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| Robin Broad & John Cavanagh

## NO MORE NICs

by Robin Broad and John Cavanagh

For more than a decade the most common policy advice to developing countries the world over has been a simple formula: Copy the export-oriented path of the newly industrializing countries, the celebrated NICs. These economies—Brazil, Hong Kong, Mexico, Singapore, South Korea, and Taiwan—burst onto world manufactures markets in the late 1960s and the 1970s. By 1978 these six economies plus India accounted for fully 70 per cent of the developing world's manufactured exports. Their growth rates for gross national product (GNP) and exports were unequaled.

No wonder the call was sounded for others to follow. Dozens have tried. But with the possible exceptions of Malaysia and Thailand, no country has come close. Why not? The answer lies in far-reaching changes in the global economy—from synthetic substitutes for commodity exports to unsustainable levels of external debt—that have created a glut economy offering little room for new entrants.

Despite these shifts the foremost international development institutions, the World Bank and the International Monetary Fund (IMF), continue to promote the NIC path as the way for heavily indebted developing countries to escape the debt crisis. Yet in 1988, 8 years into a period of reduced growth in world markets, the bankruptcy of this approach should be all too apparent. By the end of the 1970s the World Bank had singled out the four Asian NICs as models to be studied by a second rung of developing countries. Having mastered the production of textiles, clothing,

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shoes, simple consumer electronics, and other light-manufactured wares, the four NICs were moving into more sophisticated products like automobiles and videocassette recorders. Therefore, the Bank argued, as the NICs' level of industrial development advanced, they would abandon the more basic industries to other countries. As Bela Balassa, a prominent, long-time Bank consultant, asserted, the NICs would "upgrade and . . . diversify their exports in line with their changing comparative advantage," leaving "countries at lower stages of industrial development [to] replace exports of unskilled-labor-intensive commodities from the newly-industrializing countries to industrial country markets."<sup>1</sup>

But the World Bank did more than offer the intellectual underpinnings for this development theory. In the late 1970s it positioned itself as a central actor in pushing the would-be NICs up the ladder to the NIC rung. In May 1979 then World Bank President Robert McNamara, in an address to a United Nations Conference on Trade and Development (UNCTAD) meeting in Manila, called for developing countries to "upgrade their export structure to take advantage of the export markets being vacated by more advanced developing countries." McNamara added that the Bank would move to the forefront of this new "program of action." To do so, however, the Bank needed to move beyond its more traditional microlevel project lending with a new instrument that would maximize its leverage with developing countries. Loans for hydroelectric dams, highways, and urban renewal, among other projects, had made the Bank the key international development player; but they did not confer on the Bank adequate leverage for the proposed global restructuring.

Consequently, the Bank turned to a new set of policy prescriptions, dubbed "structural adjustment," the key ingredient of which was structural adjustment loans (SALs). These large balance-of-payments loans—targeted

<sup>1</sup>Bela Balassa, *The Process of Industrial Development and Alternative Development Strategies, Essays in International Finance 141* (Princeton: Princeton University, 1980), 25–26.

toward broad sectors and heavily conditioned on a recipient's economic reforms—sought to hasten the new international division of labor whereby the would-be NICs would mimic the established NICs' light-manufactures export successes. The SALs were "the World Bank's best weapon yet," as a close aide of McNamara said in 1981.

SALs carried a broad set of policy prescriptions that focused on trade-related economic sectors; they were designed to enhance efficiency and export orientation. Conditions for the loans, according to one summary of the Bank's experiences in the late 1970s and early 1980s, usually involved four elements: "the rationalization of prices or 'restructuring of incentives,' covering price policies, tariff reform, taxation, subsidies, and interest rates; the revision of public investment priorities; budgetary reform; and institution building."<sup>2</sup>

Who are these would-be NICs that the World Bank and the IMF hoped to push up the development ladder? According to various classification systems, including those of the World Bank, this group comprises up to 30 second-tier less developed countries (LDCs) across Africa, Asia, and Latin America.<sup>3</sup>

These would-be NICs largely received the big loans and amplified attention from the Bank during the late 1970s and early 1980s. Of the 9 LDCs rewarded with a structural adjustment loan of more than \$50 million as of mid-1982, 7 were would-be NICs and 1 was a NIC. Moreover, the IMF's attention largely complemented the Bank's. Of the 20 LDCs that by mid-1982 had received one of the IMF's extended fund facilities—highly conditioned loans with a 10-year repayment period—of more than \$50 million, 12 fell into the would-be NICs grouping and 2 were NICs.

More insight into the Bank's role in the

<sup>2</sup>John Williamson, *Lending Policies of the International Monetary Fund, Policy Analyses in International Economics Series, no. 1* (Washington, D.C.: Institute for International Economics, 1982), 22.

<sup>3</sup>Argentina, Chile, Colombia, Costa Rica, Cyprus, Dominican Republic, Ecuador, Egypt, Guatemala, Honduras, Indonesia, the Ivory Coast, Jordan, Kenya, Malaysia, Morocco, Pakistan, Paraguay, Peru, the Philippines, Rwanda, Senegal, Sri Lanka, Syria, Thailand, Tunisia, Turkey, Uruguay, Venezuela, and Zambia.

would-be NICs can be gained by looking at one illuminating case, the Philippines. By the end of Ferdinand Marcos's administration in February 1986, the Philippines had borrowed more than \$4.5 billion from the World Bank in more than 100 project and program loans. The country was, in the words of Gregorio Licares, one of Marcos's Central Bank governors, the "guinea pig" for structural adjustment. Indeed, one of the Bank's first SALs was a \$200 million loan geared specifically toward restructuring the Philippine industrial sector. Its final approval by the Bank in September 1980 capped 2 years of intense policy-related dialogue between the Bank and Philippine government officials. Aided by its benevolent image as a bestower of funds for long-term development projects, the World Bank was able to take on the short-term stabilization role traditionally played by the IMF.

After a record Philippine balance-of-payments deficit of \$570 million in 1979, the Bank put together the 1980 SAL package, which was attached not to a specific project but to a group of policies stipulating an export-oriented course for Philippine industry. Former high-ranking Philippine officials, including both proponents and opponents of the reforms, agree that the negotiations marked a critical juncture in the Philippine development path. Tariffs were slashed. Protective import restrictions were lifted. The exchange rate began a steady and steep devaluation, while export- and investment-promotion policies diverted resources from domestically oriented output. New free-trade tax havens, using generous incentives for transnational corporations (TNCs) to exploit low-cost Filipino labor, were established across the archipelago. Individual light-manufacturing industries, such as textiles, cement, food processing, furniture, and footwear, were slated for restructuring according to World Bank specifications.

During this period, similar policies were pushed in other would-be NICs. World Bank SALs to the Ivory Coast, Kenya, Pakistan, Senegal, and Turkey—like the Philippine SAL—all concentrated on improving export incentives and performance. In Thailand,

where a Central Bank official vowed in mid-1979 that the World Bank's policies would "never be listened to or followed by top people here," the government implemented economic policy changes almost identical to those of the Philippines a few years and a SAL later. In other cases, notably Chile and Indonesia, would-be NICs followed the Bank's blueprint for development without a formal SAL.

#### *NIC Rivalry*

In effect the World Bank was helping to create a group of countries that would compete against each other to become NICs. The result was two vicious battles—one to offer cheaper, more docile labor forces and more attractive financial incentives to lure TNC assembly lines away from the other countries, and the other to win scarce export markets.

This competition soon became clear to each would-be NIC. As a deputy governor to the Philippine Central Bank remarked in a 1980 interview: "We've got to always be careful now, always watching, on the lookout for other [developing] nations' next moves.... And then we've got to make sure we meet their offer and better it." Sri Lanka's advertisement in the October 16, 1981, issue of the *Far Eastern Economic Review* said it well: "Sri Lanka challenges you to match the advantages of its Free Trade Zone, against those being offered elsewhere.... Sri Lanka has the lowest labor rates in Asia." Variations on that appeal were issued by one would-be NIC after another, putting TNCs in a choice position from which to bargain the most lucrative investment or subcontracting deals.

The competition encouraged labor repression and exploitation. One Manila-based TNC executive explained in a 1981 interview: "We tell the [Philippine] government: you've got to clamp down [on labor].... Or we threaten to move elsewhere. And we'll do just that. There's Sri Lanka [and] now China too."

Most of the Bank's public documents sought to play down the problems associated with rivalry among the would-be NICs. But the Bank was not unaware of the potential zero-sum game. In a January 1979 working paper

assessing the LDCs' manufacturing export potential, two leading Bank economists, Hollis Chenery and Donald Keesing, forecast that "the increasing number of successful competitors may make it increasingly difficult for newcomers to get established" and that the success of a "few" could leave "too little" opportunity for the rest. The Bank's confidential final report on the Philippine SAL acknowledged that "the benefits that will result from the strengthened export incentives will depend very much upon ... the degree of competition from other developing countries."<sup>4</sup>

Yet who had set in motion this chain of competition? An October 1979 World Bank report had counseled the Philippines to take advantage of the fact that its wages had "declined significantly relative to those in competing ... countries," notably Hong Kong and South Korea. Almost simultaneously, as reported in the *Southeast Asia Chronicle* in December 1981, the Bank helped steer Indonesia onto a parallel course, advising that "incentives for firms to locate there rather than in some other Southeast Asian country ... must be provided." Meanwhile, Sri Lanka received a \$20 million World Bank loan to establish a new export platform for apparel subcontracting, and the Bank pushed the People's Republic of China (PRC), Thailand, and some of the Caribbean Basin countries into the light-manufactures arena as well.

The competition among would-be NICs was further exacerbated by the exporters of an earlier era, the Asian NICs of Hong Kong, Singapore, South Korea, and Taiwan. World Bank theory to the contrary, these countries were not abandoning textiles, apparel, and electronics assembly as they moved into higher stages of industrialization. Indeed, since the 1960s the Asian NICs had been spreading throughout the entire range of industry—from light to heavy, from unsophisticated to

<sup>4</sup>World Bank, Report and Recommendation of the President of the International Bank for Reconstruction and Development on a Proposed Structural Adjustment Loan to the Republic of the Philippines, Report P-2872-PH (Washington, D.C., 21 August 1980), 31.

sophisticated—leaving little space for would-be NICs.

The export performance of the Asian NICs between 1979 and 1985 illustrates this point. Their combined exports leaped from \$60.5 billion to \$113.9 billion, a stunning 88 per cent increase during years of slow global economic growth. More sophisticated "strategic" industries like telecommunications, complex electronic equipment, and motor vehicles were encouraged by NIC governments through various tax holidays and subsidized loans. Over this period South Korean motor vehicle exports rose from \$300 million to close to \$1 billion and Hong Kong telecommunications and sound equipment rose from less than \$1 billion to more than \$2 billion.

On a regular basis export surges in these high value-added industries captured newspaper headlines. Little attention was paid, however, to the continuing rapid NIC export growth in traditional light manufactures. Through a combination of innovation, cost-cutting measures, upgrading capital equipment, and state and private-sector cooperation these countries held on to and expanded their markets. Textile and clothing exports from the four grew from \$14.6 billion to \$23.4 billion over the 6 years, a 60 per cent rise. The Asian NICs enjoyed a rising global market share in the textile and clothing industries. The same rapid growth was noticeable in other light-manufacturing sectors. For example, Hong Kong's exports of footwear doubled, from \$125 million to \$250 million. And South Korea's exports of toys grew from \$300 million to \$670 million.

Another factor also was inhibiting the would-be NICs' economic ascension—new technologies. The more than a decade that separated the NICs' debut from that of the would-be NICs witnessed technological advances in several sectors that changed the very definition of Third World industrialization.

By the late 1970s technological innovations, led by the microprocessor revolution, made the global fragmentation of production highly profitable and desirable. Whereas the original NICs had received complete industrial processes such as shipbuilding and machinery, the

would-be NICs won marginal segments of scattered assembly lines for semiconductors and consumer electronics, textiles, and apparel. In Sri Lanka, for example, workers in export-processing zones used basic sewing machines to stitch together garments from imported fabric. In the Philippines, female workers in 1980 were performing only 1 of the 10 major operations of electronic production, attaching hairlike gold wires to silicon chips.

As a result, these new global assembly lines left gaping disparities between the gross value of the would-be NICs' industrial export earnings and the actual value added to the product in the developing country. Consider again the Philippine case. When proclaiming the non-traditional-export strategy's supposed triumphs, the Philippine government naturally focused on the higher of the two figures, the gross value of exports. Yet when stripped of import components' costs, the "value added" by the domestic side of production was but a fraction of the export earnings.

With the Philippines importing cartons for its banana exports, cans for some food exports, and a wide assortment of machinery and component parts for its limited apparel and electronic assembly lines, value added in most Philippine industries was quite low. Although a public version of a 1979 World Bank document admitted that the aggregate value added for Philippine nontraditional exports was "at best only 40 percent," a confidential report revealed the precise Bank calculation to be 25 per cent.<sup>5</sup> In other words, for every dollar of nontraditional-export earnings, only 25 cents stayed in the Philippines; the rest was siphoned off by import payments. Low value added was a fact of life in the Philippines' part in the new international division of labor.

According to one of the best analyses of electronics subcontracting, the long-term outlook for increasing the amount of value added in developing countries in the industry was

<sup>5</sup>World Bank, *The Philippines: Domestic and External Resources for Development, Economic Memorandum for 1979 Consultative Group Meeting, Report 2674-PH (Washington, D.C., 12 November 1979)*, 29; World Bank, *Philippines: Staff Appraisal Report on the Industrial Finance Project, Report 3331-PH (Washington, D.C., 7 April 1981)*, 4.

bleak. As this December 1981 United Nations Industrial Development Organization report, *Restructuring World Industry in a Period of Crisis*, detailed, the per cent of value added attributable to new LDC microprocessor production lines rose until 1973. By 1977, however, value added in the newest LDC factories already had begun to fall. This downward turn came even as the gross value of semiconductors re-exported to the United States soared tenfold from 1970 to 1978. Of the seven LDCs studied, the Philippines was the last to start silicon chip assembly. Entering on the downswing of the curve, value added in its factories was the lowest of all.

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Since 1977 a growing share of the value was being held in the electronics companies' home countries. The U.N. report emphasized that, "as the complexity of circuitry increases, more value added is produced in the early wafer-fabrication stage, i.e., in the United States, in Japan, or in some locations in Western Europe. Furthermore, the more complex circuits require much more complex, computerized final testing, which again is usually done in OECD [Organization for Economic Cooperation and Development] locations, particularly in the United States and Japan."

If the production side of the would-be NIC experience offered less than what was advertised, the marketing side was even grimmer. For light-manufactured exports to be the engine of growth for the would-be NICs, world trade—that is, global demand for these products—had to grow each year. There was no way to escape this logic in the aggregate.

But in the late 1970s and early 1980s, at precisely the time when would-be NICs were induced to embark on a nontraditional-export path, these necessary conditions were decided-

ly absent. Over the decade from 1963 to 1973 the volume of world exports rose at a rapid average annual rate of 8.5 per cent. Beginning in 1973, however, an economic deceleration slowed the average annual expansion to 4 per cent. By 1980 exports were crawling ahead at only 1 per cent per year, and in 1981 they showed no growth. Moreover, 1981 had the dubious distinction of being the first year since 1958 to experience an actual decrease in world trade in current dollar terms, a shrinkage of 1 per cent.

Behind these global trade statistics lurked the domestic stagnation of the industrialized economies. According to IMF figures, from 1976 to 1979 the real GNP of industrialized countries grew at a tolerable average yearly rate of 4 per cent. By 1980, OECD growth was limping ahead at only 1.25 per cent; the next year it increased again by only 1.25 per cent. These 2 years presaged a decade of vastly reduced growth. From 1981 to 1985 world output slowed to an average of 2.7 per cent per year and trade to 2.8 per cent. These aggregate statistics become even more dismal if Eastern Europe and the PRC are excluded: Output over the first half of the 1980s grew at an average annual rate of only 1.4 per cent in developing countries and 2.3 per cent in developed countries.

As more countries battled for the same tepid export markets, prices plunged. Between 1981 and 1985, world prices of food commodities fell at an average annual rate of 15 per cent; agricultural raw materials dropped at an average annual rate of 7 per cent; and minerals and metals fell 6 per cent. The year 1986 proved even dimmer, when a 30 per cent decline in the developing countries' terms of trade (the ratio of prices of developing-country exports to prices of their imports) translated into a staggering \$94 billion to the developed world.

Another pitfall facing the LDCs' export-oriented industrialization was the panoply of quantitative restrictions that had spread to cover fully one-half of global trade. Despite official encomiums to "free trade," the OECD countries increasingly were barricading themselves behind what even President Ronald

Reagan's Council of Economic Advisers admitted were "neomercantile" policies.

These defensive machinations to moderate the recessionary bite at home were baptized the "new protectionism"—a proliferation of American, European Economic Community, and Japanese trade barriers, notably quotas on LDC-manufactured exports. "New" referred to the dazzling array of nontariff barriers not regulated by the General Agreement on Tariffs and Trade. Voluntary export restraints and orderly marketing arrangements flourished. As the World Bank and the IMF encouraged free-trade policies on LDCs, the major voting blocs within those institutions retreated from any semblance of free trade at home. The retreat of free trade became inextricably meshed with the recession: As OECD growth slackened, quotas were tightened. The more successful a particular LDC export category was, the more restrictive the quota became.

By the calculations of the World Bank's own economists in 1979, the most dangerous of the new protectionist barriers was centered in the apparel, textile, and footwear sectors. Yet it was precisely these sectors—along with furniture, wood products, electronics, and other light-manufactured exports—that the Bank had pinpointed as the engine of growth for the would-be NICs. The restrictive allotments of the Multi-Fiber Arrangement made textiles and apparel perhaps the most heavily controlled sectors in international trade. As a result, the LDCs' share of textile and apparel exports began to shrink in the early 1980s.

Did the Bank adequately address the impact of slow global economic growth and rising protectionism on its policy directives? As early as 1974 the Bank understood certain pitfalls that the 1970s and 1980s might hold for export-oriented industrialization. That year McNamara, in an address to the Board of Governors, noted: "The adverse effect on the developing countries of ... a reduction in economic growth in their major markets would be great. There is a strong—almost one-to-one—relationship between changes in the growth of OECD countries and that of oil importing nations." The Philippines was especially vulnerable, the Bank acknowledged in a

country program paper 2 years later, "with international trade the equivalent of almost half of GNP." And in his May 1979 address to the UNCTAD conference in Manila, McNamara noted that the World Bank had perceived the onset of the new protectionism as early as 1976.

Yet in the late 1970s and early 1980s Bank officials who were planning Third World development strategies continually made assumptions that ignored slow growth and rising protectionism. Their model, grounded in theories of free trade and comparative advantage, posited the absence of such conditions. They opted instead for what was termed "one set of reasonable assumptions" without explaining their legitimacy. The set of "reasonable" assumptions about trade and protectionism that underpinned the Bank's structural adjustment reports and advice to would-be NICs was some permutation of the following: Industrial countries were to grow 4 per cent annually in the 1980s; "worldwide economic recovery" stood on the horizon; and "no major set-backs" would occur in major markets.

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Did Bank economists really believe this? In the Philippine example a wide chasm between these assumptions and the private assessments of Bank officials was revealed time and again during interviews conducted by one of the authors in the early 1980s. One World Bank consultant and member of the Bank's appraisal mission for its first Philippine SAL, John Power, privately admitted his doubts about a successful outcome of Philippine export-oriented industrialization given the gravity of the "world situation." Yet a 1979 book he co-authored as background for the Philippine SAL, *Industrial Promotion Policies in the Philippines*, refused to give credence to any such misgiv-

ings. In a similar case of conflicting assessments, a January 1979 study by the Bank economists Chenery and Keasing acknowledged existing "severe import restrictions" imposed by key developed countries and increasingly smaller quotas for up-and-coming LDC manufactures exporters. But in another working paper, published about 2 years later, the Bank economist Barend de Vries argued that "considerable opportunities" existed for Philippine nontraditional exports.

The potential effects of this unsubstantiated optimism about the Philippines and other would-be NICs were never seriously considered by Bank officials. The development prescriptions of Bank officials were transformed into a kind of dogma: "The more hostile the external environment, the more urgent" the need for restructuring, an August 1980 *Report and Recommendation* urged. In one instance, a Bank director took the floor at the executive board's final meeting on the Philippine SAL to question the management's scenario of Philippine "dynamic" export-led growth in light of "an adverse environment [including] lower than projected growth rates in industrial countries and increased protectionism." The board chairman's response epitomized the Bank's unquestioning attitude: "If the environment turned out to be more adverse than projected, then the ultimate benefits under the adjustment program would be reduced, but the nature of the adjustment needed would not be changed." But such a response was no more than conjecture. No hard evidence and no computer runs were offered to answer what should have been a basic question: If world trade did not grow, and if key markets became increasingly protected, would export-oriented industrialization be the optimal route to growth?

The Bank's 1981 *World Development Report*, in fact, did present formally a quantitative global model incorporating "slower industrial [country] growth" and "increased protectionism." But the exercise was at best questionable; at worst, it was deceptive. Although lower than either the accompanying best-case scenario or previous *World Development Report* estimates, the low-case scenario for 1980-1985

still promised growth rates higher than what transpired. Indeed, over the past 9 years the Bank consistently has projected average developing-country export growth rates of more than 5 per cent per year; between 1981 and 1986 the actual annual growth rates averaged instead a negative .4 per cent.

Why was a more accurate scenario not used? The 1978 *World Development Report* explained, "Still lower growth rates are not considered here, not only because they are thought unlikely, but also because they would be associated with structural changes in trade and other relations between countries that could not be captured in the present analytical framework."

In any event, the low-case projections were largely ignored in the plans and projections for specific countries. When incorporating global growth estimates in aggregate economic work for various LDCs, the Bank used figures closer to high-case yields. This was done without any caveat mentioning that the Bank also had somewhat less optimistic forecasts.

It was becoming increasingly clear that the World Bank had no vision of development in a world economy of curtailed growth. To a large extent Bank officials had equated growth with development. To them, development did not primarily mean providing adequate food, clean water, clothing, and housing—in short, offering a standard of living consistent with human dignity. Those had become secondary concerns to be met through growth. In the Bank's view, no growth meant no development and therefore could not be considered seriously.

In 1986, several years after the rosy predictions, the Bank conducted a confidential review of structural adjustment lending in which it acknowledged that "the impact of the adjustment programs on a country's economic performance has generally remained below expectations."<sup>6</sup> This was an understatement. Through the 1970s all but 1 of the 30 would-be NICs had registered average growth in the

<sup>6</sup>World Bank, *Operations Evaluation Department, Structural Adjustment Lending: A First Review of Experience*, Report no. 6409 (Washington, D.C., 24 September 1987), iv.

value of exports of more than 12 per cent annually. From 1980 to 1985—the first 5 years of SALs—only 7 experienced export growth rates above 4 per cent; 9, including the Philippines, suffered negative growth. The Bank report stumbled over what it called an "important reason" for the poor performance: "The world economic environment deteriorated to a much larger extent than foreseen." The document's suggestions for correcting this "over-optimism" may shock some in developing countries who thought they were heeding the advice of development experts: "The Bank should go beyond giving textbook solutions. The practical problems of implementation and the applicability of recommendations to specific country circumstances should be investigated. . . . This work needs to be supplemented with a more rigorous analysis at the country level of . . . the likely impact of the world economic environment on the domestic economy."

In recent public Bank documents, slow growth in the world economy is still viewed as a short-term or cyclical aberration that does not undermine the basic soundness of the Bank's structural adjustment advice. Indeed, as late as its 1987 *World Development Report*, the Bank was still stressing that the world economy was continuing to "expand," albeit at a "modest and uneven" rate. That outlook enabled the Bank to continue unabashedly to counsel "the outward-oriented trade policies which have proved so successful for the NICs in recent years."

### *A New World Economy*

World Bank forecasts notwithstanding, global stagnation is likely to prove harder to shake than most would like to believe. Aside from protectionism pressures, a series of corporate developments has stunted demand globally, leaving increasing numbers of people at the margins of market activity. Prominent among these developments are the commercial banks' handling of the Third World debt crisis, corporate substitution for Third World raw materials, and labor-saving technological innovations in the developed world.

The debt crisis arose inevitably from the

export-oriented development strategies, which depended on heavy borrowing for infrastructure and in many countries fed corruption and capital flight. In the early 1980s, as oil prices and interest rates rose and primary commodity prices fell, country after country announced its inability to service debts owed to banks in the developed world. In rapid succession the creditor banks sent these countries through IMF austerity programs, which prescribed a kind of shock treatment to bring countries' balance of payments out of deficit. Wage freezes, currency devaluations, and government spending cuts reduced imports into the Third World; indeed, many countries wiped out trade and national budget deficits within a few years. But lowered wages and imports also dampened global economic growth.

Technological breakthroughs in substitutes for Third World raw materials also hurt growth performance in the developing world. A single anecdote typifies the impact of longer-term corporate development on commodity markets. Until 1981 the largest consumer of the world's sugar was Coca-Cola. That year, in a move rapidly emulated by other soft drink giants, Coca-Cola began to shift its sweetener from sugar to corn syrup. Western consumers might not have viewed the change as significant to them, but it displaced millions of Third World sugar workers for a product produced within industrial countries.

Advances in plastics, synthetic fibers, food chemistry, and biotechnology are bringing similar far-reaching changes to other raw material and commodity markets. Cumulatively these substitutions have pushed tens of millions of Third World workers into the margins of the marketplace, further curbing global demand.

Likewise, new corporate technologies are transforming developed-country economies. The computer revolution, the major technological breakthrough of the last two decades, is strikingly dissimilar from earlier technological breakthroughs. The advent of electricity and the automobile, for example, generated millions of jobs in related industries and sparked economic booms in the leading countries. The

microprocessor revolution has also created millions of jobs. However, applications of microprocessors have spread through almost every manufacturing and service sector in uses that are labor saving. Bank tellers, supermarket check-out clerks, assembly-line workers, and others are all joining the ranks of the unemployed. This phenomenon is reflected in Western Europe, where for 17 straight years the unemployment rate has risen.

The result of these three changes is that all over the world industry is turning out more than consumers can buy. The new global glut economy coexists with billions of people with enormous needs and wants but with little ability to buy.

As world economic growth has slowed, so have the Third World activities of its central private institutions: TNCs and banks. Much of the growth of the 1960s and 1970s was based on a rapid expansion of production around the world by subsidiaries of such TNCs as Ford, John Deere, and Texas Instruments. Western banks followed to provide financing. Then, after 1973, they became major economic actors in the developing world in their own right as recyclers of billions of petrodollars.

This is no longer the case. Banks and corporations go where there is growth and hence profit. Since the early 1980s the Third World basically has stopped growing; many countries have even slipped backward. Consequently, U.S. banks have returned home for new short-term rewards—consumer credit, corporate mergers, and the get-rich-quick gimmicks of financial speculation.

Again, the statistics are stark. In 1983 international bank lending to developing countries, excluding offshore bank centers, totaled \$35 billion. By 1985 a mere \$3 billion in new lending had trickled in.

Unfortunately, the drop-off in bank and corporate involvement and the factors that spelled a longer-term slowdown did not seem to influence the policy advice of the World Bank and the IMF. The push to create a second tier of NICs began in the late 1970s and continued through 1982. It was derailed somewhat for the 3-year period beginning in August 1982, when Mexico's declaration that it

was unable to service its debts signaled the start of the debt crisis. That 3-year spell was dominated by IMF austerity measures; close to 100 Fund loan agreements went into force.

By 1985, however, austerity had bred considerable resistance across the Third World. The United States responded in October 1985 with a plan proposed by Treasury Secretary James Baker. Although it seized the political initiative from the Latin American debtors, the Baker plan offered little that was new. Troubled debtors still were advised to go to the IMF for restructuring advice. To buttress the Fund, however, the World Bank was brought center stage and asked to pledge billions of dollars in new loans to the 15 most troubled debtors, 11 of which were would-be NICs.

The World Bank lost no time in advancing its version of development. If the debt crisis could be used as a lever, all the better. The Baker plan offered debtor countries similar amounts of new private lending if they complied with a combination of IMF austerity by World Bank structural adjustment and privatizing industry, liberalized trade, and encouraged foreign investment, among other requirements. By the end of 1985, the Bank had granted broad SALs to 12 of the 15 Baker plan countries.

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Yet the changing world economy has created a desperate need to rethink the kinds of adjustments that will produce growth and development. At the very least, the adjustment strategies must be built on realistic assumptions. The NICs were the product of a radically different world economy. That they cannot be replicated in the 1980s is an indication of how much that world economy has changed.

Rather than increasing their reliance on a hostile world environment, developing countries should try to reduce this dependence and

to diversify trading partners and products. This approach implies a careful restructuring of trade and financial linkages to conform with a development logic that is driven by internal economic forces.

If economies can no longer be pulled along primarily by external growth, stronger internal buying power must be generated. The great challenge is to transform crushing social needs into effective demand and then to meet that demand by turning first to domestically produced goods and services, next to the region, and only after that to the wider world market. In most developing countries this development framework implies vast internal adjustment quite different from the World Bank's brand of structural adjustment. Most of the Third World's people cannot afford to purchase many goods and services. Wages are locked into rock-bottom subsistence rates; wealth and income are heavily skewed toward a relatively small, wealthy elite. As a result, spreading income more evenly requires, for a start, extensive land reform, progressive taxation policies, and guarantees of worker rights.

To offer more specifics on internal demand-driven development strategies is risky. Vastly different resource bases and social strata among countries suggest that a country-specific approach is essential. Indeed, the sin of universality in development strategies was perhaps the central weakness of IMF and World Bank adjustment programs. Further, the successful implementation of any development strategy depends on its acceptance by entrenched interests in that country. However desirable comprehensive agrarian reform may be in the Philippines, for example, a powerful landowning group has substantial influence in the government and is likely to block serious reform efforts.

These caveats noted, a few general principles for development in a hostile world economy can be sketched out. Most would-be NICs remain predominantly agricultural societies; hence the starting point of internal demand-led development must be in farming. Two undertakings are central to increasing buying power in the countryside: redistributing wealth and raising productivity.

Agrarian reform remains the major means of redistributing wealth and income and thereby increasing the effective purchasing power of the rural population. The people in Third World rural areas are largely either poor tenants or agricultural workers who earn only subsistence wages. They have meager resources to consume in the marketplace. Only through agrarian reform can this population begin to produce a surplus that can be translated into consumption. In economic terms, small farmers have a higher "marginal propensity" to consume than larger ones, and much of their consumption could be satisfied by locally produced products.

Raising productivity depends in large part on upgrading infrastructure—from irrigation and roads to credit institutions and marketing channels. In this area, as in efforts to upgrade social infrastructure through health, education, and nutrition loans, the World Bank could play a positive role by providing loans and technical assistance. In many respects, this emphasis would return the Bank to its original purpose as a development bank. In all loans, the Bank would do well to work closely with producer and neighborhood associations and cooperatives and other nongovernmental organizations that have proliferated in developing countries of late.

From this starting point, industrialization based on maximizing industrial linkages with agriculture makes great sense. In particular, three strands of industry could be encouraged:

*Agricultural inputs.* An agricultural sector with rising productivity will need locally produced fertilizer, pesticides, water pumps, and a wide range of tools, from plows to tractors.

*Processing farm products.* From cocoa and coffee to sugar and cotton, increased domestic processing offers more foodstuffs for local consumption and increases the value added of exports.

*Consumer goods.* As purchasing power grows in the countryside, so does the market for locally produced textiles, clothing, shoes, bicycles, refrigerators, and other consumer goods. Here, too, World Bank loans could help

by improving the technology of small and medium-sized industries.

The cycle of agriculture-linked industrialization does not stop there. As industry grows, the increased buying power of industrial workers provides an expanding market for farm goods from rural areas. Agriculture and industry would grow in tandem. It is worth pointing out that, popular myths notwithstanding, South Korea pursued this basic strategy in its earliest phase of industrialization. A recent study of South Korean development calculated that from 1955 to 1963, growth of domestic demand accounted for almost 90 per cent of the rise in South Korean industrial output.<sup>7</sup>

This agriculture-linked industrialization strategy should not be confused with import-substitution policies for industrialization. Those were decidedly different—more capital- and import-intensive, often dependent on protecting inefficiencies, and less sensitive to creating markets for new production. Nor does agriculture-linked industrialization shun exports. Rather, it focuses on exporting products offering higher values added.

In a highly interdependent world, such demand-centered development does not and cannot imply autarky. What cannot be produced locally is produced nationally. What cannot be produced nationally is purchased from regional partners—which suggests the importance of revitalizing regional integration institutions. Only for those products for which regional producers cannot satisfy demand is trade necessary with countries on the other side of the globe. Domestic needs should shape trade patterns rather than vice versa.

In many ways this development approach is not so different from advice offered recently from an unlikely quarter: "Reorient investment away from the export sector and toward production for the domestic market" and "strengthen domestic demand, both consumption and investment . . . in order to continue economic growth at satisfactory rates in conditions of declining external demand." That

<sup>7</sup>Joint ECLAC/UNIDO Industrial Development Division, "Thoughts on Industrialization, Linkage and Growth, CEPAL Review 28 (April 1986): 56.

recommendation came in a November 17, 1987, speech by David Mulford, assistant secretary for international affairs at the Treasury Department. Mulford directed his criticism against the Asian NICs, chastising them for an "export extravaganza" that was depriving their own people of the benefits of consumer spending and domestic development.

If the Treasury Department's new version of structural adjustment for the NICs is not enough to provoke some rethinking in the would-be NICs, perhaps a recent U.N. study is. The 1987 *World Economic Survey* offers the results of a statistical survey of the fastest growing developing countries over the slow-growth first half of the 1980s. Fourteen countries achieved per capita gross domestic product growth rates of more than 2.5 per cent over this period; 8 of them pursued policies oriented inwardly more than outwardly.

Leading the pack was the PRC. Although this period saw the Chinese begin opening up to the world market, the country's economic growth was overwhelmingly domestic. Chinese rural industries, for example, grew at more than 20 per cent annually during the 1980s. The extraordinarily rapid Chinese economic growth was attributable in good part to policy shifts since 1978 from central planning toward market incentives for production. Still, China's success was cushioned by a vast internal market made up of between 20 per cent and 25 per cent of the world's population whose real incomes had risen slowly in the decades after the PRC was established in 1949. Thus China's experience appears to make a case for opening up an economy slowly and only after a substantial domestic market has been developed and nurtured.

Beyond domestic market policies in agriculture and industry, development strategies should seek to curtail the wasteful economic activities that are rampant in some countries. These range from large, unproductive landholdings and capital flight to production and export monopolies and cronyism. Rooting out these practices is a monumental political task, threatening as it does entrenched groups of speculators, moneylenders, and landlords and bloated militaries. Development strategies also

must pay closer attention to the pressing need to maintain fragile natural resource bases around the world. The disappearance of rain forests, plant and animal species, clean rivers, and clean air has become the dominant trend in too many countries.

More than a decade ago, an apparently renegade World Bank economist offered relevant—though unheeded—advice to his colleagues against an excessive reliance on export-oriented industrialization in one would-be NIC:

Cottage and small-scale industry should be thinking first of serving the local market, by this I mean local province or region. Look at handicrafts you may say. Indeed I am delighted with the success in this area, but in a fiercely competitive and fickle international market, Philippine handicrafts will be in fashion today and [gone] tomorrow. The bread and butter and the basis of a modern manufacturing sector will always be at home.<sup>3</sup>

This kind of thinking has yet to sway many development technicians in the international development institutions or the developed countries, let alone in the would-be NICs themselves. Most observers continue to view the Asian NICs as role models. And they offer glowing imagery in support of their view: Asian NICs have "already taken off," and the rest of the noncommunist Southeast Asian countries are "on the runway revving" up to follow, as former Japanese Foreign Minister Saburo Okita has described it.

The would-be NICs have fallen for such prophecies for nearly a decade. Now is the time to demand not imagery but a realistic assessment of options. The debate on adjustment and development should be reopened; strategies that proclaim that the only option is greater dependence on an increasingly hostile and turbulent world economy need to be challenged. It is time to ask whether any more developing countries can really hope to become the South Korea of the late 1980s or the Hong Kong of the early 1990s.

<sup>3</sup>Memorandum, David J. Steel to M. A. Gould and L. E. Hinkle, "Philippines—Random Thoughts on Rural Development," 1 September 1977, World Bank office memorandum, Washington, D.C., 5.