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Trade Policies in Developing Countries

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The purpose of this paper is to examine some of the implications of the author's findings concerning the effects of trade policies followed by developing countries on their export performance and economic growth. In the discussion, use will be made of the results of several studies carried out in recent years: an investigation of the growth strategies of six semi-industrial countries, two of which, Argentina and Chile, are customarily included in the developing country category;¹ a comparative study of the structure of protection in Brazil, Chile, Mexico, Western Malaysia, Pakistan, the Philippines, and Norway;² and a study of industrial policies in Taiwan and Korea.³ Following a brief

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¹ Bela Balassa, "Growth Strategies in Semi-Industrial Countries" *Quarterly Journal of Economics*, February 1970, pp. 24-47.

² Bela Balassa and Associates, *The Structure of Protection in Developing Countries*, Baltimore, Md., The Johns Hopkins University Press, 1971. For a discussion of some of the methodological issues and a summary of the estimates of effective rates of protection, see "Effective Protection in Developing Countries" in *Trade, Balance of Payments and Growth: Papers in International Economics in Honor of Charles P. Kindleberger* (J. Bhagwati, R. Jones, R. A. Mundell, and V. Vanek, eds.), Amsterdam, North Holland Publishing Co., 1971.—In the present paper, results pertaining to Norway will not be considered. Furthermore, in the case of Argentina, Brazil, and Chile, the paper will consider the situation existing prior to the changes in policies introduced in the late sixties. These policy changes will be briefly referred to at a later point in the paper.

³ Bela Balassa, "Industrial Policies in Taiwan and Korean," *Weltwirtschaftliches Archiv*, Band 105, Heft 1, 1971. To be reprinted in a volume in honor of Raul Prebisch.

summary of the findings, guidelines will be suggested for trade policies by developing countries.

I

Instruments of trade policy employed by developing countries include import tariffs and surcharges, export taxes and subsidies, multiple exchange rates, as well as quotas and licenses. By affecting the relative prices of inputs and outputs, these measures influence the allocation of resources, including new investment, and provide incentives—or disincentives—to import-substituting and export activities.

Discrimination among economic activities introduced by the use of trade measures exists to varying degrees in the nine countries studied.⁴ Argentina, Brazil, Chile, Pakistan, and—to a lesser extent—the Philippines provide considerable incentives to manufacturing industries at the expense of primary activities. The extent of discrimination in favor of manufacturing and against primary production is relatively small in Mexico; it is even less in Korea and Taiwan; and, on the average, virtually nil in Western Malaysia (for short, Malaya).

Discrimination in favor of manufacturing entails the protection of domestic manufacturing industries against imports

⁴ The results cited in the paper have been taken from the four studies cited above and do not include recent changes in the policies that will be noted below. Some of the estimates on exports and growth have been reproduced in Tables 1 and 2.

whereas primary exports are penalized by tariffs on their inputs and by the lower exchange rate associated with protection. The protection of manufactured goods and discrimination against primary exports usually go hand-in-hand, the principal exception being Malaya, which levies a tax on its major primary exports, rubber and tin, but does not protect manufactures.

In Argentina, Brazil, Chile, and the Philippines, there is also a substantial bias in favor of import substitution and against exports in protected manufacturing industries. Firms producing for home markets can get the domestic price raised by high import protection while, in the absence of export subsidies, they could obtain only the world market price in exporting. By contrast, the bias against exports in manufacturing industries is relatively small in Mexico and Malaya where levels of protection are low and it is practically nonexistent in Pakistan, Taiwan, and Korea. In Pakistan, manufacturing industries receive high protection irrespective of whether they produce for domestic or foreign markets; in Taiwan and Korea the extent of import protection is rather low and, on the average, it is matched by subsidies to manufactured exports.

II

The trade policies followed during the postwar period have affected export performance and economic growth in the countries under consideration. The unfavorable treatment of primary exports has contributed to the decline in the shares of Argentina, Brazil, Chile, and Pakistan and, to a lesser extent, the Philippines in the world market for their major export commodities and has retarded the development of new exports. Malaya, too, has experienced a decline in the market shares of its major primary exports, but it has expanded its minor exports which receive more favorable treatment. Finally, Mex-

ico and to an even greater extent Taiwan and Korea have been successful in raising the world market share of their major primary exports and in introducing new export products. In the latter two countries, these developments have taken place during the sixties following a shift in economic policies from import substitution to export promotion.

The expansion of primary exports in individual countries has further been affected by world demand conditions in the markets for their major export commodities. The main beneficiaries of favorable world market trends have been Chile (copper) and the Philippines (oilseeds) while the slow growth of world demand and unfavorable price changes for rubber and tin have depressed export earnings in Malaya.

The trade policies followed, together with changes in world market conditions, largely explain intercountry differences in the rate of growth of primary exports. Table 1 shows Korea and Taiwan in the lead, followed by Chile, the Philippines, Mexico, Argentina, Malaya, Brazil, and Pakistan. Comparisons of growth rates are less meaningful for manufactured exports because several of the countries under consideration started from a very small base. Instead, we use the share of manufactured exports in manufacturing output and in total exports as indicators of success in exporting manufactures.

In countries with a substantial bias against the exports of manufactured goods, these commodities continue to account for less than 3 percent of manufactured output and account for at most 10 percent of total exports. Among countries with a lesser bias, Mexico's manufactured exports have reached 5 percent of manufacturing output and 25 percent of total exports. In Malaya 10 percent of manufactured output is exported although, given the relatively low share of manufacturing and the high share of exports in GNP, manufactured

TABLE 1—EXPORTS IN SELECTED DEVELOPING COUNTRIES

	Argen- tina	Brazil	Chile	Mexico	Korea	Malaya	Pakistan	Philip- pines	Taiwan
Average annual rate of growth of exports									
Primary goods									
1950-60	0.1	-0.9	5.3	4.0	-3.5	1.9	-7.5	5.4	-1.2
1960-69	3.6	4.2	8.4	5.5	21.0	0.6	2.5	6.0	16.4
1950-69	1.7	0.6	6.8	4.7	16.7	1.1	-2.9	5.7	8.3
Manufactures									
1950-60	-7.6	15.6	11.1	12.2	0.2	29.0	35.0	4.7	30.5
1960-69	17.3	19.1	10.7	19.9	69.0	12.7	14.5	25.0	34.0
1950-69	3.5	16.3	10.9	15.8	35.6	19.0	24.0	13.3	32.5
All commodities									
1950-60	-0.5	-0.6	5.6	5.0	-2.8	2.0	-2.3	5.4	3.6
1960-69	4.6	5.1	8.5	7.2	38.9	1.2	6.3	6.8	24.0
1950-69	1.9	1.1	7.0	6.0	18.2	1.7	0.4	6.0	14.9
Manufactured exports as a percentage of output—1969									
total exports—1969	2	1	3	5	18	10	8	3	36
	10	9	6	25	76	10	51	10	67

Note: For Taiwan and Korea the base year is 1953 instead of 1950. For Brazil, Chile, Malaya, Pakistan, and the Philippines, the terminal year is 1968 instead of 1969.

Source: National and international trade statistics.

goods provide no more than one-tenth of total exports.

In Taiwan and Korea, manufactured exports have been stimulated to a considerable extent by the adoption of export-oriented policies around 1960. As a result, exports of manufactures have increased to a considerable extent in the two countries, both as a proportion of total exports and of manufacturing output. By 1969, these proportions reached 67 and 37 percent in Taiwan and 76 and 18 percent in Korea.

Following the introduction of the Export Bonus scheme in 1959, manufactured exports have also assumed importance in Pakistan, with jute and cotton textiles being the principal items. But, owing to policies penalizing primary exports, foreign sales of raw jute and cotton have declined in an amount exceeding the rise in textile exports. Moreover, high subsidies to manufactured exports, together with the high protection of import substitutes,

have imposed a substantial cost on the national economy.

Owing to their favorable performance in both primary and manufactured exports, Korea and Taiwan are far ahead of the other countries studied in terms of the expansion of total exports (Table 1). Exports have increased more than the average also in Mexico where the growth of tourism and border trade (not included in the export figures) have further contributed to increases in foreign exchange earnings. For reasons noted earlier, exports have risen relatively rapidly also in Chile and the Philippines while increases have been small in Argentina, Brazil, and Pakistan.

III

The expansion of exports contributes to economic growth directly by raising national income and indirectly by providing foreign exchange for the import needs of

the domestic economy. An export-oriented policy also permits specialization according to comparative advantage—both between primary and manufactured activities and within the manufacturing sector. In particular, exports of manufactured goods enable firms to lower costs by employing large-scale production methods, reducing product variety, and participating in the international division of the production process through the manufacturing of parts and components for assembly abroad. Moreover, familiarity with foreign markets provides incentives for technological change and product improvement.

Import substitution, too, can be a source of economic growth in particular cases. A number of developing countries attained rapid rates of growth of manufacturing output and, to a lesser extent, national income, in the early stage of import substitution, which entails replacing the imports of nondurable consumer goods and their inputs by domestic production. Industries producing such commodities are the prime candidates for import substitution in developing countries since they employ chiefly unskilled and semi-skilled labor, do not require the application of sophisticated technology, and need few inputs from ancillary industries. Nor does the limited size of national markets constitute an important handicap for the development of these industries since the efficient scale of operations is relatively low and costs are not substantially higher in smaller plants.

But, in the absence of exports, the expansion of industries producing nondurable consumer goods and their inputs necessarily slows down after imports have been replaced since domestic production cannot continue to grow faster than home demand. Moreover, in the small domestic markets of developing countries, increasing difficulties are encountered in import

substitution in other intermediate products, capital goods, and durable consumer goods. These commodities have higher technological and skill requirements, require the availability of materials, parts, and components from other industries, and need large-scale production for efficient operations with costs being substantially higher at lower output levels. Last but not least, in the event of continuing protection, there will be few inducements for technological improvements.

These considerations help to explain intercountry differences in rates of economic growth (Table 2). In Taiwan and Korea, the growth of GDP has accelerated to a considerable extent following the adoption of export-oriented policies. In expanding the exports of nondurable consumer goods, the two countries have utilized their educated manpower while the capital requirements of these industries are relatively low. The leading role of exports in the growth process is indicated by the high incremental ratio of exports to GDP; in 1960-69, this ratio was 39 percent in Taiwan and 29 percent in Korea.⁵

Exports have also importantly contributed to Mexico's economic growth and the relatively low protection of manufacturing industries has limited the cost of import substitution. In turn, the low degree of discrimination among economic activities has made it possible for Malaya to attain a rate of growth of national income substantially above that for exports.

The remaining countries of the group are characterized by import substitution behind high protective barriers. In these countries, the relationship between import substitution and economic growth has been influenced by their market size and the level of their economic development.

⁵ The incremental exports-GDP ratio (the ratio of the absolute increase in the value of exports to that of GDP) was calculated in constant prices from data given in national and international sources.

TABLE 2—ECONOMIC GROWTH IN SELECTED DEVELOPING COUNTRIES

	Argen- tina	Brazil	Chile	Mexico	Korea	Malaya	Pakistan	Philip- pines	Taiwan
Average annual rate of growth of value added									
Agriculture									
1950-60	2.3	4.7	1.2	5.4	2.3	3.2	1.4	5.1	3.9
1960-69	2.0	4.2	2.5	4.0	4.6	3.9	3.7	4.6	5.0
1950-69	2.1	4.5	1.8	4.5	3.6	3.6	2.5	4.9	4.5
Manufacturing									
1950-60	4.7	8.8	3.3	8.0	13.6	5.1	7.8	10.2	10.1
1960-69	4.6	5.9	5.9	2.0	16.0	11.7	8.6	4.5	16.1
1950-69	4.6	7.5	4.5	8.4	15.0	8.0	8.2	7.8	13.5
GDP									
1950-60	3.4	5.8	3.7	5.8	5.0	4.1	2.5	6.8	6.9
1960-69	3.4	4.3	4.5	7.1	9.2	5.7	5.6	5.1	9.9
1950-69	3.4	5.1	4.0	6.4	7.4	4.8	4.0	6.1	8.6
Per capita GDP									
1950-60	1.4	2.8	1.2	2.8	3.0	1.1	0.4	3.5	3.1
1960-69	1.8	1.3	2.3	3.6	6.4	2.5	2.9	1.6	6.6
1950-69	1.6	2.1	1.7	3.2	4.9	1.7	1.6	2.7	5.1
Population									
1950-60	2.0	3.0	2.3	2.9	2.0	2.9	2.1	3.2	3.6
1960-69	1.5	3.0	2.2	3.4	2.6	3.1	2.6	3.4	3.0
1950-69	1.8	3.0	2.2	3.1	2.3	3.0	2.3	3.3	3.3

Note: For Taiwan and Korea the base year is 1953 instead of 1950. For Brazil and Malaya, the terminal year is 1968, for the Philippines, 1967.

Source: National and international statistics.

Thus, the expansion of manufacturing output has slowed down to a considerable extent in the Philippines after the mid-fifties by which time the "easy" stage of import substitution had been largely completed. Despite rapid increases in exports due to favorable market conditions, there has been a decline in the rate of growth of GDP as well.

Argentina and Chile had replaced practically all nondurable consumer goods and their inputs before the period under consideration, and their small domestic markets have made the expansion of industries producing other intermediate products, capital goods, and durable consumer goods both difficult and costly. These countries have built up an industrial structure which entails the use of small-

scale and often outdated production methods, inadequate specialization, and the manufacturing of products of low quality.⁶ Discrimination against agriculture, associated with the high protection of manufacturing activities, has further hindered their economic growth and helps to explain why they have experienced the lowest growth rates among the nine countries studied.

Brazil, too, had completed the first stage of import substitution prior to the period under consideration. Its large domestic market, however, provided possibilities for the continued expansion of manufacturing during the fifties, mostly

⁶For a detailed discussion, see Bela Balassa, "Growth Strategies in Semi-Industrial Countries," *op. cit.*, pp. 45-46.

in intermediate products, capital goods, and durable consumer goods. But, as the possibilities for import substitution have been increasingly exhausted, industrial expansion has slowed down in this country also.

Pakistan had practically no industry prior to independence and it was able to achieve rapid rates of economic growth by substituting domestic production for the imports of nondurable consumer goods and their inputs. Subsequently, the adoption of the Export Bonus scheme has contributed to its relatively rapid industrial expansion. Continuing discrimination against agriculture has however adversely affected the growth of the Pakistani economy. If national income is measured at world market prices rather than at the domestic prices distorted by protection, increases in per capita terms appear to have been small.⁷

IV

The experience of the countries under consideration suggests the conclusion that while the protection of the manufacturing sector may permit rapid growth at an early stage of import substitution, it will eventually have adverse consequences for economic growth. Discrimination among industries does not permit specialization according to comparative advantage; the high protection of domestic industry induces the establishment of high-cost import-substituting activities; and the bias against exports retards the development of manufactured exports. Finally, in the absence of foreign competition, there will be little incentive for technical progress in small protected domestic markets.

The increasing difficulties experienced by countries at higher stages of import substitution have recently led some gov-

ernments to reconsider their economic policies. In Argentina, the extent of discrimination against primary production and exports has been reduced and the protection of manufacturing industries has been moderated through a simultaneous devaluation and a lowering of tariffs. Manufactured goods also receive export subsidies in Argentina and such subsidies have assumed an important role in Brazil. Furthermore, in Chile, an effort has been made to lessen the degree of over-valuation of the currency while subsidies have been used to promote the exports of manufactured goods.

Efforts made to reform the structure of protection, however, have gone only part of the way and further progress is made difficult by resistance on the part of vested interests. Businessmen are opposed to changes in the status quo which ensures comfortable profits, and they demand continuing protection from foreign competition, whether this comes from the industrial countries or from developing nations as in the case of LAFTA. Additional problems are that transition to a more open economy would entail dislocation in particular industries and regions.

It appears, then, that once an industrial structure geared to import substitution has been established, change becomes increasingly difficult. This observation points to the need for making appropriate policy choices at the time when a country embarks on an industrialization program. In the following, guidelines will be suggested for trade policies by developing countries.⁸ Apart from their application to countries at an early stage of industrialization, the guidelines can provide a basis

⁷ In formulating the guidelines, the author has drawn on the results of the studies referred to above, his experience in advising developing countries on trade policies, and the pertinent economic literature. Limitations of space have not permitted, however, the detailed consideration of particular issues.

⁸ For such an adjustment, see Bela Balassa, *The Structure of Protection in Developing Countries*, Ch. 2.

for improvements in the policies of countries presently engaged in import substitution.

V

International trade theory tells us that small countries which do not affect the prices of their exports and imports will maximize welfare by specializing in accordance with price relations on the world market. Developing countries can generally take their import prices as given and they will not affect the prices of most of their manufactured exports either. This will not be the case, however, for traditional primary exports whenever increases in the country's exports lead to a fall in prices. For these exports, then, the relevant decision rule will involve equating marginal costs to marginal revenue from exports rather than to price. This can be accomplished by converting foreign exchange earnings from such exports at a less favorable exchange rate or—what amounts to the same—imposing an export tax on them. Export tax rates on individual commodities should be set by allowing for the elasticity of world demand, the country's share in world exports, and the possible reactions on the part of foreign competitors.⁹

The application of these measures would take account of market limitations for traditional primary exports, without unduly discouraging their production as has often been the case in the past. A further question is whether manufacturing industries should be favored over nontrad-

itional primary production, and if so, to what extent and by the use of what measures. In this connection, note should first be taken of arguments for infant industry protection, designed to compensate for assumed differences between social and private profitability. On the firm level, such differences may arise if the lack of credit facilities, the overestimation of risks, or simply the desire to exclude the possibility of bankruptcy provide disincentives for investment, although eventual cost reductions through the learning process or through increases in the scale of operations would make the investment socially desirable. Other instances are when some of the benefits of the pioneering firm's activities are enjoyed by others who utilize the know-how generated by the firm or hire away skilled labor and technicians it has trained.

It has often been said that infant industry arguments justify using production subsidies rather than tariffs since the latter limit the size of the domestic market by raising the price of the commodity in question. But while tariffs contribute to government revenue, subsidies represent a claim on this revenue. Budgetary reasons, then, may explain why developing countries use tariffs in preference to production subsidies. In fact, tariffs often account for a large part of government revenue in these countries, and their replacement by other forms of taxation may encounter practical difficulties.

The arguments for subsidies in preference to tariffs gain in force in cases when a particular distortion or cost disability needs to be corrected. This will be so if the cost of industrial labor to manufacturing enterprises exceeds its social cost in the form of the output foregone in primary activities from which labor is drawn. In some overpopulated countries, such a situation may exist on family-type farms where the contribution of the marginal

⁹ An extreme case is that of coffee where producing countries would be advised to set the export tax (differential exchange rate) at a level calculated to ensure that domestic supply be equal to quota allocations under the International Coffee Agreement. In this way, profits due to the price-raising effects of quotas in international markets accrue to the government and, rather than providing incentives to surplus production, the proceeds of an export tax can be transferred to other activities where higher returns are obtained.

worker is said to be less than his consumption. There is further the possibility that unemployment will persist at the existing wage rate which cannot be reduced lest it decline below a socially acceptable minimum. Mining industries, for example, utilize relatively little labor and countries relying on mineral exports may not be able to fully employ their labor force without providing special incentives for labor use.

In the cases described, the appropriate measure would be subsidizing the use of labor rather than imposing tariffs. Tariffs encourage the use of labor as well as capital in protected industries and they favor using labor in such industries in preference to other sectors of the national economy. Moreover, tariffs may provide incentives for the development of industries that would not be profitable under free trade even if wages were nil. In such instances, there is a trade-off between employment and growth since resources are channelled into industries with relatively high costs. Some of these industries may also have limited possibilities for improving productivity as is said to be the situation in the Indian cottage industry that receives considerable inducements. Finally, while employment-creating measures tend to improve the distribution of income, they may adversely affect savings and hence the prospects for future growth. The choice between employment and growth, then, becomes a choice between present and future employment.

Subsidizing labor use may take the form of taxing output and rebating the tax on the basis of the number of employees. This method would encourage the expansion of labor-intensive industries which use a developing country's abundant resource, labor, and would also provide incentives for employing labor-intensive production methods. However, there is no reason to restrict the application of this method to manufacturing industries, but

it should be extended to all sectors other than family farming.

Particular cost disabilities, or handicaps of manufacturing industries owing to inadequate overhead facilities, can also best be corrected by specific action rather than by protection. But again, the provision of such facilities should not be restricted to manufacturing. Thus, roads and electricity are needed for agricultural activities, just as an increase in the educational level of the labor force would contribute to the development of industry as well as to the modernization of agriculture.

VI

The question remains whether, apart from temporary protection on infant industry grounds and the correction of particular cost disabilities, manufacturing should receive preferential treatment. In support of this proposition, it has been adduced that productivity tends to rise more rapidly in manufacturing than in primary production and that the expansion of manufacturing industries provides indirect benefits by inducing investments in other branches of industry and improving the quality of the labor force.

The first claim holds true if we compare manufacturing with agricultural activities that employ traditional techniques, although modern advances in agriculture offer possibilities for improvements in productivity. Furthermore, linkages, among industries often favor the establishment of related branches of manufacturing, but one should not condone on this basis the establishment of inefficient industries which supply inputs to other industries at a high cost. There is finally some merit to the argument that manufacturing contributes to improvements in the quality of the labor force to a greater extent than does even modern agriculture.

From the point of view of long-term

policy making, further consideration should be given to possible future changes in the supply and demand of primary products. In some developing countries either the supply of primary commodities or foreign demand for them would eventually prove to be a limiting factor for the country's economic growth. In such a situation, the preferential treatment of manufacturing industry, where supply and demand limitations are negligible, would be warranted not only vis-à-vis traditional primary commodities, but also in comparison to the primary sector as a whole.

These considerations indicate the difficulties encountered in appraising the claims made for the superiority of manufacturing over primary production. The difficulties are compounded if we attempt to quantify these alleged advantages. Nevertheless, one may argue that manufacturing offers *some* advantages over primary production in the form of labor training and in encouraging the expansion of related industry that do not enter into the profit calculations of the firm but benefit the national economy. Moreover, manufacturing will improve the growth potential of the economy whenever supply or demand limitations would eventually impinge on primary activities.

There is some presumption, then, in favor of promoting manufacturing industry in developing countries. The word "promote" is used advisedly as it includes protection of production for domestic markets (import substitution) as well as assistance to firms exporting manufactured goods. Since, for reasons mentioned earlier, bias against manufactured exports entails an economic loss, equal incentives need to be provided to production for domestic and for foreign markets. This can be accomplished by granting a subsidy to the exports of manufactured goods at a rate equal to the tariff applied to the same commodity, or by using differential ex-

change rates for the manufacturing sector. Given the cost and uncertainties of entering foreign markets, it might even be desirable to provide additional incentives to exports of manufactured goods on a temporary basis.

Further questions are what are "reasonable" rates of tariffs and export subsidies and whether all manufactured goods should receive equal treatment. Assuming that particular measures are used to correct special cost disabilities and that the employment objectives are served by a direct or indirect subsidy to the use of labor, as a first approximation one may suggest providing effective protection at equal rates to all manufacturing activities that have passed the infant industry stage.¹⁰ In this way, one would apply the "market principle" in the sense that firms will be established that are profitable under such conditions and existing firms would have to improve their operations, change their product composition, or disappear altogether. At the same time, nonessential imports could be restricted by levying excise taxes that bear also on domestic production.

The choice of a "reasonable" rate of tariffs and subsidies for mature industries in the developing countries will depend on the particular circumstances of the situation and on the range of other policy measures available to a particular country. It may be suggested, however, that since most developing countries have small domestic markets, they should aim at eventually reducing the net effective protection

¹⁰In "Decision Rules for Effective Protection in Developing Countries" (mimeo, November 1970), Trent Bertrand provides an elegant proof of the proposition that maximizing welfare subject to the constraint that a certain amount of value added is generated in the manufacturing sector involves equalizing effective rates of protection within this sector. In a more general model, the desired amount of value added in the manufacturing sector and the rate of effective protection of this sector would be jointly determined.

of manufacturing to levels observed in countries such as Denmark and Norway, i.e., to approximately 10 percent.

Exceptions to the proposed equality of effective rates may be made if there is evidence that profitability on the firm level greatly understates (or overstates) the contribution of a particular industry to the national economy. But such exceptions should apply to entire industries rather than to individual firms and only in cases that are well-documented so as to avoid a "slippage" in protection. In other words, the burden of proof should be on those who request favorable treatment.

Standard rates of protection should be applied also in the case of infant industries and one should avoid "tailor-made" tariffs. While it is difficult to judge how much protection would be justified on infant industry grounds, it does not appear likely that, exceptional cases aside, a rate of effective protection more than double that for mature industries would be warranted.¹¹ This additional protection of infant industries should be set on a declining scale so that its eventual disappearance provides incentives for improvements.

VII

The described scheme may be implemented by using a basic exchange rate for nontraditional primary products, export taxes on traditional primary exports, and a combination of tariffs and subsidies on manufactured goods. The same result could be achieved by applying differential exchange rates to the three groups of commodities, with further adjustments made

¹¹ According to an OECD study, economies of scale and external economies can hardly justify effective protection of infant industries exceeding 20 percent even if direct subsidies to labor use are not provided. This figure declines to 10 percent if labor use is subsidized. Cf. Ian Little, Tibor Scitovsky, and Maurice Scott, *Industry and Trade in Some Developing Countries*, London, Oxford University Press, 1970, pp. 158-59.

for differences in the elasticity of demand among traditional primary exports. The choice between the two alternatives, or a combination thereof, would have to be made on the basis of considerations of political and administrative feasibility, with further account taken of the implications of the choice of exchange rates for invisibles and for capital movements.¹²

Compared to the policies of industrial protection followed by developing countries engaged in import substitution, the application of these guidelines would entail providing more favorable treatment to nontraditional primary commodities, reducing the protection of manufactured products, and equalizing the incentives for manufactured goods sold in domestic and in export markets. Also, as a general rule, equal incentives would be provided to all branches of manufacturing other than infant industries, and additional protection to infant industries on a temporary basis.

For countries that have already embarked on industrialization behind high protective barriers, the application of the guidelines would entail a revamping of the structure of protection. Needless to say, this could not be undertaken instantaneously but would require a transitional period, the length of which would depend on the particular circumstances of the country in question. There would also be differences in the mode of application of these guidelines, again depending on political and institutional factors. Finally, the relative emphasis on direct measures and on the tariff-subsidy scheme may differ among countries at different levels of industrialization.

¹² In some cases, however, neither of these alternatives might be feasible because of constraints in policy making. In Chile, for example, the government is said to have obligated itself not to levy special taxes on copper, the major export commodity. Accordingly, the basic exchange rate would have to be applied to copper while tariff-subsidy schemes would need to be used both for nontraditional primary products and for manufactured goods.