing sectors.

There is also the question of long-term industrial promotion. Many commentators cast doubt on the ways that the infant industry argument was practically applied. They point out that excessive application of infant industry premises caused many a developing country to tie itself to a heavily protected, inefficient manufacturing system. Nevertheless, some successful outward-looking developing countries have shown a coexistence of import substitution and export promotion. Korea, for one, pursued a policy in the early 1970s of building material-processing industries, such as petrochemicals and steel, for domestic use and of maintaining an export drive for light manufactures.³ Construction of heavy industry required imports of costly equipment, which must be financed, at least partially, by export expansion. And the bias against exports that protection caused had to be partly offset by export assistance.

This is not to justify industrial protection, for the issue is really one of balance between promotion of domestic industries and promotion of exports. If a case can be made for selective industrial promotion, export sectors might be entitled to an amount of promotion that is proportional to the bias against them. Promotion on two fronts, therefore, should be kept in balance. When industrial promotion is deep and widespread, the export sector needs a larger amount of encouragement, and vice versa. A promotion program covering both industry and exports that is too wide-ranged and too complicated, however, would require a level of management ability that far exceeds the capabilities of most developing countries.

The eleven have very similar policy menus. The present issue is balance between two promotion policies, and a mere listing of policy measures would not be enough to thoroughly elucidate that issue. We will now endeavor to analyze their relative functioning and effectiveness.

II. MEASURES FOR EXPORT PROMOTION

There are three discernible types of export promotion.⁴ The first is through fiscal measures, mainly tax incentives. Export subsidies in the most narrow interpretation of the term are among these measures, and are in fact a classical example of them. Such subsidies are rarely used nowadays for fear of violating GATT rules and inviting retaliation, although "grey zone" measures are still prevalent. A present-day characteristic of fiscal measures is their close connection with investment promotion. In fact, many developing countries use this kind of promotion as part of their investment incentive laws.

These incentives provide the basis for industrial promotion in many countries. The major way in which they work is to give tax holidays for certain types of investment. Investment allowances for tax purposes and accelerated depreciation

³ Ohno and Imaoka [7] point out that substantial proportion of growth is attributable to production for domestic market in Korea.

⁴ van Dijck et al. [10] draw similar distinctions between promotion measures.

are often provided in combination, either under the law or separately. Sometimes, an additional incentive is protection against imports.

These laws originally—and to a lesser, though not minor, degree still do—worked in behalf of import substitution. They acquired their additional functions for export promotion in the early 1970s, something that was made possible by declaring that export industries were eligible for incentives. In many cases, that eligibility is conditional on an export obligation that requires that exports account for anywhere from 50 to 100 per cent of total production. Directly linking fiscal incentive and export performance in this way made possible the transformation of the investment incentives laws. It also gives those laws an export subsidy effect, but one that does not necessarily violate GATT.

The second type of export promotion is the low interest export credit scheme, which provides cheaper and more readily accessible financing to exporters. These measures obviously have an export subsidy effect in proportion to the amount of interest margin multiplied by maturation period. In developing countries, access to financing may mean more than that. There, interest is generally high, which is a reflection of a relatively poor capital endowment. In a situation like that, provision of cheap loans can be of substantial assistance. De facto capital rationing at low interest, as in Korea in the 1960s, has worked to promote the development of certain key industries, including export industries.

Two prevalent types of low-interest export credit are pre-shipment and post-shipment export credits. The former has the longer standing, and uses letter of credit and shipping documents as collateral. It functions to bridge the gap between export shipment, arrival, and actual payment. The maturity period for these loans is usually three months maximum. The pre-shipment export credit is a relatively new development that uses the firm's export orders as collateral to finance material procurement. Repayment term varies, but is again usually three months.

The third type of export promotion measure is the tax refund, called either a tariff rebate or drawback. Under these schemes, the producer is entitled to reimbursement for the indirect taxes that he has already paid on the materials used to produce exports. Reclaimable taxes include indirect domestic taxes, such as business and value added taxes, but the most important of them is the customs duty.

Unlike the two former types of measures, tax refunds do not as a rule have elements of export subsidy, unless they are misused. This is because such schemes only place exporters on an equal footing with foreign competitors in terms of materials prices. Measures like these can be of considerable help in developing countries where the industrial base is weak and where many intermediate goods are heavily protected. Without easier access to imports of parts and materials under a system of partial trade liberalization, industries like clothing and machinery assembly would have a difficult time exporting.

There are some variations to this scheme. The oldest and most common allows the exporter to produce payment documents so that he can reclaim tariffs and other indirect taxes actually paid. Some countries permit bond deposits or bank guarantees to be used to make this claim at the time of importation. The method

has several shortcomings. For one, exporters have to be direct importers of parts and materials, which severely limits the scope of utilization. For another, the red tape and other preparations required are of such an amount that only the largest exporters with adequate personnel to handle the bookkeeping can use this method. To circumvent the difficulties of this system of reclaiming already paid indirect taxes, some countries provide a standard refund table, which lists predetermined tariff proportions for standard exports. All exporters can claim the rebate then, no matter whether they are direct importers or not. Still, however, the exporter has to bear the financial burden during the processing period, and that increases production costs.

The alternative solution to these difficulties was to designate areas as export processing or free trade zones. By providing partial free trade status and one-stop operation facilities, zones in many developing countries have attracted large numbers of exporters and large amounts of foreign investment. Similar arrangements are the licensed manufacturing warehouses or bonded factories that give the same status to individual establishments.

The reason for placing these export promotion measures in three categories is not merely for cataloguing. The classifications are important because the measures have different objectives, and most developing countries, regardless of export performance, have all three categories, at least on paper. In that sense, they all have the same policy instruments. Actual implementation is however, different, affecting industrialization and export performance differently. In other words, the actual combinations affect the course of export-based industrialization.

In addition to the three measures, macroeconomic policy has an inevitable pro- or anti-export effect. The most obvious and direct is the exchange rate policy. Provided that certain conditions are met, currency devaluation usually improves the international price competitiveness of exports. Inflationary pressures from government spending or loose monetary policy negatively affect price competitiveness. Excessive investment, as mentioned, often brings on such pressures.

What would be the likely effects that the three types would have? As outlined, the fiscal measures closely relate to industrial promotion. Therefore, fiscal measures have the quality of "picking out the right industries." But that selectivity can bring on serious dilemmas. Selection of too many industries would not be advisable because it would cause too much distortion. The latent defects of import substitution became abundantly clear to all development theoreticians in the late 1960s and early 1970s. Yet not placing priorities on promising infant industries and possible export activities may lessen the chance for future economic growth. In many countries, the list of industries covered by investment incentive laws tends to lengthen every year, with distortions occurring in both directions.

The real source of difficulty is how well the two objectives of industrial development and export promotion are in balance. Excessive emphasis on the former can damage the effectiveness of the latter, either directly through currency overvaluation or indirectly through lower profit rates that lead to disadvantageous resource distribution. Assuming a 40 per cent corporate tax, a 10 per cent normal pretax profit and a 100 per cent export rate, the tax exemption would have an

export subsidy effect for the individual exporter of 4 per cent on total exports. This translates into either higher profit or lower export prices. Whether it is effective enough depends on how much the export sector is put to a disadvantage by industrial protection.

The notion of investment incentive laws has close links to the infant industry argument. The laws are supposed to promote nascent industries by providing incentives to overcome the difficulties of the initial stage of industrialization. The implication of these programs is that the promoted industries are those with a high probability of eventually becoming exporters. Similar protection is thus required to upgrade the technological sophistication of the industrial structure to a certain level, which adversely affects already matured exportable sectors. In such a situation, selecting the same policy instruments and the same degree of assistance may not be a good choice. The effect of investment incentives on encouraging the transformation of domestic-oriented products into exports is therefore unclear.

In practice, the investment incentives law has a greater effect on the introduction from overseas of already established export in the form of direct foreign investment packages. We see here another side to the incentives multiplicity coin, where incentives promote direct foreign investment. When they do, the incentives work only to encourage further export production of the international subcontracting type.

Provision of low-interest export credit, in contrast, is a more general measure in the sense that all exporting industries have access to it. Freedom from selectivity makes this credit analogous to "uniform tariffs." Low-interest credit has a uniform export subsidy effect on all industries that automatically screens the internationally competitive from the non-competitive, with the least distortion. The beneficiaries, therefore, are many. Such businesses as small industries and miscellaneous goods benefit the most from low-interest credit, for they have fewer chances of being designated for promotion. The benefits are also greater to small business because it is less likely to have readily available credit sources.

Quantitatively, export credit has a relatively low subsidy effect. Assuming a 2 per cent interest margin and three-month maturity, the subsidy effect would be one-half of 1 per cent of total exports before taxes. Considering the magnitude of recent exchange rate movements, it is unlikely that the subsidy effect would effectively violate international market. There are also questions about the balance between export credit's wide-ranging, but small subsidy effect and the distortion of exports in the developing country. Export credit may not be effective in a regime of high protection.

The third measure, the tax rebate, obviously works most on the type of export that is highly dependent on imported parts and materials, especially on international subcontracting transactions. Assembly of semiconductors, for example, would not have been possible without such measures, something that is particularly true of the export-processing zones. The other beneficiary would be manufactures for the domestic market when they are moved into the export market. In fact, that was the main idea behind tariff rebate schemes in their original form. Such a

situation arises when a country tries to establish intermediate goods industries under a protectionist system. Until the new industries acquire international price and quality competitiveness, export sectors can make use of the situation of partial free trade under the scheme.

Here, however, lies a possible source of conflict. Tax rebate measures, clearly have an intrinsic propensity to cut off export production from domestic industrial linkages. An export processing zone that tends to depend almost exclusively on imported materials is a case in point. Its local inputs are very often limited to labor, energy, and water and other relatively simple items, although an effort is made to expand the level of these inputs.

This does not mean that the export processing zone has no benefit to the host country. For one thing it provides employment, which is especially important where the labor force is underused. For another, the zone contributes to the balance of trade at least in the form of wage payments. It must be kept in mind that these zones are unlikely to become focal points for industrial linkage, however.

III. A CASE OF TWO COUNTRIES: MALAYSIA AND THAILAND

These two countries have been chosen for our case study to examine the actual working of the three export promotion measures, the relations between those measures, and their relation to macroeconomic policies.⁵ Although Malaysia's per capita GNP is three times larger than Thailand's, and the Thai population is two-and-a-half times as big as the Malaysian, the two countries' factor endowment, growth rate, development strategy, and rapid expansion of manufactured exports give them many common development features.

The combination of policies used to promote export are dissimilar, which, however, is reflected in the over-time change in the commodity composition of exports shown in Table II. The table also includes corresponding figures for the Philippines which may be used for comparison.

The table's unconventional commodity classification requires some explanation. The classification is designed to roughly conform to industrial classifications and to differ from ordinary trade classifications. UPPP stands for unprocessed primary products, which includes farm, forestry, fishing, and mining products in crude form and PPP stands for processed products. The main component of this category is processed food but it also includes wood products and nonferrous metals.

SUBCON stands for international subcontracting exports and covers goods with exclusive specifications for foreign markets that are almost all exported. As such they tend to have a very high import content. Since subcontracting is a form of transaction, its definition commodity-wise is inevitably arbitrary. Here, it consists of electric and electronic parts (SITC 722, 729), clothing (84), footwear (85), precision instruments (86), and "consignment basis" commodities (931). In Thai-

⁵ Ingram [5] and Fong [4] give detailed descriptions of the growth process in the two countries. Tambunlertchai and Yamazawa [8] and Tan et al. [9] are more concerned with export promotion.

TABLE II
COMMODITY COMPOSITION OF EXPORTS

	UPPP	PPP	SUBCON	DOM	Quantity Index (1980=100)
Thailand					
1962	89.8	6.8	1.3	2.1	22.4
1970	64.7	26.6	5.4	3.3	33.2
1980	51.4	23.4	13.2	12.0	100.0
1983	49.5	23.9	14.2	12.4	113.3
					(8.0%/year)
Malaysia					
1962	68.4	22.3	0.8	8.1	33
1970	65.9	25.4	1.3	7.2	55
1980	68.9	12.8	11.0	7.3	100
1982	68.3	9.0	14.1	8.6	103
					(6.6%/year)
Philippines					
1962	92.2	6.0	0.2	1.6	26.3
1970	87.6	7.5	0.2	4.6	43.7
1980	55.0	11.2	23.0	10.5	100.0
1983	39.8	10.8	37.2	11.6	101.4
					(5.9%/year)

Source: AID-XT.

Note: PPP=processed primary products, such as processed food, wood products, and nonferrous metals; SUBCON=electric and electronic parts (SITC 722, 729), clothing (84), footwear (85), precision instruments (86), and consignment goods (931).

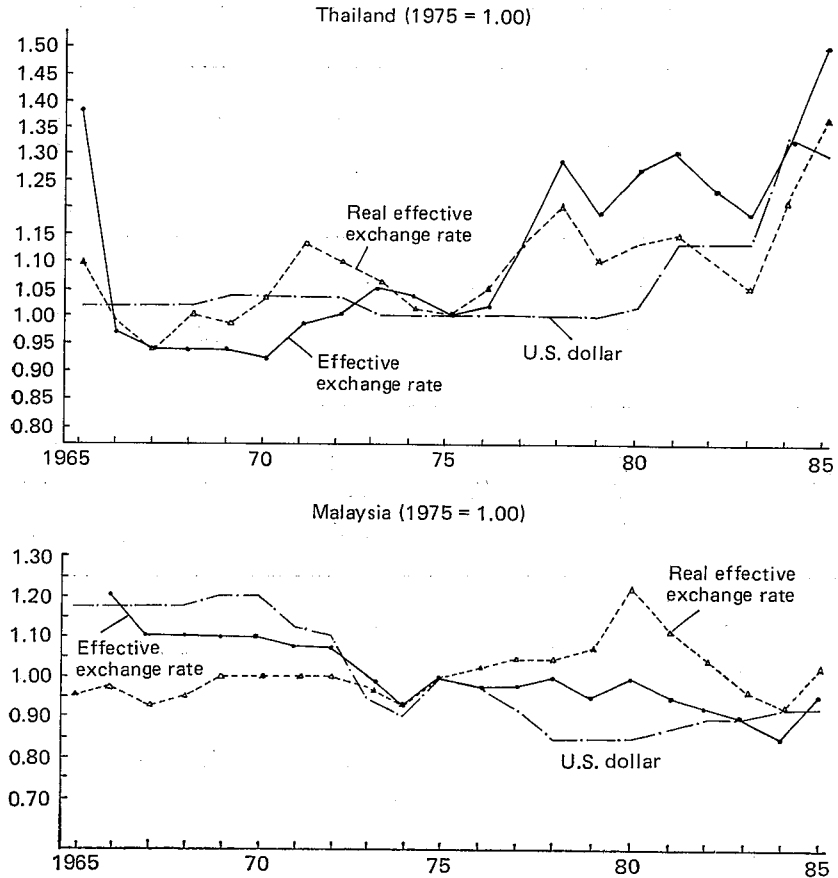
land and Malaysia they appears to cover the majority of commodities listed under international subcontracting. DOM means exports of domestic market-oriented manufactures. Unlike SUBCON goods, DOM are basically the same for the domestic and the export market.

Table II, then, should be self-explanatory. While Malaysia's export commodity composition for twenty years shows little signs of change, except for a sharp rise in SUBCON and a corresponding drop in PPP, Thailand's shares for all three manufacturing activities increase. Its overall real growth rate of exports is also faster. These factors are important enough to suggest significant differences in the administration of export promotion policies.

The two countries carried out an almost identical industrial promotion strategy, with Thailand seriously beginning industrialization in 1959 through the amendment of its Investment Promotion Act. The government set up a Board of Investment in the same year to review company applications and to make the final selection for the privilege of promotion. The board's original objective was providing tax incentives and protection to promote new import-substituting industries.

Malaysia's corresponding law was the Pioneer Industries Ordinance of 1958, the year generally considered as the start of industrial development. As its title

Fig. 1. Exchange Rate Movement



Sources: IMF, *International Financial Statistics*, various issues and AID-XT.

indicates, the ordinance had much the same purpose—with very similar measures—as the Investment Promotion Act in Thailand.

Recognizing the need to promote the export of manufactures, changes were made in the laws in Malaysia in 1968 and in Thailand in 1972. The changes were made by explicitly designating export production as eligible for promotion, and very often by providing that designation with accompanying obligatory export rates for individual commodities. This was a significant departure from previous practices, although both laws maintained the power to promote new, domestic-market-oriented, technologically sophisticated products.

The relative balance between the two objectives of promoting exports and improving the industrial structure cannot be directly assessed. Table II on export

TABLE III
EXPORT CREDIT SCHEMES

	Thailand			Malaysia		
	Finance (Million Bahts)	Exports (Million Bahts)	%	Finance (Million Ringgit)	Exports (Million Ringgit)	%
1972	2,755	22,491	12.2			
1973	3,160	32,595	9.7			
1974	7,781	50,586	15.4			
1975	10,388	44,739	23.2			
1976	16,363	60,756	26.9			
1977	19,144	71,199	26.9	139	14,959	0.2
1978	23,657	83,082	28.5	395	17,073	2.3
1979	36,795	108,166	34.0	1,178	24,222	4.9
1980	42,852	133,203	32.2	1,288	28,172	4.6
1981	53,720	153,493	35.0	1,312	27,109	4.8
1982	62,014	160,007	38.8	1,066	28,108	3.8
1983	71,325	146,469	48.7	1,447	32,771	4.4
1984				1,715	38,647	4.4
1985				1,729	38,327	4.5

Sources: [13], hearing at Bank Negara Malaysia, and AID-XT.

performance indicates, however, that the Thai efforts to transform domestic market-oriented commodities into exportables have been more effective, a difference that became more prominent after 1980. While Malaysia started to establish a wide-range of heavy industries, Thailand postponed its Eastern Seaboard Development Project. Malaysia's bold emphasis on industrial development during a period of world financial turmoil eventually exacerbated the difficulties of economic management and resulted in 1984-85's economic stagnation. This is reflected in the effective movements of the real exchange rate in Figure 1, which shows that Thailand's trend from 1975 is ragged but generally upward, with improvement in international competitiveness, while the trend for Malaysia moved sharply downward in 1980.

Thailand began its export credit scheme in 1972, Malaysia began a quite similar program in 1977. Thai commercial banks discount both pre- and post-shipment loans to exporters at 7 per cent for three months and the Bank of Thailand rediscounts them at 5 per cent. Malaysian interest rates are 5 and 3.5 per cent. Thailand's interest rate margin is 7 to 12 per cent, wider than Malaysia's margin of only 3 to 6 per cent. The before-tax export subsidy effect, therefore, is roughly 2-3 per cent in Thailand and 1-1.5 per cent in Malaysia.

The real difference, however, lies in eligibility requirements. Table III shows that Thailand applies the scheme very generally, because a very high proportion of exports qualify, almost 50 per cent in 1983. Malaysia defines eligibility more narrowly and emphasizes textile and edible oil industries. Consequently, its scheme covered only 4.5 per cent of total exports in 1985. Even allowing for such structural differences as Malaysia's higher proportion of cash and semi-cash transactions

in tin and rubber, a disparity of this size indicates a large gap in effectiveness, which at least partially explains Thailand's better export performance in PPP and DOM categories in the 1970s and early 1980s.

Although institutional settings are also similar, both being equipped with most of the earlier described legal apparatus, they differ in ways of providing partial free trade facilities for exporters.

Thailand relies more on the tariff refund method and operates both actual-payment reclaim and standard-table rebate systems, which have questionable effectiveness in promoting export of manufactures. Many small businesses, reportedly, do not use these systems, mainly because the cost of processing reclaim applications is too high. The government is now reevaluating the system for possible reforms.⁶ Judging from export performance, however, the system appears to have had some effect especially in clothing which imports one-third of its necessary materials. Bonded factory status is permitted only to those promoted industries that are subject to special bookkeeping for imported materials. Larger corporations, particularly electrical and electronics equipment, are the main beneficiaries. Two small export-processing zones were recently constructed in industrial parks, one in the Bangkok suburb of Lard Krabang, the other in Laem Chabang in the Eastern Seaboard Development area, but they have had a very limited role in promoting the export of manufactures.

Malaysia relies more heavily on free trade zones (FTZs) and licensed manufacturing warehouses (LMWs).⁷ The three states of Penang, Selangor, and Malacca have eight FTZs with ninety factories and eighty LMWs. Although no official statistics are available, it is commonly believed that the two systems account for half of Malaysia's manufactured exports, in other words, all SUBCON exports. A very conspicuous example is the integrated semiconductor circuit, which makes up for the lion's share, or roughly two-thirds of all SUBCON exports.

The Malaysian Customs Act of 1967 stipulates a tariff drawback arrangement, which is clearly ineffective judging from the FTZs and LMWs' very high share of SUBCON exports. The law is supposed to help transform domestic-market products into export products, an area in which Malaysia has not been successful. In short, Malaysia's partial free trade arrangement was effective in promoting exports by its mobilization of direct foreign investment, but failed to pave the way for local manufacturers to move into exporting.

IV. INTERACTION BETWEEN INDUSTRIAL AND EXPORT PROMOTION POLICIES—TENTATIVE CONCLUSIONS

If the infant industry argument is valid for a developing country creating local domestic linkage, building up entrepreneurial experience, and compensating for other market failures, policies based on those arguments will cause the export sector to suffer ensuing distortion. The disadvantages of an infant industry policy are twofold. First, it causes the country's production costs to rise against the

⁶ See [12].

⁷ Anazawa [1] and Warr [11] give detailed accounts of Malaysian FTZs and LMWs.

international standard. Protection tends to overvalue domestic currency, which further harms international competitiveness. Protection places the country at a disadvantage with overseas competitors in material procurement when industrialization begins its intermediate products stage. Second, protection makes profits on sales to the domestic market higher than to the export market, which places export sectors in a more difficult position in terms of resource allocation. The most important of these resources in a developing country with prevailing capital shortages may well be finance.

Export promotion policies are devised to help overcome those two disadvantages. Tax incentives and export credit schemes have a definite subsidizing effect in the way that they enable exporters to improve profitability and/or price competitiveness through direct links with export performance. Tariff rebate and export processing zones do not have a subsidy effect, but place exporters on an equal footing in material and parts procurement costs.

These three types of measures are common to many different developing countries. Being legally equipped with them however, does not ensure export expansion. This is clear from the fact that many developing countries, irrespective of export performance, have them on paper. Actual enforcement and effectiveness, therefore, are the issues to be scrutinized.

Another issue to be considered is whether the export subsidy effects violate the rules of international trade. GATT explicitly prohibits using subsidies to promote exports. Aside from the legal aspects, which are not very clear anyway, these subsidies may have an economic rationale. Deliberate manipulation of the comparative cost structure by the government is not advisable in principle. When the promoted industries have a potential advantage, however, the analogies of the infant industry argument can be applied.

An extension of the argument relates to the phases of industrial development. Protection of intermediate goods industries becomes a logical necessity at a certain stage of development. The anti-export bias of that protection however, places exportable goods at a disadvantage. Export promotion measures do not affect the comparative advantage structure to the extent that they offset bias. Here again, the export subsidy effect of promotion policies is justifiable within certain limits.

In fact, it is no accident that the start of deliberate export promotion policies roughly coincides with the start of industrial base extensions, or the second-round import substitution. Protection of new industries, in the above context, requires that exporters be compensated. Another reason for this protection is perhaps the larger imports for new investment. Financing those imports requires an expansion of exports beyond the traditional export base.

A check on successful exporters like Thailand and Malaysia suggests that they are using different combinations of measures. Since each measure has its own target, in combination they produce different patterns of expansion in export of manufactures. Malaysia's high concentration of SUBCON exports contrasts sharply with Thailand's more balanced expansion, which is at least partially explained by a greater emphasis on FTZs and LMWs, whereas Thailand emphasizes export credits.

Balance between industrial and exchange rate policies is another point that

explains the difference in performance. If we suppose that industrial protection and over-investment are some of the most important factors in inflationary pressure, excessive industrial development effort will damage the chances for export expansion. Then, investment incentive laws with their double targets of industrial development and export promotion, will have to be very delicately balanced while they are being carried out. Judging from the movement of the real effective exchange rate and recent growth performance, Malaysia has pursued the more deliberate, more active industrial policy. The resulting larger distortion may well be an underlying factor in Malaysia's relative ineffectiveness in export promotion measures, with the exception of SUBCON commodities. In other words, the high degree of distortion that arises from Malaysia's industrial protection may have eroded that country's chances to succeed with an export promotion package that is consistent with domestic industrial development targets.⁸

I would conclude that the combination of a lighter, more selective industrial policy with a more general, wide-ranging export promotion policy has performed better in the simultaneously evolving industry and expanding manufactured exports. These observations derive only from two cases, but may give much wider implications.

⁸ Ariff and Hill [2] point out the adverse effects of industrial regulations in the ASEAN countries, especially the "made-to-measure" regulations.

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