CHAPTER 7

CONCLUSIONS, POLICY RECOMMENDATIONS AND AREAS FOR FURTHER RESEARCH

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The present study has been an attempt to compare and contrast the diverse development experiences of India and two of the most 'controversial' NICs - South Korea and Brazil - in the post-World War II era from 1950 to 1989. Controversial in the sense that the level of growth and development (Brazil is one amongst the middle-income countries in terms of per capita income today at $2940[1]) that these NICs have attained have not been readily accepted as 'spectaculer' or `remarkable' in the conventional sense. At the outset it must be admitted that the study is neither conclusive nor exhaustive. The objective was to test certain hypotheses regarding the role or contribution of the countries' degree of openness or external orientation in enhancing growth. If one goes by certain specific indicators of external orientation, the four decades of development experience of the post-World War II era presents interesting facets of the pattern of orientation of the three countries to the outside world and its impact on their economic growth. The framework of the model developed in the study is based on these patterns of develepent taking into account specific indicators of the countries' external orientation. Needless to say, the countries' choice of a development strategy occupies the central theme.

It must be recapitulated here that external orientation as defined in the present study is in terms of the degree of openness not merely to trade flows (goods and services) but also

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1. World Development Report, 1993, World Bank. Estimate is for 1991.

extends to capital and technology flows. Going by this definition, the traditional classification of economies into inward and outward-looking based on their trade orientation becomes narrow. For the purpose of the present study, the growth or development strategy adopted by a country encompasses the inward or outward - looking approach to trade as well as capital and technology flows.

If one accepts the above distinction of external orientation, none of the three countries presents itself as closed economies at the initial stages of their development process as they are normally but misleadingly made out to be. In fact, trade entered as an indicator of degree of openness much later in their development. Of course, the fact that they all pursued import substitution (IS) vehemently is a matter of making it the prime objective of a development strategy be it inward or outward. Rather, it could be argued that substituting imports with domestic production must be the prime goal of any developing country and the extent of import substitution measured by the proportion of imports in GDP, should also be one of the real basis for distinguishing a developed from a developing nation. Increasing proportion of imports in GDP implies decreasing import substitution thereby implying increasing dependence on the outside world for goods and services, which is a mark of a developing country. Opposite is the case with a falling proportion of imports in GDP. What really matters basically is the combination of a development stragtegy and the prime objective - high growth, import substitution with inward orientation or high growth, import substitution with outward orientation. Of course, the argument is based on the implicit assumption that imports and domestic production of such imports which are to be substituted are at par in technology, quality, and sophistication.

India and South Korea present certain similarities as regards their dependence on the outside world in the initial decade and a half of their development process. Firstly, both these countries, though quite different in size, recieved substantial amounts of foreign aid mainly from the U.S. when they began their independent development process. Aid took the form of mainly commodity grants, technical assistance and PL -480. Secondly, the prime objective of the two countries was to susbtitute imports with domestic production over a period of time beginning with the first-stage, 'easy' import substitution in consumer goods and then gradually extending it to manufactured and capital goods. Thirdly, neither of the two countries gave prominence to foreign capital and technology inflows in the form of direct foreign investment (DFI) atleast for the initial decade and a half. Fourthly, both India and Korea reached the same export-GDP raitos of 3.5 by 1964. Finally, foreign borrowing seemed to have been a more acceptable form of external dependence as compared to DFI.

Brazil's similarity lies in the pursuit of the objective of import substitution with an inward-looking approach like India and Korea from late 1940 onward and dependence on foreign borrowing. However, the difference also lies in its'open-door' policy towards DFI ever since the beginning.

Till the mid-1960s, all the three countries carried on their development process smoothly. All three grew at a similar pace. The tables turned in the mid-1960s. It is generally accpeted that extending IS beyond the first to the second stage in manufactured and capital-intensive production requires openness to imports, technology and foreign capital in order to avoid the emergence of any high-cost and inefficient industries. The reality was immediately understood by Korea and Brazil both of which, in 1964, shifted focus to an outward-looking approach to development and increased their degree of openness particularly to trade and technology flows. India, on the other hand, continued its inward-looking approach with import controls and restrictions, and extended IS to the second stage without opening up. The different paths chosen by India and the NICs began to show results within a decade or so. While Korea and Brazil began to grow at remarkable speed and attain spectacular growth rates with high trade-to-GDP ratios, India was faltering, coughing and choking its way up. In the process, India got isolated. The emergence of high-cost inefficient manufacturing industires combined with low trade-to-GDP ratios was exactly what India experienced. After a decade, following the 1973 oil shock, sensing vulnerability to external shocks, Brazil reverted back to its initial policy stance of an inward-looking import-substitution strategy. By late 70s, India also realised its grave mistake and ushered in a wave of import liberalisation. But by then the damage had been done. Korea was far ahead of the two. Brazil never attained the same high growth rate as in the initial period of inward-oriented import substitution mainly because firstly, this time IS extended to highly capital and import-intensive industries for which access to imports was a prerequisite. Secondly, in order to maintain current levels of consumption and growth that it had experienced in the decade of its outward orientation, Brazil resorted extensively to heavy short-term foreign borrowing instead of using exports as a cushion for adjustment to the BoP disequilibirium.

On the other hand, India did experience high growth rate in the 80s, mainly because of the changed scenario of ready access to international finance following the oil shocks of 1973 and then 1979. There was a congruence of interests of the transnational banks awash with funds to lend to selected developing countries and the developing countries' need to borrow. As a result, for about a decade or so, the deficit in the current account proved to be no constraint on growth for most developing and underdeveloped nations. This implied that the strategy of inward-looking import substitution stood no place since, to begin with, it was an outcome of limited access to international finance ~~and external vulnerability.~~ Now in the changed scenario during the late 70s and 80s, the same factor that used to be the major determinant of the nature of growth strategies in the early decades posed no dilemma. The same perception prompted the liberalization of the 80s in India.

To sum up, though the three countries began their growth process with same ideologies, the nature and structure of external orientation, overtime, changed. Korea is the only country of the three to have based its development strategy on exports which over a period of time became the single driving force behind its remarkable and unparalleled growth. Brazil, with always an 'open-door' policy towards DFI also experienced high growth rates by turning outward, for a decade. India missed the opportunity of a favourable international economic environment in the 1960s and woke up too late. The high growth of the 80s failed India the 'big-push' and was left comparatively far behind the two NICs. Today Korea and Brazil have managed to transform themselves from 'developing' to the 'developed' nation category whereas India remains where it started. At the same time, the similarity of all three lies in the high and growing external debt-GDP ratios on which the growth was based.

7.1 <u>Policy Recommendations</u> :

While India and the NICs exhibited better economic performance during the 1980s except perhaps Brazil, the growth was based on excessive foreign borrowing facilitated by the unlimited access to international finance during the period as reiterated earlier. Such a process of growth does impose certain costs on the economy and becomes unsustainable over the long run. By the end of the 80s, all the three countries had one of the highest and most 'explosive' external debt-to-GDP ratios. The symptoms, actually, began to be seen over the short-term itself when the increased liberalization led to reliance on foreign capital of the kind for adjustment to BoP disequilibiria. By the end of the 80s, all three were at the crossroads of development. The question was : which way from here ?

From the point of view of policy implications and recommendations, India as well as the NICs need certain clearly defined, concrete and positive guidelines in order to choose their future paths of development to which they stand committed. How far the suggestions that follow are actually applicable and could be actually implemented remains an open question. Needless to say, the recommendations are neither conclusive nor an end in themselves.

Korea's success in structural transformation from a backward, agrarian economy to a highly industrialized, fastest growing one over the shortest span of eleven years (1966-77) may perhaps be unparalled in economic history except for China (1977-87)[2]. However, the foundations which have fuelled such growth and industrialisation, namely exports and excessive foreign borrowing, are as diverse as they could be. It is often argued that as long as the debt-to-export ratio is low or export-to-GDP ratio is considerably high, any level of debt-to-GDP ratio is self-sustainable. No doubt, as Korea's experience suggests, a high level of exports in itself is a cushion for any amount of borrowing incurred in order to tide over short-term BoP imbalances. But at the same time increasing openness has meant high export and import-to-GDP ratios matched with high debt-to-GDP ratios.This, by itself, negates and self-defeats the entire purpose of openness. By now the country has reached a level of growth and industrialisation where it could go a little slow

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2. Refer figure A of **Prologue**.

atleast on its excessive dependence on the negative source of external capital. Being one of the heavily-indebted nations, it needs to review its policy towards direct foreign investment as a positive source of external capital. As the econometric results of the study show, DFI as a source of capital formation and economic growth for Korea has been highly non-significant. This is one area where Korea's potential could be tapped. A strong factor which is very much in its favour is its openness to trade flows. DFI can bring in technology, skilled manpower,technical expertise,knowledge about new products and above all the much needed capital to sustain high trade-to-GDP ratios. DFI with all its technology-intensity can enter into export sectors and boost up capital-intensive manufactured exports in which Korea has little comparative advantage. Till now the country has depended on its comparative advantage in labor-intensive manufactured exports. DFI could do much further. No doubt, over the short-term Korea might have to sacrifice growth. But the long-term benefits would prove to be much higher than any short-term costs it may impose. In any case, DFI could always be preferred over foreign borrowing as a source of foreign capital since the former is a low-risk strategy. The repayment obligations of any foreign investment are borne by the foreign investor. Even if DFI is a flow that may not be easily influenced by government, there seems no reason why any foreign country would not prefer Korea as a ground for its overseas investments with all its openness to trade flows. Thus, what Korea requires to do now is to reduce dependence on foreign borrowing for any BoP disequilibiria. Instead, it should turn towards DFI as a potential source of economy. Instead of maintaining current levels of consumption based on borrowing or channelling funds into high-cost capital and import-intensive investments when the economy is inward-looking, Brazil could do with sacrificing such high levels of consumptions, turn more outward, boost up exports by making them more price-competitive and then channelize revenues into long-term capital investments. Moreover, Brazil must develop its manufactured export base which exhibits more price-elasticity. At the moment manufactured exports make up a very low proportion of total exports in Brazil.

In the case of India, the unlimited access to international finance that prompted the accelerated liberalization of the 80s began to show grave repurcussions by the end of the decade. Forced by a severe BoP crisis, in 1991 an elaborate process of structural reforms was undertaken intended to increase the degree of openness beyond trade to captial and technology flows. However, the basic element of the strategy for overall macro-management of the economy was no different from that of the 1980s which was the reliance on foreign borrowing. This is a negative tactic of increasing the country's degree of openness. Perhaps, in this respect, India needs to learn from the experiences of Korea and Brazil. In fact, all three countries implicitly provide lessons for each other from their development experiences over the past four decades. As Bruton very clearly points out - "India has, it seems, carried out an exceptionally successful import substitution policy in the sense that it has led to the creation of an impressive indigenous technological capacity. At the same time her output and productivity growth record is economy. Instead of maintaining current levels of consumption based on borrowing or channelling funds into high-cost capital and import-intensive investments when the economy is inward-looking, Brazil could do with sacrificing such high levels of consumptions, turn more outward, boost up exports by making them more price-competitive and then channelize revenues into long-term capital investments. Moreover, Brazil must develop its manufactured export base which exhibits more price-elasticity. At the moment manufactured exports make up a very low proportion of total exports in Brazil.

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3. For corroborative evidence on the argument,refer Bruton H.- "Import Substitution " in H. Chenery and T.N. Srinivasan (ed.),"Handbook of Development Economics",Vol. II,Amsterdam,North Holland,1989, particularly Bruton's report on Sanjaya Lall's estimates and conclusion regarding technology imports and exports by India, Brazil and South Korea, pp.1631-1633.

This brings one to the aspect of technology and DFI. It must be noted here that DFI must be viewed not as a major means of filling any BoP gap which ultimately only expansion in exports can do, but rather more as a means of access to foreign markets and technology. In the absence of any substantial increase in exports, at least in the short to medium-term, DFI can enter such export sectors and provide the much needed boost to exports in quantity as well as quality. As far as foreign capital in the form of borrowing is concerned, India needs to learn from the Brazilian experience. It must see to it that firstly, the dependence on this form of finance is reduced if not over the short-term at least over the medium-term. Secondly, again more relevent in the Brazilian context, whatever funds flow in must be channelized into productive, long-term capital investments which accelerates domestic capital formation rather than building up foreign exchange reserves which again develops inflationary pressures beyond a certain level, and maintaining current consumption levels by using them to finance short-term BoP deficits which is what India has been practicing. The deficits will have to be financed by exports and only exports or in their absence, for the short-term, by DFI of NRI remittances and such other short-term inflows. As Nayyar (1993) succintly puts it, "in the medium-term, our strategy should endeavour to raise the investment-GDP ratio by raising the export-GDP ratio and not by allowing a compensating rise in the import-GDP ratio supported by borrowing abroad"[4]. At the same time, what one has to broadly infer from Bruton's observation cited earlier is that whereas Korea needs to develop further on its technological know-why and Brazil on its technology exports as well as on the range and sophistication of its technological capacity, India needs to increasingly work towards improving and enhancing its past record of output and productivity growth. This requires attending to one of the most important aspect of access to technology imports which is often neglected and that is the ability to move from importation to absorption and adaption of the technology. The domestic development of technology at this stage of Indian industrialisation is certainly no less significant, failing which there is every possibility of domestic technological capabilities being stifled.

Finally, the most crucial lesson for the developing nations in general and for Korea, Brazil and India in particular that is brought out by the analysis in the previous chapter is that developed nations which are at similar stages of development prefer to trade amongst themselves and thereby demand similar commodities in exchange. Such developed-to-devloped trade(the so called North-North trade) cannot be explained by the traditional Heckscher-Ohlin principle which emphasises existence of dissimilar factor endowments as a pre-condition for continuous and long-term trade flows between developed and developing nations and thus lends credibility to the 'trickle-down' theory of growth. Thus the theorem does not find any credence in the

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4. op.cit. Nayyar D.(1993)-"Indian Economy at the Crossroads : Illusions and Realities",Economic & Political Weekly, April 10.

present study wherein growth in developed nations was observed to have failed to 'trickle-down' to developing nations in terms of greater foreign demand for their commodities and services. At the same time, if the developing nations think of emulating the North by increasing trade amongst themselves (also the so-called 'South-South' trade) they would miserably fail as they are more or less at similar less-developed stages of development. In other words, trade on the basis of similar factor endowments in the South may not neccessarily be as promising and successful as the North-North trade. Till the South reaches up to the level of development of the North, its dependence on the developed nations through increasing degrees of openness becomes inevitable[5]. Of the three countries analysed in the present study, only Korea and to some extent, Brazil seemed to have grasped such an inevitability reasonably at an early stage of their development process. India at the same time chose to overlook the need and neccessity to rely on positive forces for enhancing its own growth. The economy faltered and thus had to pay the price. It was only of late, 1990 to precise, that India realised its grave folly and turned outward usheing in a fresh wave of openness in all respects. The benefits however, are yet too soon to flow in but the indications are definitely in positive directions.

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5. The views are based on and shared with those put forth also by Prof. Dilip Nachane in "Flawed Opposition Stand on GATT", Times of India, Thursday, April 21, 1994,Pp.6.

7.2 Areas for Further Research :

A major limitation of the present study is that it is a macro-study at the economy-level of India and the NICs. Any extensive comparative study like the present one may not be able to cover the macro-aspects of the issues due to certain constraints. This is not to undermine the importance of taking up each issue at the micro or sectoral levels seperately for each country. In this manner perhaps more justice could be done to the outcome and policy implications. What is more important is a thorough study of the contribution of the export sector and composition of exports and detailed identification of the potentially strong aspects so that these could be developed further and taken advantage of. Secondly, it would be interesting to find out in which sectors can DFI stimulate and boost exports without much import-intensity and thereby contribute towards the growth and development of the country. This is equally true for the NICs as much as for India. Thirdly, a correlation could be found between the foreign capital inflows and the specific capital investments it flows into in order to find out whether such capital investments give rise to directly unproductive, rent-seeking activities because of easy access to foreign finance. Of course, some acceptable indicator of such an activity would also have to be investigated. Finally, as noted earlier, Korea and Brazil both present two sets of models on which growth in India could be based. As is well known, Korean exports have been mainly labour-intensive. Likewise there could be a survey of Indian exports and identify those that are labour-intensive and whether DFI can enter into such sectors and take advantage of the similar comparative advantage in India. Brazil's experience shows that import substitution as a strategy per se is not bad. It is the implementation of the strategy that matters the most. In this respect, the similarities between the two countries in implementing the strategy could be investigated. At the same time there could be a study of DFI in Brazil at the sectoral level as to how it has furthered industrialisation and growth in the country.

To sum up, all three countries could do well by reducing excessive dependence on foreign borrowing as a means of foreign capital. An increase in the export-GDP ratio by making them not only price-competitive but also more quality-competitive concentrating on total quality management and developing an effective marketing strategy and delivery schedules must be at the top of the agenda for development. In this respect, increasing the degree of openness to DFI and technology inflows, particularly in sectors and industries in which the country's comparative advantage lies, would also help by rising the investment-GDP ratio and thus accelerate domestic capital formation and, in turn, economic growth.

A final note of caution. The empirical evidence investigated in the present study in support of a more outward-oriented development strategy and a greater degree of openness is, of course, open to many doubts. Especially illuminating is the story of India which has undoubtedly pursued the most consistent policy of import substitution than Brazil or any other developing economy. Although India's output and productivity growth exhibit a dismal performance, its technological maturity and know-how are at the same time, equally impressive. This means that in terms of growth and productivity the strategy pursued and strongly implemented by India seems to have cost itself heavily. Therefore, it is to be emphasised that it is the policy-making process that is at issue and not import-substitution per se that is the root of the problem.

South Korea, on the other hand could possibly owe its success more relevently to its effective decision-making system rather than the given development strategy. As such the source of its spectacular economic growth and transformation may yet remain ambiguous. The same argument would be equally true for Brazil. The frequent policy changes and the dominating role of multinationals in its development makes its story unclear as well.

Thus, it is this policy-making process in the three economies that needs deeper investigation if one is to arrive at concrete and unambiguous conclusions regarding the choice of a development strategy. Till then, the many regressions and econometric interpretations presented here are to be treated as inconclusive and probably not really very powerful. In Bruton's words once again, " The 'right' policy or 'right' broad strategy depends then on many things. This conclusion is especially relevent when _____ one recognises that all policies are not equally doable. What the policy analyst must then be equipped to do is not to parrot, import substitution or outward looking, but to be able to so examine the economy as it is at the moment and determine what policy instruments are likely to be most effective at the moment _____ " [6].

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6. Bruton H.,ibid, pp.1641.