

**Towards an Alternative Perspective on
Trade and Industrial Policies**

S M SHAF AEDDIN

Towards an Alternative Perspective on Trade and Industrial Policies

S M SHAFIADDIN

TWN
Third World Network

Towards an Alternative Perspective on Trade and Industrial Policies

Published in 2006 by
Third World Network
131 Jalan Macalister,
10400 Penang, Malaysia.
Website: www.twinside.org.sg
E-mail: twnet@po.jaring.my

Printed by Jutaprint
2 Solok Sungei Pinang 3, Sg. Pinang
11600 Penang, Malaysia.

ISBN: 983-2729-66-1

CONTENTS

1	Why is an Alternative Approach Needed?	5
2	The Alternative Approach	12
	Development-oriented trade policy	12
	International market structure and country specificity	13
	Co-ordination of economic activities	15
	Nature of trade and industrial policies	8
	The limited role of devaluation	21
	FDI and capital flows	25
	The role of other factors	26
3	Policy Implications for the International Community	28
	References	30

NOTE:

This paper first appeared as an article in *Development and Change* (36(6):1143-1162, 2005), a journal published by Blackwell Publishing, Oxford, UK. It is reprinted with the kind permission of the original publisher. Some changes have been made to the layout but the text remains the same as the original article.

1

Why is an Alternative Approach Needed?

‘The failed WTO meeting in Cancun should serve as a warning: something is fundamentally wrong with how the global trading system is managed – and with the global financial system’
(J. Stiglitz, *The Guardian* 2 October 2003).

THE controversy surrounding trade and industrial policies began with the failure of traditional ISI strategies adopted in the 1950s through to the 1970s, and intensified after the publication of an influential work by Little et al. (1970), *Industry and Trade in Some Developing Countries*. In reaction to the failure of traditional import substitution industrialization (ISI) strategies, the International Financial Institutions (IFIs) began in the early 1980s to advocate a policy of trade liberalization through structural adjustment programme (SAPs) and stabilization programmes (SPs) – an advocacy which was continued in the early 1990s through the so-called ‘Washington Consensus’ (Williamson, 1990: Chs 1, 9). The Uruguay Round of trade negotiation in 1995 followed the same neoliberal approach, providing an internationally agreed framework for trade liberalization. Nevertheless, after nearly a quar-

Material for this article is drawn to a large extent from the recently published book by the author, *Trade Policy at the Crossroads: Recent Experience of Developing Countries* (Shafaeddin, 2005a). The author would like to thank an anonymous referee for comments on an earlier version. The views expressed here are those of the author and do not necessarily reflect the views of the United Nations.

Development and Change 36(6): 1143–1162 (2005). © Institute of Social Studies 2005. Published by Blackwell Publishing, 9600 Garsington Road, Oxford OX4 2DQ, UK and 350 Main St., Malden, MA 02148, USA

ter of a century of implementation, it is clear that the ‘outward-orientation development strategies’ which were supposed to follow from the trade liberalization policies of the 1980s and 1990s have failed (Rodrik, 2001; Shafaeddin, 2005a).¹

This is not the place for a literature survey of the orthodox, neoliberal theory of trade policy – what I call the ‘across-the-board trade liberalization hypothesis’ – and its critics.² However, a few points are worth noting. Orthodox theorists do not fully agree on the details of the hypothesis. For example, while criticizing ISI, Little et al. (1970) concluded that to expand exports of manufactured goods, imports should be liberalized and overvalued exchange rates should be corrected. They did not, however, deny the important role of the government in correcting market failure or promoting infant industries; nor did they entirely refute the need for selectivity in the choice of investment, for discriminatory tariffs, or for export subsidies or taxes. Their main concern was the removal of quantitative restrictions and other direct trade control measures and the lowering of tariff rates. Further, they were concerned that the process of trade liberalization should take place gradually.

Influenced particularly by Krueger (1978), Bhagwati (1978) and Balassa (1980), the World Bank and IMF went further than Little et al. in their proposals for trade liberalization. Even the original version of the Washington Consensus (Williamson, 1990: Chs 1, 9) does not fit with the orthodox neoliberal view in all details, and it has subsequently been interpreted differently by different people. Nevertheless, there is a common position on cer-

-
- 1 Rodrik (2001: 6) concludes that ‘there is no convincing evidence that trade liberalization is predictably associated with subsequent economic growth’. I do not agree with such a wholesale conclusion as much depends on how, and at what point during the course of industrialization, liberalization takes place. However, I do not advocate any type of protection either, as will become clear later in this article. See Shafaeddin (1991, 2005b); see also Easterly (2001); Wade (1990, 2003).
 - 2 See Shafaeddin (2005a: Chs 1, 4, 5) for a brief survey of the evolution of the orthodox theory of liberalization, the role of market and government, and theory of comparative advantage; for the evolution of the views of IFIs on these issues, see Shafaeddin (2005b).

tain key aspects: the free-market based approach to development; the lack of active government intervention in the process of industrialization and development; universal and across-the-board trade liberalization; and devaluation. Trade liberalization in this context would entail removing non-tariff restrictions on imports, reducing the level and spread of import tariff rates on all industrial products, and eliminating export taxes and subsidies. This formula was thought to be applicable to all developing countries, irrespective of their level of development and industrialization, with the expectation that trade liberalization would change the structure of incentives against import substitution industries, in favour of export activities, including exports of industrial goods, thus leading to outward-oriented industrialization and development.

There is some ambiguity in the literature as to whether industrial exports include all categories of industrial goods, or only the products of labour-intensive industries. Williamson (1990: 14, 370, 372) refers to ‘non-traditional exports’ (although what he means by this is not entirely clear), and to the experiences of East Asian countries (*ibid.*: 420), which of course have gone beyond labour-intensive manufacturing production. By contrast, various documents of the World Bank (particularly World Bank, 1987, 1993) stress an ‘outward orientation’; that they are suggesting more than the expansion of labour-intensive industrial products is illustrated by their reference to East Asian countries which started their industrialization with labour-intensive products, but which have upgraded their industrial structure over time. There is thus some question over whether industrialization is to be applied in the widest sense of the term or in some narrower way.

The main issue here is that the theoretical framework behind the neoliberal analyses and recommendations is the static version of the theory of comparative cost advantage. Williamson (1990: 19–20) admits that ‘none of the ideas spawned by . . . development literature . . . plays an essential role in motivating the Washington Consensus’. If, therefore, the orthodoxy is founded on a belief in the importance of industrialization in the wider sense of the term (which seems to be true of the World Bank, at least), the recommenda-

tions made and the theory behind them are not conducive to industrialization. However, if what is being recommended is a concentration in exports on resource-based and labour-intensive products, in line with the comparative cost advantage theory, this does not contribute to ‘catching up’, industrialization or development, beyond a short-term gain achieved through allocative efficiency.

Allocative efficiency was, in fact, one of four major issues in Adam Smith’s theory of international trade (Smith, 1776), which has been a source of controversy in trade theory. First, in the words of Kaldor (1972: 1240), he ‘focus[ed] attention on the allocative functions of the markets to the exclusion of their creative functions – as an instrument for transmitting impulses to economic change’. The second issue was his preoccupation with ‘interchangeable value’ (international trade) as against ‘productive power’ (economic development) (List, 1856: 253). Third, Smith introduced his universal theory of free trade for a ‘cosmopolitan economy’ – that is, the economy of mankind as a whole – believing that free trade would maximize the welfare of humanity and the whole world. He did not distinguish differences between the interests of individuals, nations and mankind; in particular, he ignored the fact that some nations may give more weight to their own welfare than to the collective welfare of humanity³ (ibid.: 74, 245–6, 261). Finally, Smith implied that all countries were at the same level of development and industrialization. By ignoring the existence of a ‘competence gap’ between nations, particularly the industrialized countries such as Great Britain and the latecomers, he also ignored the fact that free trade would not necessarily benefit the less developed nations.

Jacob Viner (1953: 4-5) correctly maintains that Smith and other classical economists took a cosmopolitan approach because they thought that what was in the interests of Britain was also in the interests of the world as a whole. Nevertheless, Viner argues that what was relevant to their time and

3 Although he had the interests of Great Britain in mind when he advocated universal freetrade.

country may not necessarily be relevant for other times and other countries, and, in particular, it may not be relevant for ‘economically less advanced countries’ at any time. Hence, ‘it is today always necessary, as it was for the English [sic] classical economists, to be perfectly clear whether we are considering a problem, say, commercial policy from a national or from a cosmopolitan point of view’ (ibid.: 5).

Faced with the failure of across-the-board trade liberalization and free market policies in most developing countries, neoliberals and their opponents have reacted in different ways. The former blame the failure mainly on inadequate and incomplete reform and call for more liberalization. Some critics, on the other hand, argue that industrial policy as perceived by neoliberals provides for certain preferential policies because it is presumed that ‘important externalities reside in exports and direct foreign investment’ (Rodrik, 2004: 29-30). Rodrik does not categorically refute the market-friendly approach. However, emphasizing the importance of industrialization in development, he argues that the market does not bring about industrialization on its own, and that as market failures prevail, there is a need for government intervention. It is in this context that he advocates the need to ‘get the policy process right’ and maintains that this can be done, through a ‘discovery process’ by which ‘private and public actors come together to solve problems, including those caused by market failure, in the productive sphere, each side learning about opportunities and constraints faced by other’ (ibid.: 3). In such a process ‘firms and government learn about underlying costs and opportunities and engage in strategic coordination’ to remedy market failures which restrict self-discovery (ibid.:10). Referring to external constraints and the restrictions on policy space imposed by international rules and conditionalities, Rodrik argues that (external) restrictions are exaggerated. Indeed, there is still some room for manoeuvre to implement industrial policy (Amsden, 2000).

Rodrik’s proposal for establishing a mechanism for public–private collaboration is welcome, but it is not new. Public–private co-operation has worked relatively well in East Asia (see, for example, Amsden, 1989; Shafaeddin,

2004a;Wade, 1990). A similar approach taken by some other opponents of neoliberalism advocates government intervention to address market failures which create obstacles to ‘capability building’ for industrialization and development, but also concludes that certain things cannot be done because of restrictions imposed by international regulations (see, for example, Lall, 2004).

It is worth noting at this point that there are two different categories of restrictions. The first are institutional restrictions imposed by IFIs, commercial banks, the WTO, bilateral donors, and so forth. The second – perhaps more significant – are what we might call ideological constraints, in the sense that many politicians, not only in developed countries but also in developing countries, have faith in the free market. A number of Latin American countries, for instance, have voluntarily implemented market-friendly reform as proposed by neoliberals (Shafaeddin, 2005a: Ch. 2).

The history of developing countries since the 1970s reveals the widespread failures of both ISI strategies and universal trade liberalization (Shafaeddin, 2005a). Furthermore, the present international trade rules, under the WTO, limit the policy space of developing countries. Does this mean that developing countries cannot, or should not, industrialize because of such external constraints? Or does it imply that they should design trade and industrial policies which are appropriate for themselves, and opt for changes in international rules?

In the rest of this article, I will adopt the latter position, arguing that some rethinking is required to develop a different approach to trade policy reform both at the national and international levels. Some scholars see the success of East Asian countries as proof of the need for industrial policy.⁴ Others claim that the East Asian experience is not replicable elsewhere and that even if industrial policy has any role to play in the industrialization of devel-

4 See, for instance, Amsden (2001); Singh (1992); Wade (1990, 2003 and the references therein).

oping countries, its time has passed: the current development philosophy, and particularly WTO rules, would not allow it. Instead of taking such a top-down approach –drawing international rules on trade and industrialization and expecting developing countries to act within their framework – this article adopts an alternative, bottom-up approach, taking cognizance of two important points.⁵ Firstly, no country has industrialized without government intervention.⁶ Secondly, ‘comparative advantage is arbitrary’; it has to be created over time (see, for example, Cline, 1983; Gomery and Baumol, 2000; Shafaeddin, 2005a).

5 For a more detailed and extensive treatment, see Shafaeddin (2005a).

6 Hong Kong might be seen as an exception to this; however, Hong Kong is a city state, and it has not been able to upgrade and deepen its industrial sector as other Asian NIEs have.

2

The Alternative Approach

THERE is no blueprint for trade policy, industrialization, upgrading and economic development in general. Each country's particular situation has to be taken into account. Nevertheless, drawing on the experiences of both early and late industrializers, some elements of an alternative trade and industrial policy can be outlined. First, trade policy should be development-oriented. Second, while it draws on the historical experiences of other countries, it should be based on the realities of the international market at the time, and on the specific conditions of the country rather than some theoretical abstraction. Third, it should allow for the role of market, firms and governments in co-ordinating economic activities at any particular period, but should also consider the need for changes in their relative roles over time. Fourth, trade and industrial policies should be selective, mixed, dynamic and predictable in nature; they should take into account the complementary role of 'non-price factors' and agriculture. Fifth, trade policies should enhance productivity rather than relying on repeated devaluation; finally, they should use FDI selectively as a tool of industrialization and export expansion, and should ensure the effective management of capital flows.

Development-oriented Trade Policy

Where the overall objectives are development, building up supply capacity and industrialization, trade policy is a means to those ends; so are international trade, market, industrial policies, FDI, technology, and so forth. The 'means' and 'ends', or objectives, should not be confused. As a tool of development, therefore, trade policy is not necessarily synonymous with trade

liberalization, and success in ‘liberalization’ per se is not a guarantee of success in development. Trade policy should serve to achieve the long-run objectives of development; hence, it should be an integral part of industrial and development strategy.

If we define development as ‘the movement of the whole social system upward’ (Myrdal, 1971: 356) it involves, among other things, raising the standard of living of the overall population and providing them with employment. Export expansion should not take place simply for exports’ sake. If the aim of export development and competitiveness is seen as keeping wages low, then ends are being sacrificed for means (Paus, 1989). Amongst other things, trade policy should help provide employment and improve the living standard of the citizens. Serving this purpose justifies the use of any relevant policy instrument to protect the domestic industries, including tariffs and/or quantitative restrictions, or payments of subsidies for particular goods, or any other measures which work to achieve the objectives of development. It may also be appropriate to liberalize trade.

International Market Structure and Country Specificity

The history of industrialization in both the developed countries and the newly-industrialized economies (NIEs) indicates that, with the exception of Hong Kong, no country has managed to industrialize without infant-industry protection. History also teaches us that in all successful cases, government intervention – both functional and selective – in the flow of trade and in the process of industrialization has been important. In other words, comparative advantage has been created over time. However, experience has also shown that prolonged protection and across-the-board import substitution have led to inefficiency and failure.

In reality, the international market is not competitive; international prices are distorted by the activities and interests of large oligopolistic firms, the maldistribution of income and assets among developed and developing countries, and the tastes and technologies of the former. In a globalizing world,

large firms increasingly dominate production and trade worldwide.⁷ The relative role of the market in international trade and production is shrinking, as more and more economic activities take place inside these global firms without going through the market. As rapid changes in technology and organization of production have increased the role of knowledge and experience in industrialization, the period of learning has been prolonged and the need for infant-industry support and technological development has been felt more keenly. Some support is initially required for penetrating into international markets: whether this should be provided through protection, subsidization of output or factors of production is a secondary issue. The main point is that infant-industry support is needed not only for import substitution but also for export promotion.

Economic policies, including reform programmes, need to be specific to each country's needs, the degree of market development, initial industrial base, development objectives and socio-economic characteristics. For countries with little or no industrial capacity, such as the lowest-income countries which are mostly located in Africa, the burning issue is to develop supply capacity and lay the foundation for an expanding export market. For countries which have already undertaken some degree of import substitution, such as most Latin American and Middle Eastern countries, the main requirement is to make their industries efficient and competitive and to expand exports. The challenge for those with some export capacity, namely the NIEs, is to upgrade their industrial structure, for instance through technological development, so as to exploit new opportunities in domestic and international markets. Some of these are achieved by market forces on their own.

7 For example, 70 per cent of world trade is undertaken by 500 large TNCs (Shafaeddin, 2005a: Table 5.1).

Co-ordination of Economic Activities

While the market definitely has a role to play in the process of industrialization and development – the market mechanism can deal, for example, with gradual and marginal changes – it cannot on its own accelerate growth of supply capacity and promote dynamic comparative advantage. The price mechanism is slow to create markets and develop the ‘non-price’ factors (institutions, infrastructure, information and back-up services) necessary for the operation of the market. Furthermore, the market does not have the capacity to make inefficient industries efficient and competitive, particularly through shock therapy (sudden and drastic trade liberalization). Large and sudden changes in the price structure create uncertainty; any response to incentives will be limited, particularly when non-price factors are lacking. Similarly, technological upgrading is not automatic: it involves a learning process which requires deliberate effort to generate technical and managerial skills in the chain of production and distribution. It requires time and experience; it is costly and involves risks as well as externalities. Such efforts need a systemic approach for policies and actions at all levels, national – including macro, sectoral, and micro (firm level) – and international.

It is therefore a fallacy to say that the government has no role, or even a limited role, in the process of industrialization. Some government intervention is required to compensate for market inadequacy – to build up production capacity (whether or not for export), to create markets, to provide complementary non-price factors, and to correct market failures. The market is a servant (means) not a master (end). Since prices are meant to serve long-term objectives of development, a distorted short-term price structure may be the right strategy if it helps to achieve the long-term objective of development, and to attain dynamic comparative advantage (Amsden, 1989; Fontaine, 1992; Paus, 1989).

As learning and technological change play a vital role in industrialization,⁸ attempts should be made to promote learning at different levels of the economy, and in various ways: learning by studying and training, learning by doing, learning by using, imitating and adapting, and most of all learning by trial and error. However, specialized capabilities are developed at the firm and activity levels; knowledge and skills are firm-specific and activity specific, which means that firms that are efficient in this area are able to export. Hence, not only functional intervention, through general education, but also selective and targeted intervention are required by the government to promote specific skills and learning at the relevant levels.

Although there is also a risk of government failure, this is not an argument in favour of leaving everything to the mercy of market forces. The market is not, and cannot be, the only co-ordination mechanism. Co-ordination of economic activities at domestic and international levels takes place through what we may call a co-ordination system (Shafaeddin, 2004a) – that is, the combination of markets, state and firms, complemented and supported by non-price factors. Whereas the orthodox approach sees firms as passive, I would argue that the firm is the central driving force in such a co-ordination system, around which the other co-ordination mechanisms operate. Government actions and policies should complement the market, although not replace it.

The role of each element of the co-ordination system and the degree of interaction among them will vary from one country to another and in each country over time, depending on the level of development, structural, historical and socio-political conditions, and on the interrelations between the different sectors of the economy. Similarly, the role of the private and public sectors may change over time, although close co-operation between the two is essential throughout the process of development.

8 On this, see for example Lall (1996, 2004); Lundvall (2004); Nelson and Winter (1982); Noland and Pack (2003); Westphal (2000).

In each country and in each period, the relative role of each mechanism depends on the existence of various markets and the degree of market failure which is influenced, among other things, by the nature and the degree of development of non-price factors. In the early stages, developing countries face a dilemma as all co-ordination mechanisms run a high risk of failure. Market failure is pervasive due to the absence (or underdevelopment) of markets; there is a greater risk of entrepreneurship failure because of the lack of experienced entrepreneurs and the underdevelopment of the formal sector; the risk of government failure is significant as a result of the low capacity of the government. The lower the level of development, the higher the risk of co-ordination failure. This can also lead to a vicious circle: the country is underdeveloped because of problems in the co-ordination mechanisms, and co-ordination mechanisms fail because of the low level of development. To break this circle, action should be taken on a number of fronts: to create or improve markets, to increase the organizational capacity of entrepreneurs, to develop the necessary infrastructure and institutional framework of the country and to increase the capacity of the state.

In breaking the vicious circle, however, the government must play a key role, at least initially. Given that market forces cannot on their own develop either the market or non-price factors, the (direct) participation of the public sector in industrialization may be necessary initially, particularly in areas where the private sector is not prepared to take risks or where externalities are significant. As the private sector and the market develop, public ownership and the role of the government may gradually be reduced. Nevertheless, experience indicates that the development of infrastructure, institutions and back-up services and the provision of information cannot be left entirely to the private sector because of the significant overhead investment required and the externalities involved.

The key to development at early stages of industrialization is to improve the learning capacity and efficiency of the government machinery in formulating, implementing and correcting its policies. This is not easy but it is feasible, as the experience of both early industrializers and NIEs indicate. Since

design of a trade and industrial policy differs from one country to another, there is no 'right policy' prescription: for each specific case, it is a question of trial and error, learning by doing.

The question, therefore, is not 'market or government'; it is to what extent the government should intervene and in what form, and how the efficiency of such government intervention can be improved to minimize government failure and market failure. Having acknowledged the important role of the state, however, it is also necessary to recognize that unnecessary, rigid and prolonged government intervention in the economy should be avoided; the government should not meddle in the market when it is operating well.

Nature of Trade and Industrial Policies

Trade and industrial policy should be selective, performance-linked, mixed, dynamic and predictable. The scarcity of resources and the presence of different externalities, learning effects and linkages in different industries implies that industrial development should start on a selective basis; this has indeed been the case in all successful early and late industrializers. Some consumer goods – products which are in demand in the internal market and, preferably, also involve a significant learning effect – could be chosen as a first group of industries for capacity building. Since the unit cost of production is high for newcomers (see also Fontaine, 1992), some infant industry support is necessary. While the final products of selected industries are protected, imported inputs for these industries should be free of duties.

However, protection to the selected industry should not be unconditional or unlimited: the government should insist on performance in exchange for incentives, and should sanction firms whose performance is not satisfactory. Criteria for performance should include cost reduction and quality improvement. Any industrial strategy should embody elements of both rewards and pressure from the government, the market or both. As firms develop production capacity, the government should introduce or increase competition pressure gradually in the internal market by allowing new entrants to the field.

In industries for which economies of scale are important, however, the competitive pressure should not be at the cost of production on an efficient scale.

As domestic capacity is developed in such industries, measures should be taken which facilitate a rapid entry into foreign markets, through improved efficiency and quality. At this stage of penetration into international markets, firms may require a second layer of infant-industry protection and support through export subsidies, tax holidays and/or fiscal incentives, to combat the problems of cost disadvantage, external economies in market search and marketing, lack of experience in exporting, and risks related to entry barriers. In other words, infant-industry support is not confined to the import substitution phase. Once again incentives should be provided in exchange for performance – this time for export performance. An example of this was the policy practised in Japan and other East Asian countries, to give preference in allocation of foreign exchange for importation of inputs to firms which perform better in exports.

While the first group of industries go through this second phase, the proceeds of their exports can be channelled into the parallel development of a second group of industries, again on a selective basis. These industries may include other consumer goods, or intermediate products needed for the first group of industries. A rolling system of linkages can be applied. As the second group of industries matures in the production process and reaches the export stage, some sophisticated and durable consumer goods, some inputs to the second group of industries, and some machinery used in the production process of the first group could be added to the list of infant industries for support, with some of these new additions gradually becoming eligible for infant export protection.

In this way, a combination of import substitution, export promotion, infant-industry support and import liberalization is at work for a mixture of consumer goods, intermediate products and capital goods. Infant export protection/support also takes place on a selective basis for each group of industries; over time these are subject to the same modalities as the first group.

The choice of machinery may be influenced by the size of the country and the type of existing industries. The process of deepening industrialization could continue until an industrial base is established, export capabilities are developed and capacities for efficient production of machinery are acquired. During the process, while the role of government intervention for each industry is gradually reduced, the responsibilities of the firms and the role of the market are augmented. Inter-firm relations could be developed to help undertake these responsibilities, for example through trade and industrial associations. Clustering of industries might be useful to exploit externalities in institutions, infrastructure, marketing, skill development, and so forth.

To take an illustrative example: if textiles are chosen as a first group of industries for industrial development, in the first phase textiles should be subject to infant-industry support and supplied with a free flow of imports of yarn and machinery. In the second phase, protection of production should be gradually reduced, but assistance and incentives be provided for promotion of exports. In this phase, the export of textiles can be accompanied with import substitution of yarns. Ultimately, assistance to exports of textiles should be reduced to zero as the industry matures and penetrates the international market. In the meantime, textile machines can be produced domestically and possibly be exported. Gradually, a number of industries are developed over a period of time, in a process said to resemble ‘flying geese’. Although that expression was first coined in the context of Japanese industrialization, almost all successful industrializers followed a more or less similar process.⁹

Not all industries selected for import substitution would necessarily be candidates for the export market. However, this does not imply that protection should continue forever; industries which develop through import substitution should be made efficient so that they can compete effectively in the

9 See Akamatsu (1961); see also Kasahara (2004) for a survey.

domestic market. The enterprises should know in advance that infant-industry support, in both the first and second phase, is temporary; they should also know the schedule for it to be phased out. The pressure for improved efficiency should eventually take the form of gradual liberalization of imports of final goods.

As the industrial base widens the expansion of investment in production and export capacity becomes more important. To avoid terms of trade losses, industrial widening should be followed by industrial deepening – the upgrading of products and the production process, quality improvement, and introduction of new products or new varieties of the same products. This process requires technological innovation of a different nature to that needed for the first stage of industrialization. For industrial deepening, innovation could take the form of introducing and operating new machines (imitation and adaptation). Upgrading innovation requires research and development programmes and eventually the development of new and frontier technology. This in turn necessitates infant support because of the risks and dynamic internal and external economies of the learning involved.

The Limited Role of Devaluation

Devaluation of the local currency may serve certain purposes, and can provide some incentive for production of tradable goods, particularly exports, in the short term. However, it is not necessarily the most desirable measure as a tool of industrial policy,¹⁰ when repeatedly used, for a number of reasons. First, it results in uniform (nominal) price changes over the whole

¹⁰ For example, Bautista's examination of a number of developing countries for the period 1973–79 indicated that currency depreciations, either small or large, did not lead to a permanent improvement in export competitiveness (Bautista, 1982).

range of tradable goods rather than for selected products.¹¹ Supply response to prices is much lower when all the outputs of a sector are equally affected, and stronger when relative prices increase only for one good, or for a few goods (Streeten, 1987). Even in industrialized countries there is some evidence that reallocation of resources from non-tradable to tradable sectors, and within tradables from importables to exportables (and in the latter from traditional to new products), might be more responsive to targeted incentives such as subsidies than to exchange rate adjustment (Schydlosky, 1982).

Second, the direct impact of devaluation on production costs in manufacturing products, particularly exports, is greater than on – which has, in fact, increased significantly due to import liberalization. Industrial production in low-income countries, in particular, is dependent on imports for more than half its inputs. Therefore, in countries with a high ratio of imports to GDP, where manufactures are a small fraction of total exports and the manufacturing sector is highly import-intensive, incentives for exports of manufactures should be provided by other measures than devaluation. These may include, for instance, subsidies, tax holidays and other fiscal and financial measures targeted to particular industries.

Furthermore, the indirect impact of devaluation on the cost of production in the manufacturing sector could also be higher than in other sectors if devaluation is accompanied by, or results in, a decline in productivity in manufacturing due to supply or demand factors, or a combination of the two.

11 Nevertheless, for a given rate of nominal devaluation the implied real exchange rate depreciation will be different in different sectors, industries and firms as their import intensities are different. The higher the import intensity, the higher the increase in the cost of production for a given rate of nominal devaluation, thus the lower the real exchange rate depreciation achieved as a result. The import intensity for the manufacturing sector is usually higher than for other sectors; within the manufacturing sector, it varies from one industry to another, and is higher for modern industries and large firms. Within these industries, it is higher for production for export than for the home market. Further, for each industry and firm the effective exchange rate could be different to the extent that their directions of trade are different. Hence, devaluation does not even work as a uniform price incentive, as is often claimed. To achieve uniform effective exchange rate a complex nominal rate structure is needed.

When devaluation involves contractionary effects,¹² or is accompanied by contractionary macroeconomic management, demand for domestically produced goods will be reduced. Similarly, exports may not increase in response to devaluation; when the structure of supply is rigid, export supply is constrained by import compression, or low quality, inappropriate product for foreign markets, or the lack of marketing channels. Exports may also fail to increase because of low price elasticity of demand or recession abroad. The combination of reduced effective domestic demand and little, or no, expansion in export may lead to lower capacity utilization and a decline in productivity. Ignoring the need to enhance productivity, and over-emphasizing devaluation have been important weaknesses of the reform programmes. Third, devaluation could disrupt the economy through its inflationary impact particularly in low-income countries. It has been estimated that for every 10 per cent nominal devaluation during the period 1980–87, in countries with per capita income of less than US\$ 400, the real exchange rate declined only by 3 per cent within a year (Shafaeddin, 1992; see also Edward and Wijnbergen, 1989).¹³

Fourth, devaluation, like import liberalization, tends to turn the internal terms of trade in favour of primary commodities and against manufacturing, because of differences in the nature of price determination in the two sectors (Shafaeddin, 1991). While this may have a welcome positive effect on food production, it would seem that cash crops have benefited more than food crops in many developing countries which have applied structural adjustment programmes (Stewart et al., 1992). Furthermore, simultaneous currency devaluation by a large number of countries producing the same commodity may result in terms-of-trade losses due to the ‘fallacy of composition’, and decline in real wages.

12 On the importance of the contractionary impact of devaluation, see Edward and Wijnbergen (1989: 1526-8).

13 Edward and Wijnbergen (1989) have shown, on the basis of a survey of the literature, that nominal devaluation leads to relatively high real depreciation in the short term, but the effect of nominal devaluation on real exchange rate erodes slowly, taking between eight and sixteen quarters depending on the type of macroeconomic policies undertaken.

Finally, the available empirical evidence indicates that some other factors are more important in export competitiveness than the exchange rate and the resulting costs and prices. For example, Fagerberg (1988:371) has shown that the contribution of price competitiveness was far less than technological competitiveness resulting in upgrading and the ability to compete on delivery. Of course technological development may also contribute to cost/price reduction, but its key role is in facilitating upgrading. Moreover, the nature of cost reduction resulting from technological development, which also contributes to productivity enhancement, is different from cost/price valuation due to devaluation. An empirical study by Kaldor (1978) for the period 1963-75 indicates that countries with the fastest rate of growth of exports (such as Japan) were those which also experienced faster rates of increase in their relative unit labour cost (RULC). Kaldor concluded that in the long run, relative changes in exchange rates can be the result of competitiveness, rather than its cause. Relying on changes in RULC alone as a policy tool for improving competitiveness would thus be simplistic.¹⁴ Amendola et al. (1993) reached similar results for the period 1967–87.¹⁵

In the long term, enhancing productivity rather than repeated nominal devaluation is a key to success in industrialization. Nonetheless, with the presence of strategically active international firms, the concept of productivity takes on a different meaning. It is not merely concerned with the volume of output produced, but also involves creating value to the consumers through factors which contribute to lowering price elasticity of demand. Such factors include a reputation for reliability, supplying high quality products, in-time and short-time delivery, and so forth. Productivity enhancement requires continuous learning, skill development, innovation and upgrading.

14 The simultaneous increase in RULC and market share is referred to in the literature as Kaldor's paradox.

15 See Fetherston et al. (1977) and Kellman (1983) for similar views expressed in the late 1970s and early 1980s. See also Amable and Verspagen (1995).

FDI and Capital Flows

The experience of developing countries indicates that FDI acts as an important channel for export. In some cases, it has also played a short-term role to financing investment, as in some Latin American countries in the 1990s. Nevertheless, its longer-term contribution is often limited in relation to total domestic investment, and it involves little technological spill over. The recent experience of China indicates that FDI could play an important role in industrialization, if it is guided and targeted at specific areas where foreign technology is most needed, and could contribute to learning amongst the local labour force and to expansion of domestic value added. In fact, China's experience, unlike Mexico's, suggests that one could think of a process of export promotion through FDI leading to import substitution, if it is properly managed. China began assembly operation in a number of industries, particularly electronics and telecommunications, based on imported input; gradually it has been increasing domestic production and exports of components (Shafaeddin, 2004b). Its share of components in exports of manufactured goods (excluding chemicals) increased from about 6.4 per cent in 1992/3 to 14.5 per cent in 1997/98 and 16.7 in 2002/3, after China joined the WTO. More importantly, the corresponding share of imports of components, which had increased steadily from 17.7 per cent to 23.2 per cent in the period 1992/3 to 1997/8, first saw a slow-down (reaching nearly 24 per cent in 2000/1) and then a decline, despite the accession to WTO, to 22.3 per cent in 2002/3.¹⁶

Capital flows also need to be controlled and managed, since erratic movements in capital flows will lead to erratic changes in the flow of imports, the exchange rate, interest rate, production cost, and the price structure. The resulting confusion means that the price structure, including the exchange rate, loses its signalling function as a guide to investment for expansion of

¹⁶ Based on the UN COMTRADE database.

output and export, which leads to instability in all important economic variables. Instability in the flow of imports affects the growth of manufacturing value added (MVA) and gross domestic product (GDP) particularly severely.¹⁷ In violently changing conditions and for large maladjustment, exchange rate devaluation may do considerable damage (Arndt, 1985; Henderson, 1948).

The Role of Other Factors

Trade and industrial policies cannot succeed alone: there are a host of other factors involved. The process of industrialization requires what we might call ‘COU-Ps-INS’. COU stands for: Create capacity, Operate it efficiently and Upgrade the industrial structure (for which incentives are necessary but not sufficient). The P stands for Political stability, Predictability of policies and Pressure for performance. The INs include Investment, Input, Infrastructure – not only transport and communication but also facilities such as marketing channels, distribution networks and so on – Institutions, Innovation and Information (Streeten, 1987). ‘Information’ is used here in the widest sense of the term, to include knowledge and science as well as market information; it requires investment in human resources through education and training. In fact, investment is essential for all the other INs, as well as for the expansion of supply capacity and creation of organizational capabilities and learning. Most of the INs outlined here are elements of the non-price factors mentioned earlier.

There are also two INs which are to be avoided – instability in exchange rates and inflation which are largely related to agricultural development, devaluation, capital flows and macroeconomic policies. The development of agriculture is essential, particularly at early stages of industrialization, to increase the supply of food, where feasible, in order to contribute to availability of wage goods, and to ease the pressure on the balance of payments

17 In the case of African countries, Helleiner (1986) has demonstrated a strong negative relationship between instability in the volume of imports and GDP growth rates.

and inflationary tendencies. For the same reason, ample supplies of other basic consumer goods are also important; the availability of wage goods not only eases inflation, but also contributes to the competitiveness of manufactured goods in the international market.

3

Policy Implications for the International Community

THE alternative approach proposed above may look idealistic, since it does not follow WTO rules, the Washington Consensus, or the practices of IFIs and major bilateral donors in their dealings with developing countries. Nevertheless, the existence of such rules and practices should not blind us to what is needed. These rules are not god-given; they can and need to be revised. In the words of Helleiner (2000: 19): ‘I am realistic enough to recognize that reconceptualization of WTO as a development institution may not happen quickly (although I am fully confident that it eventually will)’.

Like Helleiner, I am aware that such a reconceptualization will involve hard bargaining, as experience has shown that developed countries will not give in purely on moral grounds (Shafaeddin, 1984). Nevertheless, it is worth emphasizing two points: first, that the need for reconceptualization is realized; and second, that developing countries do have some bargaining power in international trade. According to UNCTAD figures, they absorb about 23 per cent of exports of developed countries (when trade within the EU is excluded, the figure is well over 30 per cent) and they provide the bulk of energy and raw materials necessary for the growth of economic activities in the developed countries. The question is how to mobilize these bargaining powers and strengthen their negotiation position (Shafaeddin, 1984).

A detailed redesign of WTO rules and other international trade and industrial policies relevant to developing countries¹⁸ is beyond the scope of this article. Nevertheless, a few general points are worth mentioning with respect to a framework for an international trade policy. First of all, the whole philosophy behind WTO rules needs to be changed. Developing countries do not need ‘policy space’ within the existing framework of WTO rules; what is needed is a totally different framework which allows for a flexible trade policy with dimensions of space and time, rather than a one-off and one-size-fits-all approach. The space dimension implies that trade policy should allow for different levels of development and industrialization of various countries at any given time – not as exceptions to the rules, as sometimes requested by developing countries in the context of ‘special and differential treatment’,¹⁹ but rather as the baseline situation. The time dimension implies that the rules should allow for dynamic changes in the trade policy of each country as that country develops and progresses. Second, export performance requirements and domestic content clauses should be allowed in relations between host countries and transnational corporations. Third, while some protection of intellectual property is needed to encourage invention and innovation, the agreement on trade-related intellectual property rights (TRIPS) should be revised so that it does not create barriers to the diffusion and application of new technologies to firms in developing countries, which makes industrial deepening and upgrading difficult.

In short, the international community should actively pursue the aim of fairer international economic systems and policies, in which the different situations and needs of countries at various stages of development are taken more fully into consideration. At the end of the day, this is not only in the interest of developing countries, but would also benefit developed countries.

18 For a detailed list of restrictions imposed by international rules and bilateral trade relationships on trade and industrial policies of developing countries, see Rodrik (2004: Table 2).

19 See, for example, the text of the G-20 Ministerial Declaration Adopted on 19 March 2005 at the conclusion of the Ministerial meeting of G-20 in New Delhi, 18-19 March 2005: <http://www.twinside.org.sg/title2/twninfo190.htm>.

References

- Akamatsu, K. (1961) 'A Theory of Unbalanced Growth in the World Economy', *Weltwirtschaftliches Archive – Review of World Economics* 86: 3-25.
- Amable, B. and B. Verspagen (1995) 'The Role of Technology in Market Shares Dynamics', *Applied Economics* 27: 197-204.
- Amendola, G., G. Dosi and E. Papani (1993) 'The Dynamic of International Competitiveness', *Weltwirtschaftliches Archive* 129(3): 453-71.
- Amsden, A. H. (1989) *Asia's Next Giant: South Korea and Late Industrialization*. New York: Oxford University Press.
- Amsden, A. H. (2000) 'Industrialization Under New WTO Law'. Paper prepared for UNCTAD X, High-level Round Table on Trade and Development on Directions for the Twenty-first Century (Bangkok, 12 February). Geneva: UNCTAD.
- Amsden, A. H. (2001) *The Rise of 'The Rest': Challenges to the West from Late Industrializing Economies*. Oxford: Oxford University Press.
- Arndt, H. W. (1985) 'The Origin of Structuralism', *World Development* 13(2): 151-9.
- Balassa B. (1980) 'The Process of Industrial Development and Alternative Development Strategies'. World Bank Staff Working Paper no. 438. Washington, DC: The World Bank.
- Bautista, R. M (1982) 'Exchange Rate Variations and Export Competitiveness in Less Developed Countries under Generalized Floating', *The Journal of Development Studies* 354-78.
- Bhagwati, J. (1978) *Anatomy and Consequences of Exchange Rate Control Regimes*. Foreign Trade Regimes and Economic Development series. Cambridge, MA: Ballinger Publishing Company.
- Cline, R. W. (1983) *Trade Policy and Economic Welfare*. Oxford: Clarendon Press.
- Easterly, W. (2001) 'The Lost Decades: Developing Countries' Stagnation in Spite of Policy Reform 1980-1998', *Journal of Economic Growth* 6(2): 135-57.
- Edward, S. and S. V. Wijnbergen (1989) 'Disequilibrium and Structural Adjustment', in H. B. Chenery and T. N. Srinivasan (eds) *Handbook of Development Economics*, Vol II, pp. 1482-1533. Amsterdam: North Holland.
- Fagerberg, J. (1988) 'International Competitiveness', *The Economic Journal* 98(391): 355-74.
- Fetherston, M., B. Moor and J. Rhodes (1977) 'Manufacturing Export Shares and Cost Competitiveness of Advanced Industrial Countries', *Cambridge Economic Policy Review* 3: 87-99.

- Fontaine, J. M. (ed.) (1992) *Foreign Trade Reforms and Development Strategies*. London: Routledge.
- Gomery, R. E. and W. J. Baumol (2000) *Global Trade and Conflicting National Interests*. Cambridge, MA: Massachusetts Institute of Technology.
- Helleiner, G. K. (1986) 'Outward Orientation, Import Instability and African Economic Growth: An Empirical Investigation', in S. Lall and F. Stewart (eds) *Theory and Reality in Development, Essays in Honour of Paul Streeten*, pp. 139-54. London: Macmillan.
- Helleiner, G. K. (2000) 'Markets, Politics and Globalization: Can the Global Economy be Civilized?'. 10th Raul Prebisch Lecture. Geneva: UNCTAD.
- Henderson, H. D. (1948) 'The Price System', *The Economic Journal* (December): 467-82.
- Kaldor, N. (1972) 'The Irrelevance of Equilibrium Economies', *The Economic Journal* 82(338): 1237-55.
- Kaldor, N. (1978) 'The Effects of Devaluations on Trade in Manufactures', in N. Kaldor *Further Essays on Applied Economics*, pp. 99-116. London: Duckworth.
- Kasahara, S. (2004) 'The Flying Geese Paradigm: A Critical Study of its Application to Asian Regional Development'. UNCTAD Discussion Paper No 169. Geneva: UNCTAD.
- Kellman, M. (1983) 'Relative Prices and International Competitiveness: An Empirical Investigation', *Empirical Economics* 8(3-4): 125-38.
- Krueger, A. O. (1978) *Liberalization Attempts and Consequences*. Foreign Trade Regimes and Economic Development series. Cambridge, MA: Ballinger Publishing Company, for the NBER.
- Lall, S. (1996) *Learning from the Asian Tigers*. London: Macmillan.
- Lall, S. (2004) 'Reinventing Industrial Strategy: The Role of Government Policy in Building Industrial Competitiveness'. G-24 Discussion Paper series, April. Geneva: UNCTAD.
- List, F. (1856) *The Natural System of Political Economy* translated by G. A. Matile. Philadelphia: J. B. Lippincott & Co.
- Little, I. M. D., T. Scitovsky and M. Scott (1970) *Industry and Trade in Some Developing Countries*. Oxford: Oxford University Press.
- Lundvall, B. (2004) 'Why the New Economy is a Learning Economy'. DRUID Working Paper No 2004-01. Frederiksberg: Danish Research Unit for Industrial Dynamics.
- Myrdal, G. (1971) *Asian Drama, An Inquiry into the Poverty of Nations*. London: Penguin Books.

- Nelson, R. and S. G. Winter (1982) *An Evolutionary Theory of Economic Change*. Cambridge, MA and London: Harvard University Press.
- Noland, M. and H. Pack (2003) *Industrial Policy in an Era of Globalization: Lessons from Asia*. Washington, DC: Institute for International Economics.
- Paus, E. (1989) 'Political Economy of Non-traditional Export Growth: Argentina and Brazil in the 1970s', *Journal of Developing Areas* 23: 173-200.
- Rodrik, D. (2001) The Global Governance of Trade as if Development Really Mattered'. Paper prepared for UNDP. Available online: www.undp.org/poverty/docs/pov_globalgovernancetrade_pub/pdf
- Rodrik, D. (2004) 'Industrial Policy for the Twenty-First Century'. Discussion Paper Series No 4767. London: Centre for Economic Policy Research.
- Schydrowsky, B. D. (1982) 'Alternative Approaches to Short-term Economic Management', in T. Killick (ed.) *Adjustment and Financing in the Developing World*, pp. 105-35. Washington, DC: GDI/IMF.
- Shafaeddin, M. (1984) 'Import Capacity as a Bargaining Tool of Developing Countries', *Trade and Development, UNCTAD Review* 5: 53-79.
- Shafaeddin, M. (1991) Trade Policies and Economic Performance of Developing Countries', in H. W. Singer and R. Prendergast (eds) *Development Prospects in 1990. Proceedings of the Annual Conference of the Development Studies Association*, pp. 77-102. London: Macmillan.
- Shafaeddin, M. (1992) 'Import Shortages and the Inflationary Impact of Devaluation in Developing Countries', *Industry and Development* 32: 19-37.
- Shafaeddin, M. (2004a) 'Who is the Master? Who is the Servant? Market or Government? An Alternative Approach: Towards a Coordination System'. Discussion Paper No.175. Geneva: UNCTAD. Available online: www.unctad.org/Templates/Page.asp?intItemID=2101&lang=1#
- Shafaeddin, M. (2004b) 'Is China's Accession to WTO Threatening Exports of Developing Countries?', *China Economic Review* 15(2): 109-144.
- Shafaeddin, M. (2005a) *Trade Policy at the Crossroads: The Recent Experience of Developing Countries*. Basingstoke and New York: PalgraveMacmillan.
- Shafaeddin, M. (2005b) 'Economic Reform, Economic Performance and Structural Change in Developing Countries', in S Maxwell, A.Paloni and M. Zanardi (eds) *The IMF, the World Bank and Policy Reform*. London: Routledge (forthcoming).

- Singh, A. (1992) 'Close vs. Strategic Integration with the World Economy and the Market Friendly Approach to Development vs. an Industrial Policy'. Faculty of Economics. Cambridge: University of Cambridge (mimeo).
- Smith, Adam (1776/1986) *The Wealth of Nations* (ed. Andrew Skinner). Harmondsworth: Penguin Books.
- Steward, F., S. Lall. and S. Wangwe (eds) (1992) *Alternative Development Strategies in Sub-Saharan Africa*. London: Macmillan.
- Streeten, P. P. (1987) 'Structural Adjustment: A Survey of the Issues and Options', *World Development* 15(12): 1469-82. UN Commodity Trade Statistics (Comtrade) Database. Available online: <http://www.unstats.un.org/unsd/comtrade/>
- Viner, J. (1953) *International Trade and Economic Development*. Oxford: Clarendon Press.
- Wade, R. (1990) *Governing the Market: Economic Theory and the Role of Government in East Asian Industrialization*. Princeton, NJ: Princeton University Press.
- Wade, R. (2003) 'Creating Capitalisms', Introductory Chapter to new edition of *Governing the Market: Economic Theory and the Role of Government in East Asian Industrialization*, pp. xiii-liv, Princeton, NJ: Princeton University Press.
- Westphal, L. E. (2000) 'Industrialization Meets Globalization: Uncertain Reflection on East Asian Experience'. Swathmore, PA: Swarthmore College (mimeo).
- Williamson, J. (ed.) (1990) *Latin American Adjustment: How Much Has Happened?* Washington, DC: Institute of International Economics.
- World Bank (1987) *World Development Report*. Washington, DC: The World Bank.
- World Bank (1993) *The Asian Miracle: Economic Growth and Public Policy*. Washington, DC: The World Bank Policy Research Department.

Titles in the TWN Trade & Development Series

- No. 1 From Marrakesh to Singapore: The WTO and Developing Countries
by Magda Shahin (48 pages)
- No. 2 The WTO and the Proposed Multilateral Investment Agreement: Implications for Developing Countries and Proposed Positions *by Martin Khor* (40 pages)
- No. 3 Some Key Issues Relating to the WTO *by Bhagirath Lal Das* (40 pages)
- No. 4 The New Issues and Developing Countries *by Chakravarthi Raghavan* (48 pages)
- No. 5 Trade and Environment in the WTO: A Review of its Initial Work and Future Prospects *by Magda Shahin* (68 pages)
- No. 6 Globalisation: The Past in our Present *by Deepak Nayyar* (40 pages)
- No. 7 The Implementation of the WTO Multilateral Trade Agreements, the 'Built-In' Agenda, New Issues, and the Developing Countries *by Xiaobing Tang* (68 pages)
- No. 8 Strengthening Developing Countries in the WTO *by Bhagirath Lal Das* (48 pages)
- No. 9 The World Trade Organization and its Dispute Settlement System: Tilting the Balance Against the South *by Chakravarthi Raghavan* (48 pages)
- No. 10 Negotiations on Agriculture and Services in the WTO: Suggestions for Modalities/Guidelines *by Bhagirath Lal Das* (24 pages)
- No. 11 The Implications of the New Issues in the WTO *by Bhagirath Lal Das* (20 pages)
- No. 12 Developing Countries, the WTO and a New Round: A Perspective *by Ransford Smith* (40 pages)
- No. 13 Review of the TRIPS Agreement: Fostering the Transfer of Technology to Developing Countries *by Carlos Correa* (48 pages)
- No. 14 The Proposed New Issues in the WTO and the Interests of Developing Countries *by Martin Khor* (32 pages)
- No. 15 WTO: Challenges for Developing Countries in the Near Future *by Bhagirath Lal Das* (24 pages)

- No. 16 Dangers of Negotiating Investment and Competition Rules in the WTO
by Bhagirath Lal Das (32 pages)
- No. 17 WTO Agreement on Agriculture: Deficiencies and Proposals for Change
by Bhagirath Lal Das (28 pages)
- No. 18 Some Suggestions for Modalities in Agriculture Negotiations
by Bhagirath Lal Das (24 page)
- No. 19 The WTO Agriculture Agreement: Features, Effects, Negotiations, and Suggested Changes
by Martin Khor (48 pages)
- No. 20 Market Access for Non-Agricultural Products: A Development View of the Principles and Modalities
by Martin Khor & Goh Chien Yen (32 pages)
- No. 21 Financial Effects of Foreign Direct Investment in the Context of a Possible WTO Agreement on Investment
by David Woodward (28 pages)
- No. 22 Implementation Issues Again Off WTO Radar Screens?
by Chakravarthi Raghavan (28 pages)
- No. 23 Effects of Agricultural Liberalisation: Experiences of Rural Producers in Developing Countries
by Meenakshi Raman (40 pages)
- No. 24 The WTO Negotiations on Industrial Tariffs: What is at Stake for Developing Countries
by Yilmaz Akyüz (68 pages)
- No. 25 The Commodities Crisis and the Global Trade in Agriculture: Problems and Proposals
by Martin Khor (44 pages)
- No. 26 Implications of Some WTO Rules on the Realisation of the MDGs
by Martin Khor (48 pages)
- No. 27 Development Issues in the WTO in the Post-July Package Period: Myth or Reality?
by Bonapas Onguglo (72 pages)
- No. 28 Trade, Growth and Industrialisation: Issues, Experience and Policy Challenges
by Yilmaz Akyüz (52 pages)
- No. 29 The WTO Negotiations on Non-Agricultural Market Access: A Development Perspective
by Martin Khor and Goh Chien Yen (80 pages)
- No. 30 Towards an Alternative Perspective on Trade and Industrial Policies
by S M Shafaeddin (36 pages)

TOWARDS AN ALTERNATIVE PERSPECTIVE ON TRADE AND INDUSTRIAL POLICIES

Trade policy is at a crossroads, as is trade diplomacy, in the form of trade negotiations under the auspices of the World Trade Organization (WTO). The traditional import substitution industrialization (ISI) strategies, which prevailed during 1950s till 70s failed. Across-the-board trade liberalization, recommended by the International Financial Institutions (IFIs) and neoliberal scholars in the 1980s and 1990s to promote outward-oriented industrialization and development, fared no better. What is next?

Drawing on the experiences of developing countries in trade liberalization and economic reform in recent years, as well as the history of those countries which underwent early industrialization, this paper aims to develop an alternative approach to trade and industrial policy by taking a bottom-up approach.

The author presents a national policy framework (that is, a view of what is needed at the national level to catch up in the process of industrialization) and, on that basis, argues for changes in international rules.

S M SHAF AEDDIN is a (former) senior economist in the Macroeconomics and Development Policies Branch, Globalization and Development Strategy Division, of the United Nations Conference on Trade and Development (UNCTAD). He is the author of many books and articles on trade policy, including the book *Trade Policy at the Crossroads: Recent Experience of Developing Countries* (Palgrave Macmillan, 2005). The author can be contacted at: MShafaM@Netscape.net

TWN TRADE & DEVELOPMENT SERIES

is a series of papers published by **Third World Network** on trade and development issues that are of public concern, particularly in the South. The series is aimed at generating discussion and contributing to the advancement of appropriate development policies oriented towards fulfilling human needs, social equity and environmental sustainability.