



EXECUTIVE SUMMARY

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*Executive Summary*

EXPORT PROMOTION  
AND  
ECONOMIC GROWTH

Edgardo Favaro  
Claudio Sapelli

**Centro de Estudios de la Realidad Económica y Social**

International Center for  
Economic Growth



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This is an executive summary of a Spanish book, *Promoción de Exportaciones y Crecimiento Económico*, by Edgardo Favaro and Claudio Sapelli, to be published in Chile.

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## Preface

The International Center for Economic Growth is particularly pleased to publish this executive summary of the results of a Joint Research Project between ICEG and the Centro de Estudios de la Realidad Económica y Social (CERES) in Uruguay. This project is the work of Edgardo Favaro and Claudio Sapelli and was first published in Spanish as *Promoción de Exportaciones y Crecimiento Económico*.

The authors discuss the history of trade expansion and economic growth in Uruguay and show that periods of economic stagnation are clearly associated with trade restrictions. They explain the correlation between open trade systems and growth by the increased productivity of resources generally associated with export-oriented development strategies. Favaro and Sapelli show that despite these general relationships, partial trade expansion based on incentives to protected sectors and exporting to protected markets does not necessarily raise productivity and can in fact be detrimental to economic growth.

This study has important policy implications not only for Uruguay, but also for Latin America as well as developing and developed countries throughout the world. In Latin America many countries have added export promotion measures to existing economic policies in an attempt to follow the broad example of the Asian NICs. Unfortunately, unrestricted import substitution policies remain in place, often leading to the counterproductive policy combination described by Favaro and Sapelli.

Nicolás Ardito-Barletta  
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Panama City, Panama  
September 1989

## About the Authors

**Edgardo Favaro** is a former academic director of the Centro de Estudios de la Realidad Económica y Social (CERES) and is currently on leave at the University of Chicago. He has been a professor at the Universidad de la República, visiting professor at the Universidad de Chile, and economic advisor to the government of Uruguay. He has served as a consultant to the United Nations Development Program, the World Bank, the Interamerican Development Bank, and the Economic Commission for Latin America. In 1986 he received the Economics Prize Award for "External Shocks, Degree of Openness, and Domestic Policy," which he cowrote with Claudio Sapelli. He is also the author of articles on the political economy of poverty, equity and growth, and trade liberalization policies and the effects of entry regulation on oligopolistic interaction in the Uruguayan banking sector.

**Claudio Sapelli** is currently academic director of CERES. He has been a visiting professor at the Universidad de Chile and an advisor to the Central Bank of Uruguay and the National Chamber of Commerce. Dr. Sapelli has served as a consultant to the World Bank, the United Nations, the Interamerican Development Bank, and a variety of private enterprises. In 1986 he received the Economics Prize Award for "External Shocks, Degree of Openness, and Domestic Policy," which he cowrote with Edgardo Favaro. He has also written papers on labor markets, international trade, public finance and agricultural economics, modernization of the tax system in Uruguay, unemployment and indexation policies, the political economy of taxation, and other topics.

# Executive Summary

The purpose of this study is to examine the relationship between trade policy and economic performance. Focusing on the case of Uruguay, the study begins by examining the connection between import-substitution policies and economic stagnation; it goes on to analyze policies implemented to promote exports, and their effect upon the performance of the economy.

- After years of following import-substitution policies, Latin American policymakers have recognized that this strategy has had much to do with poor economic performance, and as a result they have ventured into what most call export-promotion policies.
- Some of these new export-promotion policies are simply continuations of import-substitution policies, encouraging the export of the same products manufactured previously and doing nothing to improve economic performance. Policymakers seem to believe promoting exports means increasing the volume of exports without regard to what is exported. In fact, however, growth is achieved through either the increased use of resources or an improved allocation of resources. This improvement in productivity is what leads to increased exports.
- Uruguay makes an interesting case study, because it has a long history of import barriers accompanied by a stagnation in GDP. These barriers (tariffs, quotas, deposits, prohibition, and multiple exchange rates) were gradually tightened

between 1930 and 1971. The trend was broken in 1974, when import barriers were lowered and a number of other policy changes (tax reform, export subsidies, and preferential trade agreements with Argentina and Brazil) also occurred. At about this time both exports and GDP began increasing substantially, but it is difficult to determine which of the new policies was responsible for this.

- In order to determine the cause of the increase in exports, a closer examination is made of four policies, and conclusions are drawn about their significance.
  1. The trade agreements with Argentina and Brazil are essentially “subsidy-swapping” agreements, which consist of an exchange of preferential tariffs, import quotas, and quota exemptions. Most of the exporting industries are highly protected and export only products that had been produced under import-substitution policies; these exports lead to a minor increase in productivity. It is also true that under this type of agreement, Uruguay effectively subsidizes Brazilian and Argentinian firms.
  2. There is no support to the claim that earlier import-substitution policies encouraged human capital formation, without which the increase in exports would have been impossible.
  3. Export subsidies did not substantially increase total exports. What the export-subsidy policy tried to do was to subsidize each sector enough to export. When the subsidies disappeared, most of the subsidized exports disappeared as well, but total exports did not fall, because other, nonsubsidized exports increased. The lack of change in total exports occurs because subsidies lower the price of foreign exchange, thus raising the price of exports in foreign markets; this in turn, makes unsubsidized exports too expensive overseas. When the subsidies are removed, the

previously subsidized exports are no longer able to compete in foreign markets.

4. Reforms in fiscal and foreign trade policies are thought to be responsible for most of the increase in exports. Although productivity and exports did increase while discriminatory subsidies and preferential trade agreements were in place, increases in both would have been *much* greater without subsidies or the trade agreements.
- Import-substitution policies do not lead to sustained growth; they encourage low productivity and poor economies. An easy way to increase exports, but one that also encourages low productivity, is to subsidize import-substitution sectors and arrange trade agreements to make it easier for these sectors to export. Because they are detrimental to other, unsubsidized sectors, these policies do not, in fact, increase exports.
  - A more difficult, but more productive method of increasing exports involves removing all discriminatory barriers and subsidies. This has the effect of reallocating resources to more productive exporting sectors, which should be the consequence of every policy that claims to be “export promoting.”

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Edgardo Favaro  
Claudio Sapelli

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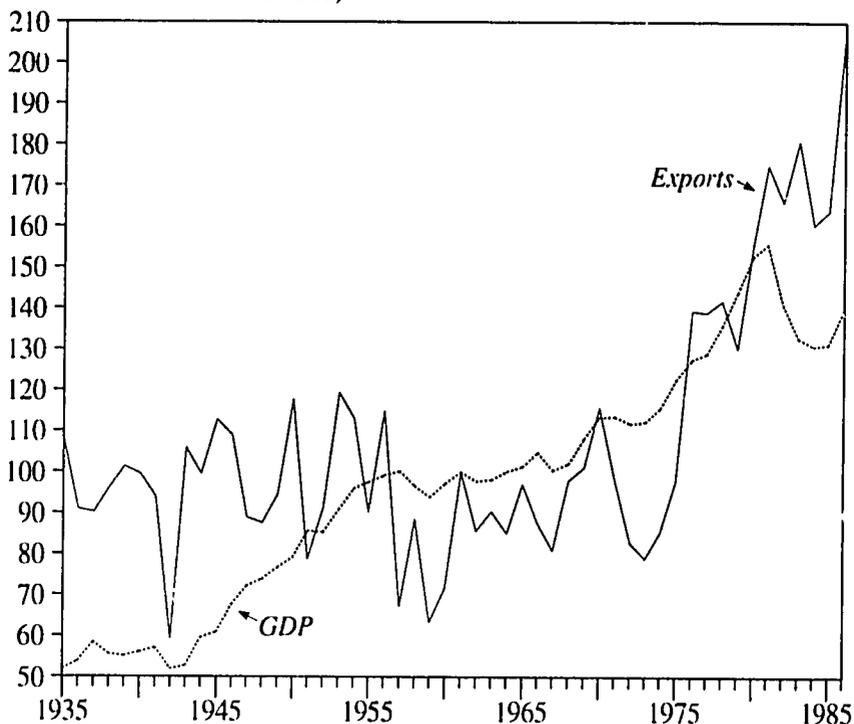
## Export Promotion and Economic Growth

After years of following import-substitution policies, Latin American policymakers have recognized that these policies, which greatly limited trading opportunities, have had much to do with their economic problems. As a result, a number of countries have tried to correct the problem by promoting exports.

Unfortunately, some of the policies implemented under the banner of export promotion are only new versions of old import-substitution policies. They have, therefore, very little growth-inducing potential. Policymakers seem to have understood the message that we must export, but they have overlooked the *reasons* for exporting. In doing so, they have pursued a policy based on the belief that any new export is as good as any other, rather than on the recognition that exports are evidence of high productivity and good quality—the real reasons for promoting exports.

Our study of trade policy and economic performance in Uruguay began by exploring the hypothesis that economic growth was led by high exports, and that import substitution produced both export stagnation and falling per capita incomes (see Figure 1). In doing so, we delved into the history of Uruguay and the development of import-substitution policy. Once we became convinced that import substitution and stagnation were in some way connected, it was clear to us that the import-substitution policies had to be changed, as was done in the

FIGURE 1      Indexes of GDP and Export Volume, 1935-1986  
(1961=100)



SOURCE: H. Finch, *Historia Económica del Uruguay Contemporáneo* (Montevideo: Ediciones de la Banda Oriental, 1980). Uruguayan National Chamber of Commerce studies. Central Bank of Uruguay statistics.

mid-1970s. We went on to analyze the policies that were then instituted, with an eye to answering the following questions:

- If it is clear that it is in a country's best interests to export, what is the best way to promote this?
- Are all exports alike in their growth inducing potential?
- In what way should the new export-promotion policy be related to the old import-substitution policy? In short, what is a *real* export-promotion policy?

One important conclusion of the paper is that the language used in economics often leads to confusion. We have used conventional language up to this point, and perhaps nothing has sounded wrong. What does it mean to say “export-led growth”? What does “the growth inducing potential of exports” mean? How do exports “lead to” or “induce” growth? Once we look at growth theory, we see that this language is plainly wrong. Exports do not induce or lead growth. Instead, growth is produced either by increasing the use of factors of production or by using them better or more productively—what we usually call an “improved allocation of resources.”

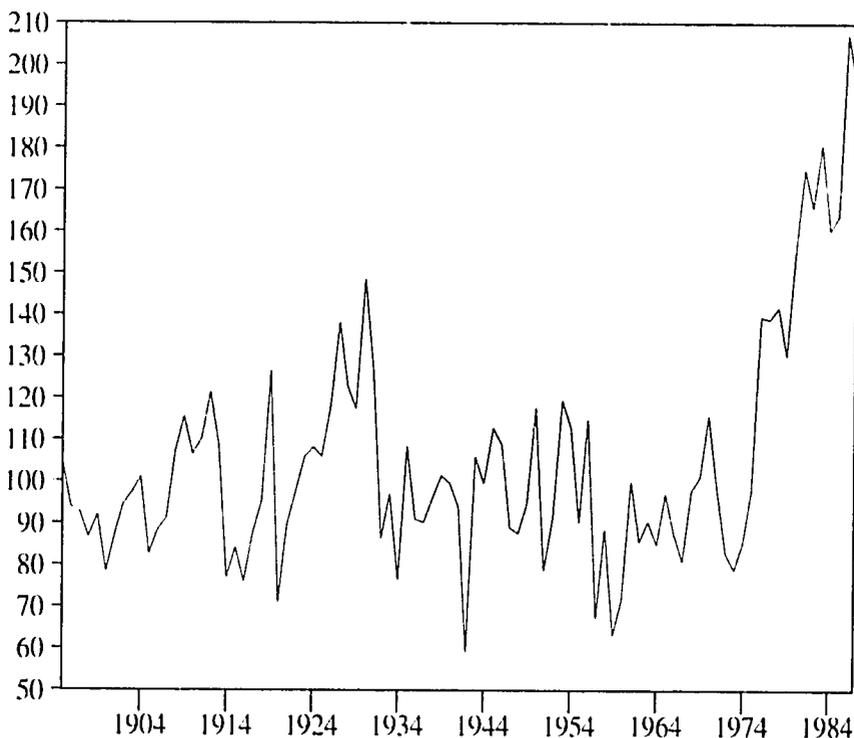
With phrases such as “export-led growth” as slogans, it is not surprising that policymakers conclude they have to export, no matter what: to promote exports, then, means to increase the volume of exports, period.

The real policy lesson is, regrettably, not this one. It is that import-substitution policies lead to low overall productivity, and therefore to stagnation of both exports and GDP. Export-promotion policies are those policies that lead to higher overall productivity in the economy, and therefore to more exports and growth. They are policies that lead to the reallocation of resources toward more productive sectors. As politicians shy away from policies that imply (sometimes large) reallocation of resources, the easiest way to go from an import-substitution to an export-promotion policy—as they understand it—is to subsidize the export of those goods that are produced under import substitution. That is, to subsidize them as much as necessary to make their prices competitive in foreign markets. Another policy that makes this transition easy is to find foreign markets more protected than the domestic market, with even less productive industries, and offer trade-diverting concessions (to buy there what would otherwise be bought elsewhere) in order to obtain preferential tariffs to export to those markets. In this strategy no opposition exists between import-substitution and export-promotion strategies; one simply perpetuates the other. Obviously, no resource reallocation will take place through these export-promotion policies. Therefore, exports can grow, but no growth will follow. But we have gone too far in telling the end of the story. We must begin by examining

how Uruguay's experience shows a need for a change in policies to achieve growth.

Uruguay provides an attractive case study because exports, after years of stagnation, grew strongly after 1974 (see Figure 2). At the same time, the economy started growing after twenty years of declining per capita incomes. A clear policy change occurred in the mid-1970s, but the changes were complex, and it is important to determine which particular changes produced the sudden export explosion.

FIGURE 2 Index of Export Volume, 1895-1987 (1961=100)



SOURCE: See Figure 1.

We will begin by examining the history of Uruguay's GDP stagnation, which is accompanied by progressively restrictive anti-import policies. In 1974 a reversal of these policies occurred, some barriers disappeared, and tariff rates were considerably reduced. We will then turn to

analyzing how exports were affected by other policy changes that occurred at the same time. These include trade agreements with Argentina and Brazil, and export subsidies. Finally, we will discuss the policy conclusions of our study.

### **History of Import Barriers**

The volume of exports shows two clear inflections in trend in the 1930s and the 1970s (see Figure 2). The first coincides with an increase in import barriers and the second with a decrease in import barriers accompanied by other changes in foreign trade legislation (see Table 1). The average maximum tariff was 37 percent until 1931 when, with the balance of payments crisis that coincided with the Great Depression, a considerable policy shift occurred that resulted in the imposition of exchange controls and import quotas. The exchange controls—monopolization of the foreign exchange market by the Banco de la Republica Oriental del Uruguay BROU, who decided on what items foreign exchange was used, and the exchange rate at which it was bought and sold—led to multiple exchange rates. Both quotas and exchange controls, as well as monetary policy, were managed by the BROU, which, as central bank, investment bank, and foreign trade customs, exercised a lot of discretionary power in assigning quotas and exchange rates. The haphazard use of this power over the next twenty-five years led to a system of such complexity that it was said nobody understood it. An attempt was made to rationalize the system in 1956; this reduced the number of exchange rates to fourteen—eleven for imports and three for exports.

A new protective device was then implemented: if a firm wanted to import something, it had to deposit, at the time of starting the import formalities, 100 percent of the value of imports. Since no interest was paid on this deposit, the result was a new cost on importers, which increased with the inflation rate. In this way legislators had designed a system in which inflation became a protective instrument: high inflation meant high protection against imports.

In the 1950s the BROU adopted the Real Bills Doctrine (which states that money issued to back a real transaction is not inflationary and leads to a greater GDP, but evidence does not support this) and so

TABLE I Import Barriers, 1815-1987

Year	Maximum tariff	Changes in other barriers
1815	45%	
1829	25	
1837	31.5	
1850	31	
1856	35	
1861	22	
1875	42	
1886	51	
1912	31	
1931	48	Foreign exchange controls, quotas, BROU intervention
1956	48	Simplification to 14 exchange rates, 50-150% deposits
1960	150	Single exchange rate, quotas end
1963	300	90 day prohibition
1964	450	Prohibition, 200% deposits
1965	450	Prohibition, 100% <i>consignaciones</i>
1966	450	Prohibition
1967	450	Prohibition, 200% <i>consignaciones</i>
1971	450	1200% <i>consignaciones</i>
1974	200	35% <i>consignaciones</i>
1975	200	<i>Consignaciones</i> , prior deposits, and foreign exchange controls end
1977	150	Port taxes reformed
1978	110	
1979	90	
1981	75	Gauge prices (minimum import prices) introduced
1982	55	
1987	45	

SOURCE: Authors.

issued money to finance real transactions backed by commercial paper. This discounting process had a substantial subsidy implicit in its low fixed interest rate. The business community in Uruguay then became a partner with the government in collecting the inflation tax. More inflation meant more protection against imports and more subsidies through credits.

In 1959, the Blanco Party took power for the first time in this century. It decided to change the entire quota system for a more transparent tariff system and abolished the multiple exchange rates and quotas. It increased the maximum tariff from 48 to 150 percent. The same law authorized the executive power to prohibit imports for short periods.

Together with a considerable deterioration in the management of fiscal and monetary policy, the 1960s became a decade of recurrent balance of payments crises. In 1963, the second Blanco government enacted the first import prohibition for ninety days and raised the maximum tariff from 150 to 300 percent. Prohibitions were enacted again in 1964, 1965, 1966, and 1967. Also, in 1964 the maximum tariff was raised to 450 percent. The deposit that had to be made before importing was increased to 200 percent of the value of imports. In 1965 a new protective device called *consignaciones* was enacted: this worked similarly to the deposits but had a quota system incorporated. That is, above the 200 percent non-interest-paying deposit (inflation averaged 50 percent in the 1960s), a 100 percent *consignacion* had to be made. But importers with quotas did not have to make the deposit required by the *consignacion* system. This deposit requirement was increased to 200 percent in 1967 and to 1200 percent in 1971.

It is clear that any change the 1960 reform made was merely formal. The new tariff and export tax system merely replicated the multiple exchange rate system; 450 percent tariffs and 300 percent deposits continued the quota system. Deposit requirements of 1200 percent were equivalent to a prohibition of imports unless you held a deposit exempt quota. So, whatever the protection device was, Uruguay had de facto a complex protectionist system that used quotas, or quota equivalents, and multiple exchange rates or their equivalents for most of the 1931–75 period.

The drive towards higher and higher taxes on imports stopped in 1974, when the maximum tariff was reduced from 450 to 200 percent and *consignaciones* were lowered from 1200 percent to 35 percent. A year later *consignaciones*, as well as prior deposits, were eliminated altogether, implicitly ending the quota system. The exchange controls were also lifted. Since then the maximum tariff has been steadily reduced from 200 to 45 percent in 1986. Nevertheless, during the 1981 depression a new protective tool, the "gauge" price, was implemented: a tariff was placed on goods priced below this level. This policy was enacted originally as an antidumping device, but was transformed into a protective mechanism thereafter.

In any case, the trend towards liberalization was clear and uninterrupted between 1974 and 1981. From this story and the evolution of exports seen in Figure 2, it will become clear why economists usually regard import protection as equivalent to a tax on exports. When protectionism grew, exports stagnated. When protectionism started to decline, exports grew steadily.

Because an import-substitution policy is the same as an anti-export policy, economists usually recommend dismantling the protectionist measures as an export-promotion policy.

In any case, the term "protectionism" has in this context a warm ring to it, not reflecting the nature of the reality associated with the policies named. This may be a problem of the terms used in economics.

An import-substitution policy is a system that authorizes certain firms to use scarce resources in unproductive ways. In addition to constituting permission for inefficiency, it hides important monopoly profits. The extent of these profits becomes clear when we see that under the quota system 80 percent of all imports were made by only twenty-eight firms. There is no better way to characterize import substitution than as a system of privileges. This system had to be changed, and a change occurred.

Actually, many other policy changes were enacted at the same time. A tax reform replaced part of the employers' payroll tax, as well as more than 100 minor taxes, with a value-added tax. This tax is very good in complying with the golden rule of "not exporting taxes," since it is easy to do the border-adjustment. Other policies included a boost to the integration policy with Argentina and Brazil, and an increase in export subsidies.

All of these changes occurred at approximately the time that exports started growing at incredible rates. Which of them was the key to the transformation? By answering this question, we would know a great deal about the best way to go from import substitution to export promotion.

### **Analysis of Recent Trade Policies**

**Integration with Argentina and Brazil.** The agreements with Argentina and Brazil have become similar as a result of the 1985–86 changes. They consist of a host of preferential tariffs, quotas, and quota exemptions for Uruguayan exports to enter the highly protected Argentinian and Brazilian markets. These are made for a wide range of products, though trade with both countries differs. Most exports to Argentina are from highly protected industries that export only to Argentina. Exports to Brazil include goods that have alternative markets or goods that have high transport costs.

Uruguay's concessions to Argentina and Brazil are mostly trade diverting. That is, tariff concessions are given so that capital goods that had been bought from third countries are now bought from our neighbors. Especially with Argentina, the agreements can be summarized as an exchange of subsidies to industry. Argentina gives Uruguay a quota to enter its market, with which Uruguay's firms capture part of the monopoly rents produced by the quotas. Uruguay imports from Argentina what it was importing from other countries by lowering its tariffs and losing revenue; it is as if this revenue was used to subsidize the Argentinian industry. Therefore, instead of being constituted of "industry swapping" arrangements, in which each country specializes at what it does best, integration agreements are constituted of "subsidy swapping" agreements, in which the subsidized firm is selected at the negotiating table. Through this "subsidy swapping," countries formally comply with the current impulse to promote exports.

Unfortunately, this does not change the substance of the preexisting system. Uruguay exports import-substitution products to its neighbors; this is only a step towards deepening the import-substitution policy.

To corroborate this impression, we did some econometric work to test the hypothesis that exports promoted by these agreements "pro-

duced" less growth than other exports. It is very important to see that this last assertion is incorrect. This is, as we said, a key conclusion of the paper. What we should attempt to demonstrate is whether the policies that increase exports to the rest of the world produce a different increase in productivity than those that increase exports to our neighbors—given that these last policies are dominated by the agreements described. Our results show that policies that "promote" exports to the rest of the world increase productivity *fourteen times* more than policies, such as preferential trade agreements, that use exports as a way to extend the import-substitution policy.

It is important to realize that what is wrong is not the integration policy per se, but the particular way these countries have chosen to integrate. Economic integration can be welfare enhancing or not, depending on the kind of agreement that forms it.

**Infant industry.** The Economic Commission on Latin America (ECLA), the institution that originally backed import substitution has not accepted that this policy is largely responsible for GDP stagnation. ECLA claims that the export-promotion drive would have been impossible without the previous import-substitution policy, which, it is claimed, encouraged human capital formation in industries that later exported—the infant industry argument for protection. These assertions are made without evidence. We designed a test for the assertion that the growth of the industrial sector led to the formation of a human capital stock with a positive value at the time exporting began. The test showed a zero value of that stock. There is, therefore, no evidence that the import-substitution policy had a positive effect on the export-promotion drive of the 1970s. Import substitution was a tax on exports prior to the 1970s, and this does not seem to have been compensated by a positive externality in exports when the import-substitution policy was removed.

**Export subsidies.** To extract the influence of export subsidies from the data was not easy. The impression one gets (it is difficult to make definitive judgments here) is that export subsidies were not the major driving force behind the export boom. We will center on explaining the growth of nonbeef, nonwool exports. We do this because beef and wool exports are affected in the medium run by a host of noneconomic variables,

such as disease and climate, and also because the growth of other, nontraditional exports was the main feature of the boom. In 1973 nontraditional exports were 26 percent of total exports. In 1980 they were 61 percent of total exports and have remained at that level up to the present. Between 1973 and 1987, they grew at an average annual rate of 12 percent.

We can perform a sort of static experiment by comparing averages for 1961–67 and 1984–87. Both periods are comparable in that subsidies are very low, and nontraditional export prices are similar (see Table 2). But nontraditional<sup>1</sup> exports were twelve times larger in 1984–87. As a matter of fact, Table 2 shows that the evolution of the real exchange rate, of export subsidies, and of prices cannot explain the evolution of exports. Between 1969–73 and 1973–78 the effective exchange rate (measured in pesos per dollar and obtained by multiplying all three variables) rose 16 percent and exports grew 251 percent. Between 1973–78 and 1984–87, the effective exchange rate fell 17 percent and exports grew 35 percent. Thus we conclude that the structural reforms, in the legal framework of foreign trade and fiscal policy, were the key to the increase in exports.

An econometric test of these assertions was made, comparing the effect of the effective exchange rate and of structural reforms. The test revealed that most of the increase in nontraditional exports can be attributed to the reduction in the anti-export bias produced by changes in fiscal policy and in import-substitution policy.

These results, in turn, can explain why neither the decrease in the effective exchange rate nor the reduced subsidies produced a reduction in exports (on the contrary, they continued growing). In 1985, with an effective exchange rate similar to 1974 (123 vs. 128) and all reforms in effect, the level of nontraditional exports was three times higher than in the earlier year.

The subsidy policy seems to have been marginal to the export boom—though some people without evidence, still defend it as an “infant-industry” policy for exports. We now need to study the *real* effects of this policy.

The export-subsidy policy was biased towards giving higher subsidies to the import-substitution sector. In a sense, the policy tried to give every industrial sector the subsidy it needed to export. When subsidies

TABLE 2 The Effect of Subsidies on Imports

	Change in exports <sup>1</sup> (%)	Export subsidy (%)	Real exchange rate <sup>2</sup> (pesos/\$)	Price of nontrad. exports <sup>3</sup> (pesos)	Effective exchange rate <sup>4</sup> (pesos/\$)	EER without subsidies <sup>5</sup> (pesos/\$)
1961-67	39	1.0	100	101	102	101
1967-69	91	9.0	107	101	118	108
1969-73	-5	14.7	91	115	120	105
1973-78	251	18.0	82	144	139	118
1978-84	3	10.6	78	137	118	107
1984-87	31	1.0	114	100	115	114

1. Percentage change in nontraditional exports from preceding period.

2. 1961-67 equals 100.

3. 1984-87 equals 100.

4. Obtained by multiplying subsidies, the real exchange rate, and the price of nontraditional exports.

5. Effective exchange rate without subsidies obtained by multiplying the real exchange rate by the price of nontraditional exports.

SOURCE: Authors.

disappeared, these exports disappeared as well, but total exports did not fall. Other exports increased because subsidies lower the equilibrium exchange rate, effectively favoring those exports with high subsidies and deterring those with low subsidies. The end of discriminatory subsidies boosted undersubsidized exports. The ultimate effect of subsidies, therefore, was to change the structure of exports. This leads us to ask how this type of export-promotion policy, and the bias in exports it produced, affected growth and productivity.

The structure of subsidies changed quite a lot between 1974 and 1978. It became more diverse, favoring those sectors that had a higher effective protection in the domestic market (these sectors had a subsidy 8-12 percent higher than the rest). These were sectors that existed because of the import-substitution policy, which although considerably reduced, persisted at levels higher than the pre-1931 era. This strategy of subsidizing sectors that were created under import substitution, en-

abling them to export, has effects identical to those produced by the preferential trade agreements described above.

The subsidy system worked to favor the same sectors favored by the import-substitution policy. It is a policy concerned with the formal act of increasing exports and not with the more substantive act of increasing productivity. The similarity of the two policies is evident in the fact that subsidies for those sectors that exported predominantly to Argentina or Brazil were higher than for other sectors. Therefore, the effect of subsidies interacting with the preferential tariffs biased exports toward these two countries. As was seen above, this change in the composition of exports biased them towards those with lower growth potential. To put it more precisely, neither the subsidies nor the preferential tariffs increased productivity substantially. Both distributed income to those sectors that employ resources (at international prices) in less productive ways. By promoting their expansion, it is possible that these policies could have lowered average productivity in the economy. But it seems that in this case, by taking advantage of economies of scale made available through increased exports, these policies had a small positive effect on productivity. Nevertheless, as said above, policies that promote exports in a less discriminatory way, such as tax simplification or reduction in import protection, have a considerably larger effect on productivity—an effect that is in fact fourteen times as large.

The cost of promoting exports through discriminatory subsidies and preferential trade agreements (with “subsidy swapping,” as we called it) is to exact resources from sectors that can produce more with these resources, making the nation poorer. In summary, although the 1970s reforms caused exports and GDP to grow, without these two policies GDP probably would have grown even more.

### **Policy Conclusions**

Import-substitution policies have not produced sustained growth. They have encouraged low productivity and therefore poor economies. A change was and is needed. In implementing a new policy, it is important to understand the leitmotif of the change. In this case the objective is *increased productivity*, which is similar to increased competitiveness:

more output per unit of input or unit of account. Such a policy would lead to increased growth and therefore more exports.

The objective is *not* a simple increase in exports. Uruguayan policy-makers have seen it this way and so devised a way for a costless transition between import-substitution and export-promotion policies. The policy was to subsidize import-substitution sectors so they could export. However, this policy had no major effect on productivity, and reallocated few resources. These policies were not the keys to the export boom and high growth of the 1970s that followed 40 years of export stagnation and 20 years of GDP stagnation. The policies that induced growth in the 1970s produced a reallocation of resources—the most noteworthy of which is the sudden reversal of the increasing closure of Uruguay to imports that occurred in 1974–75.

We should not conclude that integration is a bad policy. A customs union is not good or bad per se. It is an instrument; it can be either, depending on which sectors are included in the agreement, and which countries enter into it. Agreements such as the one with Argentina do not imply more competition for Uruguayan firms, since Uruguay gives preferences only in goods it does not produce. On the other hand, it obtains preferences (quotas) that permit Uruguayan goods access to a market with a higher rate of protection: this is a captive market and access to it does not stimulate competition or increase efficiency. These agreements have not increased productivity. But there are ways to write an agreement that does. For example, an across-the-board agreement, with no quantity limits, would be much better.

Something similar can be said of the subsidies: they did not increase overall productivity and discriminated in favor of sectors with low productivity. This does not mean that export subsidies are bad per se. An overall export subsidy can work towards compensating the anti-export bias that import-substitution policies introduce. But a selective program, as was implemented, has results that become more ambiguous as discrimination in favor of import-substitution sectors increases. The policy of subsidizing exports and discriminating according to their comparative disadvantage (the less comparative advantage, the higher the subsidy) could even have negative consequences by increasing the resource transfer to low productivity sectors.

In both cases, the costs or benefits of preferential trade agreements or export subsidies result from the way in which these policies are designed. The removal of import barriers is good because it will induce a resource transfer out of low-productivity, import-substituting sectors toward high-productivity, export-promoting sectors. This *should* be the consequence of every policy that can really be called an "export-promotion policy." Policies with other results, like those described, are import-substitution policies under new names.

There is no short cut towards growth. Import-substitution policies failed because they diminished overall productivity. There is, therefore, no way to growth apart from transferring those resources to higher productivity sectors. Going from import substitution to meaningful, efficient export promotion *requires* a reallocation of resources.

There is no costless transition; to carry out export-promotion and import-substitution policies at the same time, with both policies biased towards distributing income to import-substitution sectors, is a round-about way of deepening the import-substitution policy.

The costs of the transition depend largely on the flexibility of the labor market—on the ability to retrain the workforce and produce the new human capital needed in the new sectors. Inflexible labor markets, poor retraining schemes, and inefficient education systems all add to the costs of the transition and make the temptation of ducking change all the more difficult to resist.

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