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FEEDBACK LOOPS AND ECONOMIES OF SCALE:
ACHIEVING EXPORT-LED GROWTH IN THE CARIBBEAN BASIN

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This paper proposes an explanation of why export-oriented development strategies have proven extremely successful in stimulating rapid economic growth and eliminating extreme poverty in some developing countries. It seeks to understand the factors at work in the rapid-growth countries of East Asia, as well as recent experience of several Caribbean Basin countries that appear to be moving toward a similar growth path. The paper is divided into five parts. Section I asks why economists have been largely unsuccessful in convincing policymakers of the soundness of their prescriptions. Section II provides a hypothesis regarding the process of economic policy formation to address this issue, relating it to the success of the Asian countries. Section III applies this concept to Costa Rica's export growth over the past seven years, suggesting that Costa Rica may be emulating the Asian success. Drawing on this experience, section IV suggests a staged approach for moving from a closed, stagnant economy to an open, export-led growing economy. Finally, Section V provides additional comments on making incremental reform work, and its expected impact on poverty.

I. Why Aren't Economists Convincing?

There is broad agreement among economists on the policies most likely to produce rapid and sustained economic growth in

developing countries. The basic prescriptions are fairly simple: avoid excessive government presence in the economy, keep monetary and fiscal policies disciplined, and open the economy to world trade. The country's natural competitive advantage and free markets will do the rest.

While straightforward in theory, this prescription has often failed in practice. Countries attempting to implement this approach -- for example, the "Southern Cone" liberalizations of the late 1970s -- ultimately failed in most of the countries because the improved policies were not maintained for a sufficient period of time. Political opposition steadily rose as time passed, the positive results of the reforms were judged to be insufficient, and politicians eventually went off in another direction. In Chile, where the improved policies have been maintained for a long period, their eventual success in laying the basis for sustained growth came only after more than a decade, and included a disastrous recession in 1982-83. This was the result, among other things, of failure to grasp some of the risks in nominally market-determined policies. Had Chile been a parliamentary democracy at the time, the government would surely have fallen, and the new government would have reversed policy.

While economists frequently attribute failures to maintain sound policy to shortsightedness or venality of politicians, they cannot avoid responsibility for ivory tower theorizing if their prescriptions cannot be sustained in the

real world. Confident statements that reform-induced dislocations are only temporary, and all will turn out for the best in the long run, fail to acknowledge that economists' lags are politicians' nightmares. Some of this is simply due to focus on different aspects of reality: economists see macro aggregates moving in a desired direction, while politicians see rioting in the streets, factories closing, or rising prices. Many economists seem to suffer from a technocratic delusion that economic strategy can (or should) be managed by technocrats or "economist-kings" without recourse to public opinion. This is seldom the case. Governments change, so sustainable economic policy requires political support that pushes policy in the correct direction.

Moreover, macroeconomic distortions explain too little of a basic puzzle of most developing countries, particularly in Latin America: why these countries do not dominate world markets for products requiring substantial amounts of unskilled labor. A typical wage in poorer Latin American countries is 40¢ per hour. Why is the region not overrun by entrepreneurs hiring this cheap labor to export labor-intensive products to markets -- the industrial countries -- where labor costs \$10 per hour? If a country's exchange rate is overvalued by 50%, this is equivalent to saying that labor costs 60¢ instead of 40¢. The gap is still so massive that other factors besides macroeconomic distortions must be at work in preventing this labor force from flooding world markets with cheap products.

II. Feedback Loops and Export-Led Growth

The basic thesis of this paper is that how reform is implemented is crucial to its sustainability. Economists seriously concerned with producing permanent improvements in policy must attend to building constituencies that will sustain and extend the reforms as time passes. More specifically, the job of the "reformmongering" economist is not to attempt policy perfection at the outset, but to seek incremental reforms that will lead policymakers on their own to seek further reforms.

Many Latin American countries have large cadres of well-trained economists who have succeeded in gaining substantial influence over economic policy. There are cases where the top political leadership is convinced enough of the economists' prescriptions to follow through for long periods of time. Much more commonly, however, economists are listened to in an initial crisis period, but their policy prescriptions are gradually eroded away by the political instincts of the president, the pleadings of his political advisors, or political powerful members of the legislature or the private sector.

These other actors are generally unlikely either by training or instinct to accept the economists' paradigm, and much more likely to base judgments on visible evidence (factory closings or openings, protest demonstrations) or the opinions of politically-attuned people, for whom reduced fiscal deficits

or greater order in the foreign exchange market are not self-evident proofs of progress.

Feedback Loops

Faced with this array of forces that will steadily pull down the "consistent-policy" edifice, the economist must look for ways to mobilize these actors to support, rather than tear away, the framework. The concept of a feedback system is a useful way to characterize the policy process. In a feedback system, a course of action, or set of policy controls, is established at the outset, intended to produce a desired outcome. As time passes, information on the actual outcomes is "fed back" to the political leadership. If these outcomes accord with expectations, policy will continue unchanged. If not, adjustment of the policy framework is inevitable, and alternative policies are tried. Thus, a sustainable economic policy mechanism requires several characteristics:

- it must be producing concrete positive results that accord with expectations;
- deviations or relapses from the proper policy direction must produce negative effects that are apparent;
- it should highlight next steps essential for continued success.

It is just such feedback loops which explain the rapid spread and consistent maintenance of import-substituting industrialization (ISI) in virtually all countries of Latin America during the 1960s and 1970s. The initial policy package -- high tariffs or import prohibitions -- quickly produced visible positive results in factories established and people employed. Initial import barriers led policymakers to impose others, with continued positive results in the expected direction of more industry. Deviations from the favored course -- reduction in import protection -- produced layoffs and clamor from firms impacted by "disloyal competition," and encouraged policymakers to get back on the protection path.

The ISI approach has proven, as economists expected, unsustainable in the long run. Nevertheless, this did not become evident until the crisis of the early 1980s and the proof by the Asian tigers that an alternative approach might work. The generally favorable international economic environment of the 1960s and 1970s (rising commodity prices and substantial net capital inflows) provided what appeared to be positive feedback.

The Asian Tigers

Export-led growth has produced a dramatic transformation of the four "Asian tigers" -- Hong Kong, Korea, Singapore and Taiwan -- over the past 25 years. Korea is the most astonishing case. Manufactured exports from Korea rose from

\$39 million in 1963 -- considerably less than many Caribbean Basin countries today -- to \$32 billion in 1986. The changes in the Korean economy over the period included a sixfold increase in real wage levels, dramatic changes in the productive structure and rapid expansion of the educational and technical capabilities of Korean workers.

Although it has become fashionable to assume that the success of the Asian tigers was foreordained or inevitable in view of their hard-working, educated labor force, this is not self-evident. This view cannot explain why the inherent characteristics of these countries had not produced rapid growth prior to the mid-1960s. Moreover, while education and skills levels in Korea and Taiwan are now far above most of Latin America now, they were no better than much of Latin America in 1960. Nor was the potential for manufacturing exports obvious to all in the 1960s. Bela Balassa, an advisor to Taiwan during the early 1960s, recalls incredulity at his idea that Taiwan could become a manufacturing center. Centuries of tradition were seen as proving that Chinese were excellent traders and merchants, but not manufacturers.

The more plausible explanation of the Asian success is that export production was seen as important, and initial success in export growth (e.g., through export processing zones) led to changes in the economy which made further export growth possible. The further success led to reinforcement of the policy framework, and exports grew further.

Overall, the Asian tigers experienced annual growth rates of manufactured exports that averaged 19.9% in real terms between 1963 and 1980. (After 1980, growth slowed somewhat, so that the average between 1963 and 1986 was lower, at 17.0%.) Thus, in simplest terms, the task of emulating the Asian tigers would seem to be one of sustaining 20% real growth per year for nontraditional exports. Because of the small relative size of the export sector in imitating countries, the overall impact on the economy during the early years will be small. Continued over a decade or two, however, it will have a dramatic effect on the total economy. The task of the reformmongering economist is to find the keys to ensuring sustainability.

Increasing Returns to Scale

The Asian tigers maintained generally stable and consistent policies over this rapid growth period. This accords with our feedback model. Initial efforts met success, policies were maintained and reinforced, and success continued. Yet the rapidity of the progress and the complete restructuring of these economies over the period suggests that there is something more than policy consistency. I believe the only plausible "something" is what economists call "external economies" or "increasing returns to scale".

Economists typically think of the world as having "diminishing returns to scale," where rapid growth in production can take place for a time, as previously unemployed

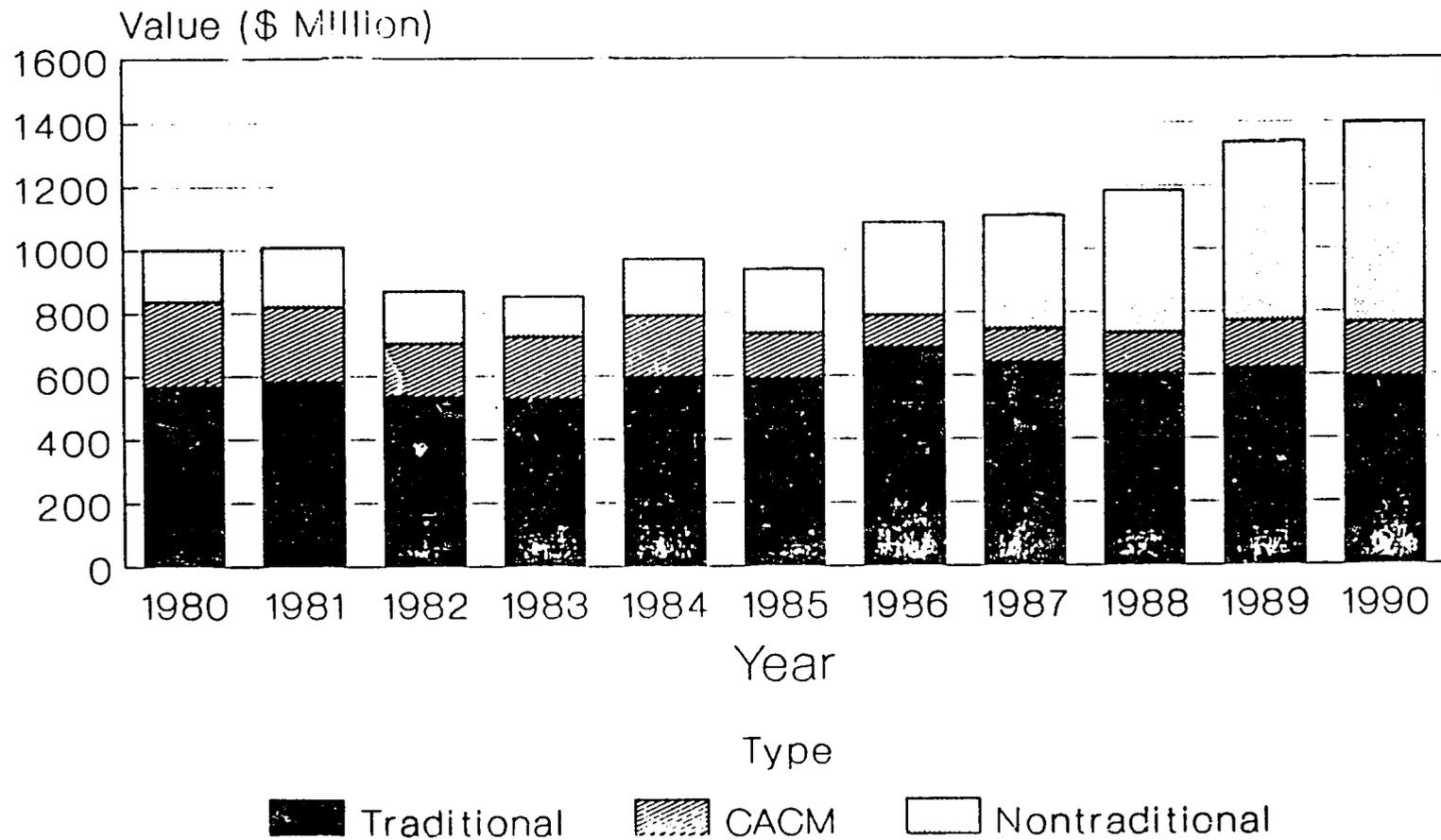
or underemployed resources become more fully utilized, but growth eventually slows down because of rigid supplies of one factor of production. This rigidity (e.g., lack of additional arable land, lack of skilled workers, lack of capital) then causes a slowdown in output growth. Under increasing returns to scale -- the ultimate economist's fantasy -- an increase in output makes a further increase in output less costly.

III. A Costa Rican Application

The idea of increasing returns to scale is sufficiently counterintuitive that some concrete examples of how this might occur may be needed. Costa Rica is one of several Caribbean Basin countries showing signs of emulating the success of the Asian tigers. For the last seven years (since major policy reforms were undertaken in 1982) nontraditional exports from Costa Rica have been growing rapidly, and new products have overtaken the four traditional agricultural exports (bananas, coffee, sugar and beef) that have been the mainstay of Costa Rican exports for decades. The trend in exports is shown in Chart I. The new exports include numerous manufactured products, as well as a variety of agricultural products -- including pineapples, melons, ornamental plants, and cut flowers. Apparel, mainly clothing assembled from imported materials, is the leading manufactured product, but furniture, plastics, electronic goods, and a variety of smaller products have all maintained similar export growth rates.

COSTA RICA

Composition of Exports, 1980-90



1990 is GOCR Estimate

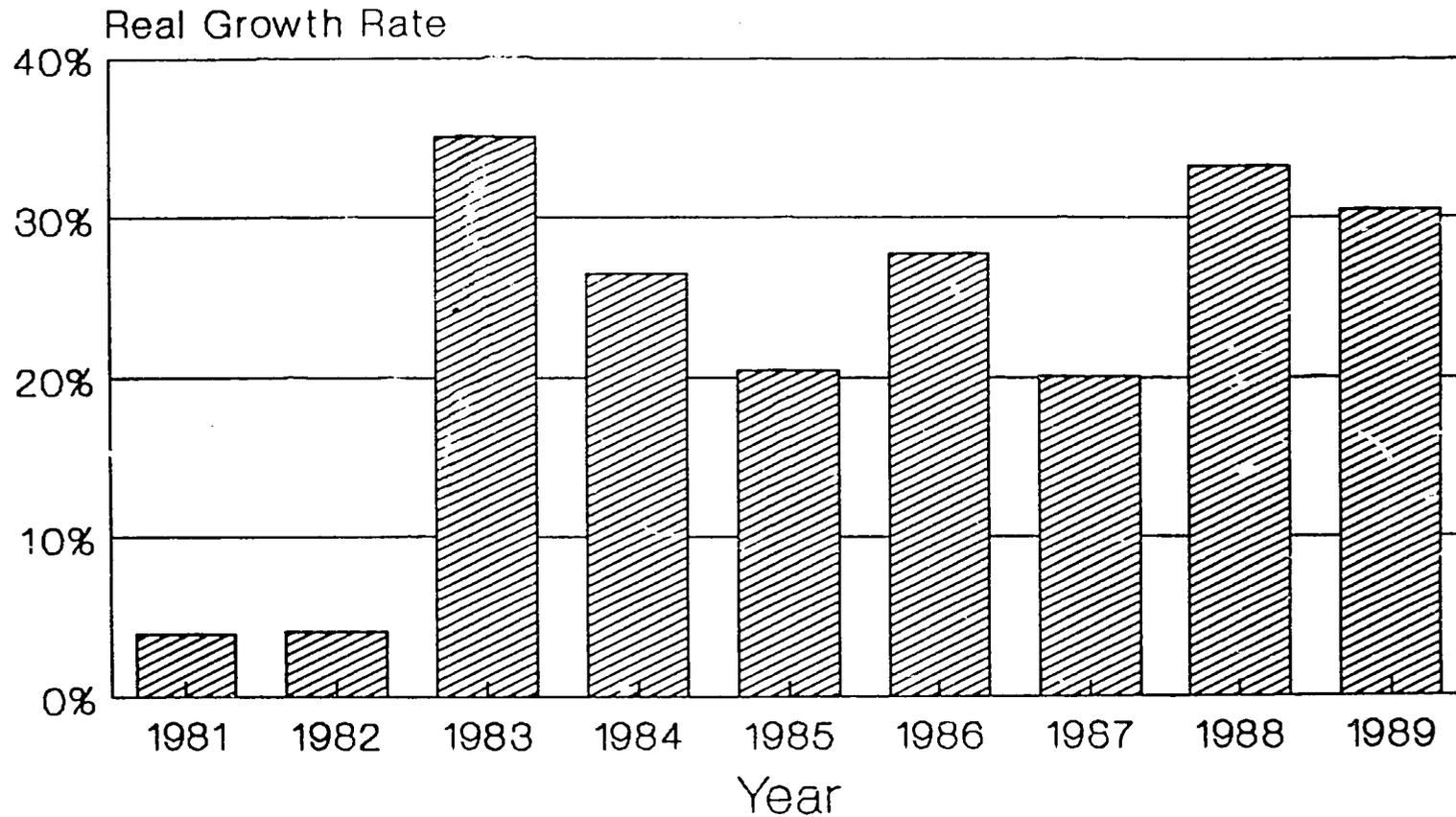
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Most of this growth has been toward the U.S. market. In each of the last seven years, nontraditional exports to the United States have grown by more than 20% in real terms. Annual growth rates are shown in Chart II. Exports of these products to the U.S. rose from \$80 million in 1982 to \$600 million in 1989. Table I summarizes the commodity composition of Costa Rican exports to the United States during the 1980s.

Costa Rica experienced a deep recession during 1980-82, before major policy changes in support of export promotion were adopted in 1982. Consequently, rapid growth in the immediate post-recession period is consistent with traditional ideas. An immediate surge in exports could be attributed to use of existing underutilized productive capacity. By 1984, however, GDP had returned to its pre-recession level, so one would expect a slowdown in growth in the later part of the decade, as full capacity was reached and bottlenecks in infrastructure and skilled workers appeared. Just the opposite happened. Nontraditional export growth accelerated during 1987-89. Somehow exports were able to grow faster when the country was near capacity-utilization limits than when substantial excess capacity existed.

Nor is there any current evidence that the high growth rates are likely to slow down soon. Nontraditional exports to the U.S. during the first quarter of 1990 increased 24% over the same period of 1989. Some fifty Costa Rican exporters were asked in May 1990 to project future trends in exports. The

Annual Real Growth Rate, Costa Rica Nontraditional Exports to U.S.A.



From U.S. Import Data and GDP Deflator

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Table I

COSTA RICAN EXPORTS TO THE UNITED STATES

(Based on U.S. Import Data)

(\$ Million)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	Annual Growth Rate 1983-89
Primary Products											
Four Traditional*	257.0	260.8	241.9	250.9	283.9	253.1	331.7	301.3	287.3	310.1	3.6%
Fish	8.6	11.0	14.2	10.9	19.5	30.5	38.8	33.3	39.7	45.1	26.7%
Ornamental Plants	8.1	5.8	6.3	6.1	11.0	11.8	13.1	15.2	15.3	15.9	17.3%
Fruits and Vegetables**	5.3	5.9	6.7	8.9	10.8	11.9	20.8	26.9	40.1	56.2	36.0%
Other Primary Products	13.0	10.0	11.2	5.5	9.1	11.3	16.7	9.8	8.9	20.6	24.6%
All Primary Products	292.0	293.5	280.3	282.3	334.3	318.6	421.1	386.5	391.3	447.9	8.0%
Manufactures											
Apparel	39.3	41.5	45.8	64.3	78.9	96.9	141.8	180.6	249.8	323.6	30.9%
Electrical Equipment	8.1	12.5	13.7	17.3	25.4	24.8	19.1	22.6	32.7	51.2	19.8%
Jewelry	0.0	0.0	0.0	0.0	0.3	2.6	3.9	8.5	14.1	20.7	n.m.
yarns and fabrics	0.1	0.2	0.2	1.5	4.2	4.4	9.3	10.0	10.4	10.9	39.2%
Furniture and Parts	1.2	0.6	0.7	1.4	1.7	3.9	4.8	6.9	8.7	14.5	47.6%
plastic, rubber articles	1.0	1.4	2.0	4.4	6.6	9.7	10.3	9.4	7.9	15.6	23.6%
Other wood mnfrs.	2.4	2.9	2.4	2.2	2.8	3.9	3.7	4.4	6.9	7.0	21.3%
Footwear	2.0	1.1	2.2	3.9	1.9	1.0	1.1	2.5	4.3	3.3	-2.7%
Other Manufactures	3.7	5.8	6.0	7.4	12.5	19.4	24.6	26.4	39.0	53.6	39.0%
Total Manufactures	57.8	65.9	73.0	102.4	134.3	166.6	218.6	271.3	373.8	500.4	30.3%
Total Exports	349.8	359.4	353.3	304.7	468.6	485.2	639.7	657.8	765.1	948.3	16.2%

Apparel Share of Mnfrs.	68.0%	63.0%	62.7%	62.8%	58.7%	58.2%	64.9%	66.6%	66.8%	64.7%
Traditional Share	73.5%	72.6%	68.5%	65.2%	60.6%	52.2%	51.9%	45.8%	37.6%	32.7%

*Coffee, Sugar, Bananas and Beef

**Excludes Bananas

04-Aug-90

Source: U.S. Department of Commerce, Imports for Consumption, Customs Value

firms expect to export \$212 million in 1993, compared to \$118 million planned for 1990, and \$31 million exported in 1987. These firms had added 6,000 workers in the last three years, and expect to add another 5,000 during the next three.

How is this rapid growth being sustained? A major part of the explanation appears to lie in organizational and service innovations that make it much easier for a firm to enter export markets in 1990 than in 1982. Recent studies document some changes in the country environment that support this hypothesis:

--the number of cargo flights to the U.S. increased from 9 to 28 per week over the last five years.

--contractual arrangements have been developed between shippers and producers on liability for spoilage in transit;

-- industry associations for producers have been established in a number of sectors, increasing information flow and providing cooperative approaches to marketing;

-- changes in government export registration procedures have substantially eased the paperwork burden for exporters, thus speeding processing;

-- access to credit has improved, as bankers no longer see exporting as a new and risky business;

- a large number of service firms supporting exporters with specialized exporting, documentation, and packing services has sprung up;
- a number of trading companies have been established as links between small exporters and foreign buyers.

The effect of these changes is to reduce either the risk or the cost of exporting now compared to the early 1980s. These changes generally occurred in response to needs in the marketplace, rather than in anticipation of future new entrants into the export sector. Yet their existence makes it substantially easier for new firms to enter the market. From the economy's perspective, this is the essence of increasing returns to scale.

In addition to Costa Rica, several other countries participating in the Caribbean Basin Initiative (CBI) -- most notably, the Dominican Republic, Guatemala, and Jamaica -- have achieved extremely rapid growth of nontraditional exports over the past five years. This performance is described in a companion piece, "Is the CBI Working?".

IV. Promoting Export-Led Growth

Several policy recommendations flow from this conception of the export development process. First, governments should look for the quickest means to increase exports. Like the case

of import substitution, any evident success in exporting is likely to help reinforce policy commitment. Second, governments should seriously consider subsidizing exports, at least at the outset. The existence of increasing returns to scale is sufficient grounds for subsidies on economic efficiency grounds. The subsidies will pay for themselves in increased production later. More generally, one can envision a process of export development and policy reform that achieves the economist's preferred policy framework (stable macroeconomic policy and little interference with international trade) in the long run through interventions that cause the private sector to push policy in the desired direction.

A strategy for the development of sustained growth through exports might go as follows:

Stage I -- Proving that Exports Are Possible. The first step in developing a successful export strategy is to find something that works. A frequent characteristic of Latin American attitudes toward the possibility of successful exporting of nontraditional products is what Albert Hirschman has called "fracasomania." Policymakers "know" in advance that little will result. Consequently, efforts at change are half-hearted, and the lack of immediate success is taken as proof that nothing can be done.

Sectoral Emphases

The easiest means for quick payoff from exporting is to create an environment where the largest single element of comparative advantage of poor countries -- low-cost labor -- can be embodied in exports without all of the baggage of poor policy environment (import restrictions, extensive legal or bureaucratic complications, poor infrastructure) that hinder development of new exports. The Export Processing Zone (EPZ), or any of a variety of other schemes that is analytically equivalent, is the ideal mechanism. Capital and expertise can be obtained from abroad quickly, start-up costs are relatively low, and rapid growth in unskilled employment can result.

Free trade zones have been used by many countries, including Taiwan and South Korea, as an initial export tool. Free trade zones are unlikely to be the entire solution to an export-led growth strategy, and economists would generally argue that it is preferable to make the entire country a free-trade zone by eliminating barriers to export throughout the economy. As noted earlier, however, only an economist in an ivory tower would see this course as politically feasible and sustainable.

Two frequently-cited disadvantages of free zones -- "footlooseness," and lack of connections to the rest of the economy -- are actually big advantages at the initial stage of exporting. Once firms have begun to locate in a country's

EPZs, any indication that they are packing up to leave before wages have risen sharply is a powerful signal that something is wrong. If policymakers are serious about exporting, they will use this negative feedback to correct problems to prevent further defections. In sum, the ability of firms to leave a country is a quick means of providing feedback to policymakers.

The lack of connection to the rest of the economy is what is initially most desirable for new exporters, for it is the rest of the economy that has been preventing exports from happening (see a separate paper, "Why Haven't CBI Countries been Exporting Manufactures?"). Later on, lack of connection would be a disadvantage, but countries cannot solve all their problems at once.

Apparel assembly is the ideal first sector in EPZs for proving that rapid export growth is possible, for several reasons. First, capital requirements -- basically sewing machines -- are small and the required skills both broadly available and easily acquired. Second, foreign investment is relatively easy to attract compared to other sectors. Third, there is scope for domestic firms to become involved, for sub-contracting is well established in the apparel assembly industry. Fourth, each country has some "comparative advantage" in this area due to the U.S. quota system, which limits competition from established exporters, and encourages production in additional countries not yet subject to quota

limitations. Finally (in large part due to the previous factor), this sector is likely to be profitable despite substantial policy and institutional problems imposed by the host government. Although much has been made by Latin American governments of the impact of Multifibre Agreement restrictions on their export possibilities, the fact is that most CBI countries still do not export sufficient volumes to even have any quota limitations in effect.

Government Policies

In this first phase, the principal requirement for government policy is the establishment of a legal framework supportive of private EPZs. While many governments have previously created EPZs, these have often both carried too much baggage (e.g., locations in backward or remote regions, government ownership) and suffered from poor management. As EPZs begin to produce export results, government policymakers must begin to listen to the exporters regarding bottlenecks and impediments to continued growth.

Expected Achievements

The potential dynamic achievements from free zones can be summarized as follows. At the beginning, opportunities are exploited, probably first in apparel, where the profitability of an investment is so high that even great impediments can be tolerated. As the pioneer firms in this sector begin to

operate, they identify, and try to overcome, some of these impediments. They discover that, despite government promises, it takes ten days to clear a container of materials through customs to their factory, or that pilferage is rampant in the port, or that bribes are needed to move merchandise, or that the national power utility shuts off electricity at frequent and inconvenient times, or that transport of their product out of the country is not available on a timely basis, or that telephone service with U.S. distributors is inadequate.

The key to generating positive feedback loops lies in solution to these problems. If port and customs problems can be solved for the first entrants into export production, additional potential entrants will find opportunities for profitable investment where none existed before, for the costs of production in the particular country will have fallen (i.e., the production function will have shifted in a way that increases potential exports). If again the bottlenecks that affect this second wave of firms can be identified and resolved, yet more firms can enter profitably into production for the export market. For example, as export volumes increase, shipping space becomes larger and more frequent. New entrants can then take advantage of this "external economy."

Emerging Problems

Reliance on EPZs has several inherent limitations. First, it provides training effects for only limited skills,

largely for unskilled workers. Second, there is little prospect for steady increase in value added for the export products as experience is acquired because of the isolation of the EPZ from the rest of the economy. Third, domestic entrepreneurs may have only a limited role. If the profits to be made are seen as largely accruing to foreign companies, political opposition may choke off continue expansion.

Fourth, the visibility of the zone as an enclave with a large labor force may have political repercussions. In Jamaica, for example, the existence of ten or twenty thousand workers employed in the same physical area could move labor relations from the economic to the political sphere. Government mandated wage or fringe benefit increases or other means for implicitly taxing production in the zone could then choke off its continued growth.

As these problems begin to emerge, government policymakers must alter the environment in a way that builds upon the initial success, but begins to address the emerging problems. The quick payoff benefits -- employment, demonstration of the feasibility of exports, some skills and "industrial habits" to the labor force, and improvement in transport and customs procedural problems -- must be used to begin to impact on the rest of the economy.

Stage II -- Export Promotion and Backward Linkages.

If exports are to continue to be a dynamic element, the entire domestic economy must gradually shift toward participation in the world economy. Even after EPZs have shown some initial success, few countries are willing to do this directly. Powerful and successful import substituters are likely to convince policymakers that the adjustment costs are (and may actually be) very large. An intermediate step -- where some domestic firms also demonstrate that the country can compete internationally -- is likely to be required before policymakers will be willing to take any dramatic action to open up the country to foreign trade. This is the stage of export promotion, where subsidies and other policy interventions are used to establish successful exporters outside the EPZs.

Sectoral Emphases

Once the most severe procedural and institutional bottlenecks have been eliminated by EPZ operation, there should be a wide range of light manufacturing and winter-market agricultural products which can be profitably produced for export in Caribbean Basin countries. The diversity of the range of potentially-exportable products can be illustrated by Table I, which compares Costa Rican exports between the early 1980s and 1988 for a variety of agricultural and manufactured goods.

Government Policy

The creation of an environment supportive of exporting is the essential characteristic of government policy at this stage. This means that the incentive structure for private business needs to shift from encouraging import substitution to exporting. Exoneration of import duty for inputs into export products and/or income tax exonerations for exporting firms can play an important role. Direct export subsidies -- tax credit certificates, or CATs -- have been particularly important in some countries in shifting the incentive structure.

In addition to the direct intervention in shifting incentives, there will still be much for government to do in identifying and eliminating procedural or legal problems for new exporters. Since the most constraining of these cannot usually be known in advance, government needs to listen closely to exporters.

Expected Achievements

Several important developments should come out of this stage of the process. First, as domestically-owned firms begin to export successfully, a greater degree of self-confidence and interest by non-exporters in searching out possibilities is likely to occur. Second, as the market for unskilled workers begins to tighten because of the added demand, wage rates will begin to rise. For some skilled categories (production

managers, supervisors, engineers, quality-control specialists), shortages may lead to intense competition among firms for the best workers and to easy mobility and high wages. This is an important part of the process, for it stimulates skill accumulation by workers. Workers will actively seek out opportunities to upgrade their qualifications because of the promotion and higher-income possibilities that are evident. This will increase pressures on national apprenticeship institutes (generally, hidebound institutions providing training of little relevance) to alter their programs to meet the needs. Other alternatives (night schools, private institutions) will also spring up, and firms themselves will be forced to do significant amounts of training. As time passes, engineering may -- as it has in the Asian countries -- become a preferred career choice for high school graduates instead of the traditional professions.

Emerging Problems

As the second phase proceeds, two problems are likely to emerge. First, the fiscal cost of export subsidies may become large. In Costa Rica, it has grown to about 15% of total government revenues. Second, distortions in the productive structure are likely to become pronounced. Scarce capital will continue to be invested in inefficient import substitution, and some exporting firms will have found ways to "play the game" of exporting that yield little benefit to the economy.

Self-confidence by exporters should have grown dramatically, however, and the political influence of vested interests in import-substitution been sharply reduced. (Many firms are likely to be in both markets.) At this point, government policy must turn the policy screw again.

Stage III -- The Integrated Economy. The task at this stage is to re-integrate the economy, eliminating special incentives for particular types of production. Import tariffs will need to be reduced to low and uniform rates, and non-tariff barriers generally eliminated. Export subsidies (which could be viewed in part as compensation for other distortions) need to be phased out. Countervailing duties by trading partners and other trade-related problems will be a spur to joining the General Agreement on Tariffs and Trade (GATT).

At this point, the feasible growth rate of the economy will depend upon the basic economic characteristics of the population -- national savings rates, entrepreneurship, investment in education -- as well as trends in the international economy. This is not likely to be Nirvana, but it is likely to bring forward conditions that are currently absent from most developing countries. Workers, either skilled or unskilled, will have opportunities for work that is potentially much more productive than they have at present. In a sense, the central problem in developing countries is not that people are willing to work hard for low wages (say 40¢ per

hour), but that the economic system somehow prevents sufficient demand for labor to cause wages to be higher.

V. Making Incremental Reform Work

The essential argument of this paper is that the key ingredient of a successful development strategy intended to produce rapid overall economic growth in a stable macroeconomic environment is to use export expansion to create a cumulative process one step at a time. It is the continual interaction between the exporting firms, government, and the work force that can create feedback loops that generate new investment, better government policies, and steady expansion of the capabilities of the labor force. To the extent that exporter/government cooperation can steadily reduce impediments they will steadily expand the number of products that can be exported profitably.

In essence, then, the process of rapid³ export expansion is one of continual feedback. Bottlenecks continually appear. If the economy responds to the bottlenecks with additional supplies, the expansion continues. As it continues, larger and larger sectors of the economy are drawn into the process.

As production expands, other bottlenecks appear. As mentioned earlier, one such bottleneck will be shortages of trained managers appear, which causes the salaries of such workers to rise, as firms bid good managers away from each

other. Such problems threaten to slow the expansion of the export sector, for costs have risen, reducing the potential profitability of additional investment. The key element in maintaining the expansion is response to these constraints or bottlenecks. If the institutional response is fast enough, expansion can continue.

The major advantage of this problem-driven approach is that government officials do not have to seek out the areas that need immediate attention from the plethora of problems that exist in any developing country. They only need to respond to immediate, pressing ones. As Albert Hirschman has argued, decisionmaking is a scarce commodity in developing countries. Because problems and needed courses of action are obvious, governments need only react to pressures.

Obviously, failure by government or other actors to respond to emerging problems that are identified in this feedback loop will choke off the expansion. If, rather than taking appropriate supply actions to ease bottlenecks, governments exacerbate them (e.g., through price controls or other non-market allocative devices), the expansion will be halted or reversed.

There is some evidence that governments in some countries have taken the latter course. The bauxite industry in Jamaica during the 1970s may be one example. Jamaica may have responded to the expansion of the industry by "rent seeking"

behavior by labor and government. Wages in this industry appear to be far higher than the rest of the economy, the result of collusion between labor unions and government at the expense of the producers. This, combined with heavy taxation of the industry during the 1970s, led to the decline and near collapse by the early 1980s. There appear to be other cases where labor unions in the ports or in free trade zones have raised costs, thus reducing the potential for expansion.

The Role of the Reformmonger

While the discussion in the paper has been largely in terms of an automatic feedback process, it in fact requires some strategists, both in government and in private actors and/or donor agencies who can visualize the policy evolution process as a whole and actively push in the proper direction. "Reformmonger" is another Albert Hirschman term that seems appropriate. Such people need to be continually sending two messages to government officials and informed public opinion: that great progress is being made; and that the gains are at risk because of some immediate problem.

Lauding the progress that has been made -- for example, closely tracking and continually publicizing the number of jobs, investments and exports resulting from the new strategy -- is essential to building the constituency and showing results. Equally important is talk of impending doom if some needed action -- ending the bottleneck caused by customs

procedures, or issuing new regulations for drawback imports, or improving the reliability of electric power generation, or ending some restrictive regulation on internal transport so more trucks are available -- is not immediately taken by the government.

Impact on Poor People

Finally, some comments are needed on the question of distributional impacts of export-led growth. Export promotion programs are often criticized for favoring large firms and established interests at the expense of small business and poor people. This does not come from experience. Indeed, the empirical evidence from the Asian tigers is unambiguous that poor people have benefitted enormously from the export success, and income distribution in those countries -- initially much more equal than in Latin America -- has become more equal. Rather, it comes from the evident fact that the most sophisticated entrepreneurs are the ones best able to take advantage of these new opportunities.

It is important to think analytically about this, however, and not simply to treat the exporting firm -- whose owner may be driving a new Mercedes-Benz -- as the only beneficiary of the process. Particularly for EPZs, the primary beneficiaries of the new exports will be unskilled workers. A consulting firm providing services to companies interested in EPZ operation cites the following data as typical for an

apparel assembly firm in the Dominican Republic: overall labor requirements of 300 unskilled workers, 71 skilled and clerical workers, and three professional and managerial workers. For such a firm, labor costs account for 80% of all in-country costs excluding shipping, with rents, utilities and spare parts representing the other 20%. Of the total labor costs (or labor income), 58% is paid to unskilled workers, 22% to skilled and clerical workers, and the remaining 20% to plant management -- with the plant manager's salary of \$100,000 accounting for most of this. While the plant manager will quickly be able to buy a Mercedes-Benz, 58% of the first-round income generation could be expected to go to workers likely to be in the bottom half of the income distribution and another 22% to people in the 6th to 8th deciles, and only 20% to people in the top 20% of the income distribution. Needless to say, this is starkly different than income distribution in the typical Latin American country.

The improvement in distribution of income effects is due to the fact that the plant uses large amounts of unskilled workers, and only limited amounts of professional labor. Or, said another way, it corresponds much more closely to the skills mix in a poor country than does the typical import-substitution firm.

Economy-wide support for this view comes from Costa Rica. Overall, employment grew rapidly, and unemployment fell steadily, from a peak of 9.5% in 1982 to 3.8% in 1989. Talk of a labor shortage became current in Costa Rica, and it appears

that large numbers of undocumented emigrants from neighboring Nicaragua have been essential in filling needs for traditional agricultural workers, such as cane cutters and coffee workers. An analysis of income trends during the 1980s by Ronulfo Jimenez and Victor Hugo Cespedes, drawing on household survey data for employed workers suggests a tilting of incomes in the direction of greater equality. Growth in income for households was inversely correlated with education of the head of household. Real incomes for households with heads with no education or only partial primary education rose by 5% and 4%, respectively, while all other education levels showed declines of at least 5%. Households with University-educated heads did worst, losing 11%. Somewhat similar results were obtained by looking at income deciles. Real average household incomes for the second and third deciles rose by 16% and 12% respectively, while those for all other deciles rose in a narrow 2-4% range.

This improvement likely traces to the opening of EPZ jobs for relatively unskilled workers. EPZs are often criticized as sweatshops that exploit workers. Aside from the obvious response that workers in this situation must feel less exploited than did prior to working in the EPZ or they would not be there, one should note that the most promising means for eliminating poor working conditions is providing workers with alternatives. The faster the labor-intensive export sector expands, the more alternatives will be opened up for workers. As this occurs, the least-progressive employers will find it increasingly difficult to hire and keep workers.

Initially, wages in exporting firms are likely to remain stable as new entrants are drawn into the labor force and the pool of disguised unemployment is exhausted. Once this happens, the operation of the labor market will steadily push up wages. As wages in the export sector rise, workers will be drawn from other occupations (cane cutting, informal services, low-productivity agriculture) that cannot compete. These other sectors will gradually decline because low productivity of labor in them will not permit competitive wages to be paid. As workers acquire experience and skill, their productivity should continue to rise. Because the willingness to invest is dependent on the relation between wages and productivity, and not on wages alone (for this reason, South Korea exports a dramatically larger volume of labor-intensive products than India or Bangladesh) profitable investment can continue to be made as wages rise.

In sum, export-led growth can be expected to substantially benefit low-skilled workers. In a sense, it has promise over the longer term in eliminating the basic paradox of poor countries -- that people are willing to work hard for low wages, yet few want to hire their services.

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