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Trade Liberalization, Industrialization and Development: The Experience of Recent Decades

Mehdi Shafaeddin

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NOTE

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1 Introduction

"We cannot go back to the past. But neither should we fail to recognize the failures of the present." (Stiglitz, 2005: 32)

IS trade liberalization conducive to industrialization and development? The purpose of this paper is to argue that trade liberalization is necessary for industrialization if it is regarded as part and parcel of a package of dynamic and flexible trade and industrial policies, and is undertaken at the right time, gradually and selectively. More importantly, trade policy should be an ingredient of a comprehensive set of industrial and development policies and measures to enhance the capabilities of firms for establishing industries, making them efficient and upgrading them. By contrast, if trade liberalization is undertaken prematurely, rapidly and uniformly, i.e., across the board, it will lead to de-industrialization and unemployment; it will lock the country in specialization in production and export of primary commodities and, at best, natural-resource-based products and/or labour-intensive assembly operations.

We will first review the background to, and features of, the trade liberalization hypothesis (TLH).To examine the validity of the TLH, we will then shed some light on the historical experience of the successful early and late industrializers in Chapter 3. Subsequently, we will refer, in Chapter 4, to the results of trade liberalization forced on colonies during the colonial era. The increased need for infant-industry support in the case of late industrializers and the characteristics of trade liberalization during recent decades, as

compared with the colonial era, will be studied in Chapters 5 and 6. Chapter 7 will be devoted to the examination of available evidence on the result of trade liberalization in more recent decades. In Chapter 8 the contrasting experiences of China and Mexico will be examined. The final chapter will conclude the study and discuss the policy implications of our findings for developing countries.

2 The Trade Liberalization Hypothesis: Background and Features

THE dominant views of scholars on trade and industrial policies have gone through considerable changes since the Great Depression of the 1930s, shifting from one extreme to the other. The Great Depression led to beggar-my-neighbour policies in industrialized countries of the time and across-the-board import substitution in developing countries. Nevertheless, import substitution as an official trade and industrial policy of developing countries only began following the Second World War. During this period until the early 1980s two tendencies were observed.

The first was the one observed in East Asian countries following the initial experience of the Republic of Korea. Facing a severe balance-of-payments constraint around 1958, Korea began to stimulate exports of manufactured goods. With some success being experienced in export expansion, the combination of import substitution and export promotion became the official policy of the Korean government till around the mid-1990s, when the industrial structure of the country became more or less consolidated. Learning from Japan, the country began a process of dynamic trade policy resembling the flying-geese model, by which it initially restricted imports of some consumer goods but left imports of intermediate inputs and machinery relatively free. Subsequently, it gradually liberalized imports of those consumer goods and tried to penetrate the international market. To do so, the government provided some export subsidies. Meanwhile, it embarked on import substitution of some imported intermediate products used in the established industries. When such industries reached the stage of maturity, it

began liberalizing them, and ventured into machinery manufacturing and heavy industries by providing these sectors with government support. This dynamic process of mixed import substitution/export penetration and upgrading of the industrial structure continued till more recent decades (see Shafaeddin, 2005.c; Lall, 1996; Huang, 2002; Amsden, 1989).

A somewhat similar, although not necessarily exactly the same, process took place in a few other East Asian countries/territories, i.e., Singapore, Hong Kong and Taiwan Province of China (together with Korea, these countries made up the so-called "gang of four").

In the meantime, many developing countries continued a long process of "traditional import substitution", i.e., across-the-board protection – as against temporary infant-industry protection as an element of a dynamic trade policy. These countries gradually faced balance-of-payments problems, which intensified after the oil price rise of 1973-74 and the subsequent debt crisis.

In the early 1970s, Little et al. (1970), confusing the infant-industry argument with "traditional import substitution" and misinterpreting the Prebisch thesis on industrialization, attributed the success of the "gang of four" to an "outward-oriented industrial strategy" (see also Baldwin, 1969). Subsequently, a number of other neoliberals, such as Krueger (1974 and 1978), Balassa (1980 and 1989) and Bhagwati (1978), put forward strong arguments against the infant-industry thesis and presented their "trade liberalization hypothesis". Thus across-the-board trade liberalization became an ingredient of conditionalities in the Structural Adjustment Programmes (SAPs) and Stabilization Programmes (SPs) of the international financial institutions (IFIs) in the early 1980s. In the early 1990s the IFIs went further by propagating the "Washington Consensus" initiated by John Williamson (1990).

Elements and features of the trade liberalization hypothesis

While the views expressed by various neoliberals and neoliberal institutions are not exactly the same, one may outline the common elements of the trade liberalization hypothesis as follows:

- removal of import quotas, import licences and other quantitative restrictions, or their initial replacement with tariffs;
- subsequent reduction of the level and dispersion of import tariff rates;
- devaluation of the national currency in order to compensate for the removal of protection or remedy over-valuation of the exchange rate;
- removal of export taxes and subsidies; and
- privatization of ownership of productive firms.

Emphasis was placed on: outward orientation and market orientation; uniformity of the nominal tariff structure; and universality of the hypothesis, i.e., universal applicability of the TLH. Outward orientation, it was argued, requires neutrality of incentives for production for both the domestic and international markets. Market orientation implies the lack of, or minimum, government intervention in the economy and in the flow of trade. Uniformity of the nominal tariff structure would imply the need for across-the-board trade liberalization of various sectors and industries. The ultimate goal is zero tariff rates for all activities. Nevertheless, a low and across-the-board tariff rate of 10 to 20 per cent is exceptionally accepted, for revenue purposes, by some neoliberals. Similarly, it is argued that devaluation will provide uniform incentives for all tradeables (Krueger, 1978: Chapter 4). Universality implies that the hypothesis is applicable to all developing countries, irrespective of their level of development and industrial capacity, and to each country over time.

Neoliberals seem to regard trade liberalization as an end *per se*, rather than a means to industrialization and development. Some neoliberals argue, in fact, that developing countries should undertake unilateral trade liberalization even if developed countries do not do so (Corden, 1993; see also Kowalski et al., 2009)!

Even when some government intervention is accepted, it is to "enable" or "facilitate" a country's "current comparative advantage" (read: static comparative advantage) rather than achieve dynamic comparative advantage and development (see, e.g., Justin Lin in Lin and Chang, 2009). Williamson (1990: 19), advocate of the "Washington Consensus", has confessed that "none of the ideas spawned by … development literature … plays an essential role in motivating the Washington Consensus…"

The philosophy behind the trade liberalization hypothesis

The TLH is based on the assumption that trade liberalization leads to static and dynamic efficiency gains through stimulating investment, export expansion, GDP growth as well as export and output diversification in favour of manufactured goods (Bhagwati, 1988: 36; Krueger, 1980; World Bank, 1987: 21-22). In the particular case of the World Bank, in more recent years the Bank has admitted the failure of across-the-board liberalization, the risk in indiscriminate opening of the capital account, the importance of "country specificities" in drawing up policies, and a superior performance of countries which have not followed orthodox policies. For example:

> In retrospect, it is *clear* [our italics] that in the 1990s we often mistook efficiency gains for growth. The "one size fits all" policy reform approach to economic growth and the belief in "best practices" exaggerated the gains from improved resource allocation and their dynamic repercussions, and proved to be both *theoretically incomplete and contradicted the evidence* [our italics]. Expectations that gains in growth would be won entirely through policy improvements were unrealistic. Means were often mistaken for goals – that is, improvements in policies were mistaken for growth strategies, as if improvements in policies were an end in themselves (World Bank, 2005: 11).

Yet, in the end the Bank recommends "across-the-board", uniform and "accelerated" trade and financial liberalization, significant devaluation,

deregulation of domestic and foreign investment, etc. (see World Bank, 2005 and Shafaeddin, 2006.c for more details).

The philosophy behind the TLH is the theory of static comparative cost advantage, although sometimes lip service is paid to the dynamic issues. Such philosophy has also been the basis of conditionalities imposed on developing countries not only by the IFIs but also by developed countries directly, through multilateral [World Trade Organization (WTO)], regional and bilateral trade agreements, and practices of donors since the early 1980s. In the negotiations for Economic Partnership Agreements (EPAs), for example, the European Union (EU) demands trade liberalization by the African, Caribbean and Pacific (ACP) countries (most of which are least developed countries) on a reciprocal basis and tries to impose "WTO-plus" conditions on them.

Has trade liberalization led to export expansion and diversification? Has it stimulated investment and growth of manufacturing value added (MVA) and GDP?

3 The Experience of Successful Industrializers[1]

THE historical evidence on the performance of successful early and late industrializers is not supportive of the TLH. In fact, their experience, including that of Great Britain as the first industrializer, indicates that, with the exception of Hong Kong Province of China, all have gone through an infant-industry phase. Hong Kong was a city territory; moreover, its ability to upgrade its industrial structure was limited. While different countries did not follow exactly the same path, all learned from the experience of others; the USA learned from Great Britain, Germany from the USA, Japan from Germany and the Republic of Korea from Japan, etc. (Shafaeddin, 1998). In all cases functional and selective government intervention was not confined to trade; the state also intervened through other means, directly and indirectly, to encourage savings, to promote investment, to develop agriculture and the necessary institutions and infrastructure, and to provide facilities for training. Foreign direct investment (FDI) was also used and targeted to specific areas to enhance industrialization. In all cases, including Great Britain, industrialization began on a selective basis, although to different degrees, and continued in the same manner until the industrial sector was consolidated. When their industries matured, the industrial countries began to liberalize, also selectively and gradually.

In all cases industrialization was supported by attention to and growth in agricultural production. The Corn Laws in Great Britain (see below) and protection of rice production in Japan and other East Asian countries are only two examples.

Premature trade liberalization, whether by early industrializers, by colonies or, in more recent decades, by developing countries, has been disappointing. In the particular case of the USA, when it tried to liberalize prematurely in 1847-61, the industrial sector suffered and the country had to revert to protectionism.

All main early industrializers tried to open the markets in other countries when their industrial sector matured by using tariffs as a tool of bargaining in trade negotiations or even by force or political pressure (see below).

The particular case of Great Britain as the first industrializer

The literature on the use of infant-industry support by such countries as the USA, Germany, France, Japan, Republic of Korea, etc., which industrialized after Great Britain, is ample. But it is interesting to note that, contrary to the contention of some famous classical and neoclassical economists such as Adam Smith and Alfred Marshall, Great Britain, the first early industrializer, also undertook infant-industry protection.

Marshall (1920) attributed the industrialization of the country to the industrial revolution, cultural issues related to "the spirit of economic nationality … patriotism … [and] pride in their [Englishmen] work" (ibid.: 32), and the introduction of the policy of free trade around the 1860s (ibid.: 10 and 89). Smith (1776) maintained that Great Britain achieved industrialization despite its protectionist policies. The historical evidence contradicts these views (see Box 1).

Box 1
Great Britain, the first industrializer

The beginnings of the process of industrialization in Great Britain can be traced back a couple of centuries before the industrial revolution of the 18th century although the latter accelerated the process. By around 1700, industrial production already accounted for about 20 per cent of the country's total income. Trade restrictions begun by Elizabeth I (1553-1603) sharply increased in 1690 and continued until around the 1860s. "As of 1820, Great Britain showed the highest rate of tariffs on imports of manufactured goods (50 per cent) in Europe" (Shafaeddin, 2005.a: 157 and Table 7.2).

The country's industrialization process has some features in common with those of other successful early and late industrializers. Protection was selective, and trade policy was dynamic and flexible. Protection started with woollen and cotton cloths and iron, and eventually extended to shipbuilding and restrictions on transportation through the Navigation Act (1651). The agricultural sector was also protected through the Corn Law of 1434 followed by the Corn Bounty Act (1614-89) and the Corn Law of 1815. The government prohibited the sale of imported grain to millers, unless the home price exceeded a certain limit. Moreover, exports of some products such as wheat were subsidized.

The government also intervened extensively, particularly after 1760, in other areas: to encourage savings, investment and scientific activities; to develop infrastructure, roads, waterways and railways; to provide facilities for training; to establish necessary institutions, etc. The Bank of England was established in 1694; small and provincial banks, banking houses and private banks were established in 1716; saving banks were established in 1798. To encourage investment, the law of partnership was passed, joint stock companies were initiated, insurance services were developed and the stock market was created.

When Great Britain consolidated its industrial base, after over two centuries of protection, the government began reducing its tariffs gradually, over a period of nearly 30 years, beginning in 1833. The Corn Law and Navigation Act were abolished in 1846 and 1849, respectively, before a policy of free trade took hold (around 1850-60). Further, the nature of government intervention changed in other areas. Many ineffective regulations were abolished between 1760 and 1850. Around the early 19th century the government began to take a more positive role in the economy, but its intervention did not cease even after the 1850s (Deane, 1965: 232).

Source: Based on Shafaeddin (2005.a: 156-165).

4 Impact of Forced Trade Liberalization Imposed on Colonies

FREE trade policy was forced on colonies, semi-colonies and independent countries through the so-called 5 per cent rule and "unequal" bilateral treaties, mostly during the first half of the 19th century. Under the 5 per cent rule, 5 per cent was the maximum tariff rate allowed on any item imported by colonies of Great Britain. When a country did not submit, military force was employed (e.g., the imposition of the opium war of 1839-42 on China). To deprive the colonies of new technology, Britain prohibited exportation of machinery to, and their use in, the colonies until the 1830s. High-value-added manufacturing activities were outlawed in the colonies and exports of competing items from colonies to England were banned. Instead, production of primary products was encouraged (Chang, 2005.a).

The result of the forced liberalization was sluggish growth, de-industrialization and destruction of handicrafts of the colonies (Bagchi, 1982: 32-39). The Latin American countries modified their commercial policies from 1880 onwards, while some other countries did so between 1913 and the Great Depression of 1929 (Bairoch, 1993: 41-42 and Chapter 8). As can be seen in Table 1, during the height of compulsory liberal trade regimes (1800-80), growth in per capita income was negative in the Third World. Only after 1880, when the Third World began to gradually regain its policy autonomy, did the per capita income of the group begin to accelerate (see also Chang, 2005.b: 30-34). Generally speaking, "in all parts of the developing world economic growth accelerated after the end of imperialism" (ibid.: 32). Growth also accelerated during 1950-80 as the remaining colonial territories gained independence and were able to implement their own trade policy.

Table 1: Annual average growth rates[a] in per capita GNP, 1800-1980

Period	Third World[b]	Developed countries
1800-1830	-0.2	0.6
1830-1870	0	1.1
1870-1880	0	0.5
1880-1890	0.1	0.9
1890-1900	0.2	1.7
1900-1950	0.45	1.34
1950-1980	1.7	3.4

a: Three-year average. b: Excluding China.

The de-industrialization effect of the forced liberal trade policy imposed on the Third World was between 85 and 95 per cent; i.e., in the absence of trade liberalization the size of the manufacturing sector of the Third World would have been 85 to 95 per cent larger (Bairoch, op. cit.: 88). For example, in the case of the Indian textiles sector, it is estimated that the de-industrialization effect was equal to the destruction of between 55 and 75 per cent of national consumption around 1870-80 and 95 to 99 per cent in 1880-1900 (Bagchi, 1982: 32-39 and 82-83; Chang, 2005.b: 61).

5 The Increased Need for Infant-Industry Support in Late Industrializers

IN the case of Great Britain, the process of infant-industry support lasted over 200 years before the country consolidated its industrial structure. By contrast, to be able to catch up, the time pressure on late industrializers has increased over time, particularly during recent decades (Shafaeddin, 2005.a). The more backward is a country, the greater is the need for acceleration of the process of industrialization in order to catch up with the early industrializers. Yet, the wider will be its competence gap. While the need for government intervention in the process of industrialization has increased, the policy space of the latecomers has shrunk. To begin with, the pace of technological development has accelerated and the technological gap between the industrial countries and the late industrializers has grown. In the case of Great Britain, the emergence of new technology was dependent on invention, which was a slow process. For the late industrializers, some technology is already available elsewhere. Therefore, there is a need for application, adaptation or imitation of the existing technology. But the technology is not available readily and freely. Further, as the pace of technological development accelerates and technology becomes more complicated, the longer will be the period needed for technological learning (see, e.g., Lall, 2004).

Secondly, during the industrial revolution firms were relatively small. Over time, the size of established firms of industrial countries has enlarged, international market power has become more and more concentrated, and thus monopoly and oligopoly power has increased in the international market. Large established firms enjoy the advantages of increasing returns to scale. Barriers to entry for newcomer firms have increased, inter alia, because of

the strategic behaviour of large firms which can exercise their Schumpeterian "creative destruction".

Thirdly, the combination of the time pressure, technological gap, capital intensity of production and large scale of operations increases the need for investment and savings, thus putting pressure on consumption. At the same time, population growth and changes in taste due to the appearance of foreign goods increase demand for luxury consumption, reducing the savings necessary for investment (Gerschenkron, 1962).

Fourthly, even if the required savings were available, the higher the needed rate of growth for catching up, the faster would be the required rate of social, institutional and infrastructural changes, hence the greater the need for government intervention to deal with these issues.

In more recent decades, the risks of investment by new firms have also increased. According to Lazonick (1991), a newcomer firm faces risks related to productive uncertainty (the risk related to the development of a product and the utilization of productive capacity) as well as competitive uncertainty [related to the rivalry of established firms such as transnational corporations (TNCs)]. One can add risks related to the fallacy of composition (Blecker and Razmi, 2008), development of protectionism in the main international markets, increased exposure to world demand and increased frequency of booms and busts during international business cycles, and volatility in the foreign exchange market.

FDI provides marketing channels to international markets, but the objectives of the TNCs are different from the development objectives of the host countries and their contribution to development is limited unless they are managed. Even then they can only supplement the capabilities of local firms.

The increase in risks requires the provision of higher rewards (expected income) for newcomer firms. In other words, the newcomer firms need more support and a greater degree of nurturing than before. Yet, the policy space of developing countries has declined, for the reasons mentioned below.

6 The Characteristics of Trade Liberalization During Recent Decades

ONE can draw an analogy between the trade liberalization during recent decades and that imposed on colonies during the 18th and 19th centuries. For example, when Great Britain consolidated its industrial base and enjoyed technological supremacy, the government opened its market to imports. Meanwhile, it tried to open up the markets of its colonies to its exports through the so-called unequal treaties (1810-50) and the 5 per cent rule, together with equal taxes imposed on their domestically produced goods. If a trade treaty was not accepted by a country, it was forced on it by war (e.g., the opium war imposed on China). All colonies were forced to give preference to products of the mother country (Bairoch, 1993: 41-43). The Fair Trade League Act of 1881 (through which retaliatory import taxes were imposed on imports of manufactured goods from colonies) was used as an instrument of reciprocity to open up the markets of other countries. Further, as mentioned earlier, England prohibited exports of machinery to the colonies.

During recent decades, developed countries have sought to open the markets of developing countries by other means. For example, according to Peter Mandelson, then EU Trade Commissioner, "The aims of our trade policy should be to achieve better market access for European goods and services worldwide" (Mandelson, 2005). He has repeated this statement in different forms many times on various occasions (see Curtis, 2006). Thus developing countries have been pushed, through the SAPs and SPs of the World Bank and International Monetary Fund (IMF) and through bilateral trade agreements, to open their markets (Chang, 2005.a: 10 and Shafaeddin, 1998). Towards this end, the unequal treaties of old were replaced by "unequal

trade agreements" and letters of credit, while denial of loans or financial aid by IFIs and donors took the place of military intervention. For example, according to EU officials, "poor countries will receive EU aid and improved treatment on trade if they sign up to deepening liberalization" (Curtis, 2006: 3). Reciprocity is now imposed on low-income countries through EPAs rather than through the Fair Trade League Act. When 10 per cent import duties are allowed in exceptional cases for fiscal reasons, it is also recommended that a 10 per cent value-added tax be imposed on the sale of similar domestically produced goods. Production of high-value-added products in developing countries is not prohibited, but it is constrained by unfair competitive pressure from imports, and hampered by tariff peaks and escalation and arbitrary and unjustified anti-dumping and countervailing measures (Shafaeddin, 2010.a). Exports of machinery are not prohibited, but transfer of technology to developing countries is restricted through the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). Further, severe loss of policy space is experienced by developing countries through such other WTO agreements as the Agreement on Trade-Related Investment Measures (TRIMs), General Agreement on Trade in Services (GATS) and the Agreement on Subsidies and Countervailing Measures (see Shafaeddin, 2010.a). Summarizing the impact of the first three agreements (TRIPS, TRIMs and GATS), Wade (2005) concludes that "With a touch of hyperbole the agreements could be called a slow-motion Great Train Robbery". Even more policy space will be lost if the demands of developed countries during the ongoing Doha Round of multilateral trade negotiations are met and the EPAs, with their "WTO-plus" conditions, come into effect. In fact, if the EPAs are finalized, it would be the last nail in the coffin of the industrial sectors of ACP countries which are at early stages of development (see Oxfam, 2008 and Shafaeddin, 2010.a).

In short, in recent decades the means of pressure on developing countries to liberalize across the board, universally, and most often prematurely, have been economic rather than political or military. But the result has been the same as that during the colonial era: de-industrialization of countries at early stages of industrialization. We will return to this issue below.

7 Recent Experience in Trade Liberalization[2]

WHILE across-the-board import substitution and prolonged protection have led to inefficiency and failure, the experience of developing countries in implementing the TLH during recent decades has also been disappointing. However, the neoliberals and the neoliberal-oriented institutions try to convince us to the contrary (see, e.g., Sachs and Warner, 1995).[3] The studies undertaken by the neoliberals suffer from many methodological problems. In fact, the results of cross-sectional studies undertaken by other scholars have revealed little or no evidence that there was any statistically significant correlation between trade openness and economic growth in recent decades (Rodriguez and Rodrik, 1999; Rodrik, 1997; Wacziarg and Welch, 2003; Moguillansky and Bielschowsky, 2001; Di Maio, 2008). More importantly, UNDP (2003) finds a positive correlation between a country's tariff rate and growth rate for the 1990s. There is also some evidence that trade liberalization has led to de-industrialization of low-income countries, particularly in sub-Saharan Africa (Bennell, 1998; Shafaeddin, 1995; Noorbakhsh and Paloni, 2000; Thoburn, 2002).[4]

According to Stiglitz (2005: 31): "Today the inadequacies of Washington Consensus reform [in general] are apparent…" He maintains that stabilization policies do not ensure either growth or stability; the benefits of trade liberalization are questionable, particularly as "workers move from low-productivity jobs to unemployment" instead of moving to high-productivity jobs; capital market liberalization does not necessarily lead to faster growth and exposes the countries to higher risks; privatization often leads to higher prices of utilities; and the adverse social consequences of wrong policies

imposed on developing countries have been seen in many countries (ibid.: 16-18).

The results of our own studies on the experience of developing countries in trade liberalization are mixed, depending on the stage of industrialization of the country which undertakes liberalization and the way it has been done. We have studied a sample of 50 developing countries for the period 1980-2000. Then, we repeated the analysis for the period 2000-04 in order to examine the possible impact of the lag between liberalization and economic performance as well as the degree of vulnerability of the countries during the economic slowdown in the early years of the decade (Shafaeddin, 2006.a and 2006.c). The study for the 1980-2000 period shows that 20 countries experienced rapid expansion of exports of manufactured goods. In several countries, mostly East Asian newly industrializing economies (NIEs), rapid export growth was also accompanied by fast expansion of industrial supply capacity (MVA) and upgrading. In these countries, after they had reached a certain level of industrial maturity, trade liberalization took place gradually and selectively. By contrast, the performance of the remaining countries, mostly in Africa and Latin America (majority cases), was not satisfactory. These countries embarked, in the main, on a process of structural reform in the 1980s, including uniform, across-the-board and often premature trade liberalization. They further intensified their liberalization efforts in the 1990s. Consequently, half of the sample countries, mostly low-income ones, have faced de-industrialization. In cases where manufactured exports grew extremely fast, e.g., Mexico, MVA did not accelerate and little upgrading of the industrial base took place. In the 1990s Mexico achieved an annual average manufactured export growth rate of about 30 per cent, yet its corresponding growth rate of MVA did not exceed 4 per cent, as against an average of 7.5 per cent for Malaysia, Thailand, Indonesia and Singapore (Shafaeddin, 2005.a: Table 2.1) and its own MVA growth rate of about 7 per cent in the 1960s.

In the case of low-income countries, the example of Ghana is telling. Despite two decades of reform, Ghana's annual average growth in MVA was

significantly negative during the 1990s (-3.5 per cent). Further, the liberalization efforts did not encourage exports of manufactured goods beyond some wood processing, the production capacity of which in the late 1990s remained in fact below the level of the mid-1970s (ibid.: 46-48). Although the country's growth performance has somewhat improved in subsequent years, mainly due to high commodity prices, the sustainability of growth is questionable as investment has not picked up much.

The reform programmes designed by IFIs failed to stimulate private investment, particularly in the manufacturing sector; the ratio of investment to GDP fell even in cases where the inflow of FDI was considerable, including Mexico and a number of other Latin American countries. While trade liberalization changed the structure of incentives in favour of exports, the balance between risk and return shifted away from the manufacturing sector in favour of non-tradable activities and speculation in property. In contrast to traditional import-substitution strategy, the outward-orientation strategies reduced the incentive for investment in the manufacturing sector due to the reduction in its profit margin resulting from competitive pressure from imports. At the same time, it increased the risks of investment for the reasons mentioned earlier.

Generally speaking, in the "majority cases" trade liberalization has led to the development and reorientation of the industrial sector in accordance with static comparative advantage. Resource-based industries and some labour-intensive activities, such as assembly operations, expanded in most countries and little upgrading took place. In fact, some labour-intensive industries also shut down, leading to significant layoffs as resources did not shift to new activities, except for shifts to resource-based and speculative activities, as predicted by neoliberals.

The performance of two categories of industries in the particular case of Latin America was, however, exceptional: industries that were near maturity and/or that had been dynamic during the import-substitution era. Both categories continued to be dynamic in terms of production, exports and

investment. The aerospace industry of Brazil is an example; it was near the stage of maturity after years of nurturing, and benefited from trade liberalization as the competitive pressure from imports made it more efficient despite the initial difficulties it encountered (Shafaeddin, 2006.a).

The result of the study of the same sample countries for the period 2000-04 indicated that the differential performance of the "minority group" in general continued, in relation not only to the "majority group" but also to its own performance during the 1990s. Further, the majority group, particularly Mexico, Costa Rica and low-income countries, showed more vulnerability to global slowdown. Export processing zones (EPZs) are responsible for the bulk of the exports of Mexico and Costa Rica (see also Paus, 2005 on Costa Rica). Other countries which also have concentrated on EPZs, by liberalizing FDI, have not fared much better than Costa Rica and Mexico. One example is Mauritius, which not only has not been able to upgrade its production and export structure, but has also experienced a slowdown in its pace of export growth (Shafaeddin, 2009). Only China is an exception; in particular, its performance stands out as compared with Mexico. The contrasting experiences of the two countries require closer attention as they share many similarities but also differ in their policy performance and the role of government (see below).

On the basis of the aforementioned studies, we have concluded that "where there is a correlation between export growth and output growth [manufactured goods], a causal relation goes from output to exports rather than the other way round" (Shafaeddin, 2006.c).[5] This is particularly true in the case of low-income countries such as least developed countries (LDCs).

Least developed countries

LDCs are at the early stages of industrialization. Hence, one would expect, based on the experience of other countries (Chenery and Syrquin, 1985), that the share of MVA in their GDP should have increased during the last couple of decades. Yet, premature trade liberalization during the 1980s and

early 1990s was accompanied by de-industrialization in most LDCs (Shafaeddin, 1995 and 1996). The neoliberals' response is that low-income countries should intensify trade liberalization in order to improve their performance (IMF, 2001). Has the situation improved during the following period when trade liberalization was in fact intensified in these countries, particularly in African LDCs (Shafaeddin, 2009: Table 11)? The data indicates that de-industrialization has also intensified since 1990.

We have taken the MVA/GDP ratio as an indicator of the degree of industrialization.Table 2 shows that on average the ratio in LDCs has declined between 1990 and 2006, influenced mainly by the performance of African LDCs. Nevertheless, the average figure for Asian LDCs is heavily influenced by the performance of Bangladesh, Cambodia and Laos. When these countries are excluded, the ratio for Asian LDCs declines from 12.9 per cent in 1990 to 10 per cent in 2006. Furthermore, de-industrialization seems more pronounced in countries which are, relatively speaking, at earlier stages of industrialization. Thus, 78 per cent of countries which show a decrease in their MVA/GDP ratio over the same period figure among those with MVA/GDP ratios of less than 10 per cent in 2005-06 (based on Tables 2 and 3). The corresponding figure for countries which show an increase in the ratio is 63 per cent. Moreover, on the basis of the same sources, out of 24 countries

Table 2: Changes in the share of MVA in GDP of LDCs[a] (1990-2006)

Year	LDCs				Other developing countries[b]	
	All	Asia	Africa[c] and Haiti	Islands	All	Major exporters of manufactured goods
1990	10.5	12.1	9.7	6.1	22.5	25.6
2000	10.2	13.2	7.7	6.4	23.2	27.1
2006	9.8	13.8	7.5	6.4	24	28.5

Source: Shafaeddin (2009), based on UNCTAD (2008.a: Table 8.3.2).

a: All variables are in current terms.
b: Excludes LDCs.
c: 10.7 for 1980.

Table 3: Changes in the share of MVA in GDP of LDCs (2005-06)

MVA/GDP (per cent)	Asia		Africa		All LDCs	
	Increased	Decreased	Increased	Decreased	Increased	Decreased
Less than 5	-	5	5	3	5	8
5-10	3	2	7	8	10	10
10-15	-	-	4	3	4	3
15-20	2	-	2	2	4	2
20-21	1	-	-	-	1	-
Total	6	7	18	16	24	23
Per cent in total number for each region	46	54	53	47	51	49

Source: Calculated by the author, based on UNCTAD (2008.b: Table 3).

which do not show a decline, two countries show no change (Eritrea, Sao Tome and Principe), five register a marginal change of 0.1 per cent (Djibouti, Ethiopia, Gambia, Haiti and Madagascar), and a few others record minor changes of 0.2 per cent (Guinea and Togo), 0.3 per cent (Somalia and Sudan) and 0.6 per cent to 0.9 per cent (Uganda, Tanzania and Yemen). Such small changes over more than a decade cannot be regarded as progress in industrialization.

Note that the increases in the MVA/GDP ratio cannot be necessarily attributed to trade liberalization in all cases. Countries with noticeable increases in the ratio include Cambodia (10.6 per cent), Equatorial Guinea (9.3 per cent), Mozambique (8.5 per cent), Liberia (8.1 per cent), Laos (5.4 per cent), Afghanistan (4.7 per cent), Myanmar (1.8 per cent) and Bangladesh (1.5 per cent). Nevertheless, with the exception of Equatorial Guinea and the last two countries, all are among special cases which had suffered from low capacity utilization in the initial period due to a war or internal conflict. Equatorial Guinea enjoyed expansion of oil revenues and the increases in the ratios for Bangladesh and Myanmar are relatively small. In fact, if the ratio for 2006 is compared with that of 1980, it declined slightly in the case

of Myanmar and remained the same for Bangladesh (UNCTAD, 2008.b: Annex Table 5).

Generally speaking, the degree of de-industrialization will become even more evident if one compares the MVA/GDP ratios for 2006 with 1980 or 1970. In the first case, 25 out of 40 countries for which data are readily available show a decline in the ratio, and two cases show no change (based on op. cit.). Again, the exceptional cases mentioned above figure in the list of countries where the ratio went up. The results of comparison with the 1970s will be even more dramatic (see also Jomo and von Arnim, 2008: Table 7).

While a number of factors, including structural weaknesses, may have contributed to de-industrialization, the influence of premature liberalization cannot be denied (Shafaeddin, 2006.c and 2009). During the last two to three decades, quantitative trade restrictions have been eliminated and tariff rates have been reduced drastically. In particular, tariffs on imports of manufactures have been reduced significantly, ranging from 33.5 per cent to 83.2 per cent (Shafeddin, 2009: Table 14).

8 The Comparative Experience of China and Mexico[6]

AS mentioned earlier, among countries with some industrial base the performance of China in particular stands out as compared with Mexico. Their comparative performance provides a good opportunity for testing the neoliberals' hypothesis vis-à-vis developmentalists. In 1978, MVA accounted for 44 per cent of Mexico's GDP; the ratio was around 40 per cent for China around 1980. Both countries started opening up their economies to foreign trade and FDI and reforming their economies more or less around the early 1980s. Mexico, however, intensified its trade liberalization through the General Agreement on Tariffs and Trade (GATT) (1986) and North American Free Trade Agreement (NAFTA) (1995) and relied heavily on market forces in general; it is regarded as a champion of trade liberalization and economic reform (Moguillansky and Bielschowsky, 2001). China's trade, financial, capital and labour market reforms continued in the 1980s and 1990s; it acceded to the WTO in 2001. Export processing zones have been mainly responsible for export expansion in both countries.

During 1980-2000, Mexico registered considerably faster expansion of exports of manufactured goods than China, but unlike in the case of China, such rapid expansion was not associated with acceleration of growth of MVA and GDP. Further, in contrast with China, its rapid growth of exports could not be sustained after 2000; the ratio of investment to GDP fell; public investment was cut and domestic private investors hardly responded positively to liberalization. Unlike in China, FDI crowded out domestic investment and the trade balance ratio for its manufacturing sector [(exports-imports)/exports] deteriorated (for details, see Pizarro and Shafaeddin, 2010);

little increase in value added and upgrading has taken place in its export processing zones. There has also been a shift to resource-based industries and less risky activities (than productive activities) such as residential construction (Shafaeddin, 2005.b: 50-52 and Table 3.3). In comparison, China has developed comparative advantage in production of non-electronic capital/ technology-intensive products [mostly produced by state-owned enterprises (SOEs)] and in exports of assembled electronic products. Unlike Mexico, it has improved its comparative advantage in production of components and finished items of electronic products and other intermediate goods.

In short, Mexico has intensified its static comparative advantage and its prospects for rapid growth of exports of manufactured goods are slim. By contrast, China managed to upgrade its industrial structure to achieve dynamic comparative advantage accompanied by rapid growth of exports and MVA. What has China done which Mexico has not?

Differences in policies of the two countries

In a nutshell, the answer to the above question lies in the two countries' different approaches to trade and industrial policies as well as learning. Mexico followed the recommendation of neoliberals who are proponents of market-led industrialization, rapid and across-the-board liberalization and "learning by trading". It was assumed that the market would take care of research and development (R&D), technological development, learning through trade and FDI. By contrast, China pursued a strategy advocated by neo-developmentalists and the proponents of "capability building theory" who stress gradual and experimental liberalization, functional and targeted government intervention, "learning by doing" and development of capabilities of domestic firms, particularly in technology.

More specifically, unlike Mexico, the Chinese government targeted some strategic industries, particularly information technology (IT) industries (in 1986), through SOEs or government support for private firms, while it was also responsive to market forces. The government developed an institutional

framework for science and technology (S&T) development, a national system of innovation and learning through R&D and training. It also provided some incentives to TNCs and directed them to specific activities.

A sophisticated system of national innovation, for basic research as well as R&D, was developed, as shown in Table 4. The Chinese Academy of Science, Ministry of Information Technology and four other ministries were involved in providing guidance to S&T development. Universities, research institutes, and public and private enterprises, including foreign firms, were also involved. The 1986 "863 programme", 1988 "Torch programme", 1992 "climbing programme", 1995 "decision on accelerating scientific and technological progress", and 1996-2000 and 2001-05 Five-Year Plans targeted development and intensification of technology and provision of training for six high-tech industries as well as energy. Some technology parks were also established for the purpose; commercialization of technology was encouraged. By 2003, 18,669 R&D institutes had been established. As is shown in Table 5, expenditure on R&D expanded considerably faster in China than in Mexico. The share of business enterprises in China's total R&D expenditure also increased from 43.3 per cent in 1996 to over 68 per cent in 2004.[7] By contrast, in the case of Mexico it increased only from over 22 per cent in 1996 to about 32 per cent in 2004 (Gallagher and Shafaeddin, 2010: Table 5, based on Zhong and Yang, 2007 and UNESCO, online database on R&D expenditure). Although foreign enterprises have become more active in R&D in China as compared with Mexico (see below), national enterprises took the lead in technological development.

According to World Bank sources, each year more patents are filed in China than in the whole of Latin America. More importantly, as late as 2002, 112,103 patents were granted to Chinese firms as against 20,296 granted to foreign firms (MOST, 2006).

Table 4: Development of China's national innovation system

Policy	Dominant feature	Year established
Key technology R&D programme	Encouraging efforts in key technology	1982
Resolution on reform of S&T system (CCCP)	Adopting flexible system on R&D management	1985
Sparkle system 5	Promoting basic research in agriculture	1985
863 programme	High-tech promotion	1986
Torch programme	High-tech communication, high-tech zones	1988
National S&T achievements spreading programme	Promoting product communication	1990
National engineering technology research centre programme	Technology transfer and communication research	1991
Climbing programme	Promoting basic research	1992
Endorsement of UAEs by SSTCC	Promoting university and industry linkage	1992
S&T progress law	Technology transfer, S&T system reform	1993
Decision on accelerating S&T progress (CCCP)	Promoting URI-industry linkage	1995
Law for promoting commercialization of S&T achievements	Regulating the commercialization of S&T	1996
Super 863 programme	Commercialization, breakthrough in key areas	1996
Decision on developing high-tech industrialization	Encouraging technology innovation and commercialization	1999
Guidelines for developing national university science park	Accelerating the development of university science parks	2000

Source: Gallagher and Shafaeddin (2010: Table 4). Based on Zhong and Yang (2007).

Table 5: Expenditure on R&D in Mexico and China (1996-2005)

		Share in GDP	Per capita ($)
Mexico:	1996	0.31	22.4
	2004	0.41	40.4
China:	1996	0.57	15.7
	2005	1.34	89.6

Note: GDP is in PPP.
Source: UNESCO online database on R&D expenditure.

The role of the government in developing capabilities of domestic firms

In addition to its direct involvement in R&D activities, the Chinese government provided a high level of support for tertiary education, training and skills development. For example, in 2005, the number of graduates in the field of S&T was over 1,000 per million of population; government expenditure on tertiary education per student was equal to 90 per cent GDP per capita, as against 48 per cent for Mexico (World Bank, 2008). In the field of training, the number of graduates from vocational schools increased from 79,000 in 1978 to 1,700,000 in 2005 when there were 198,566 vocational schools in the country.

To develop the capabilities of domestic firms, a division of labour was established between private firms and SOEs. The objective of the former was to exploit short-term opportunities for profit-making. The latter concentrated on long-term goals through development of new products while benefiting from the "National Science and Technology Diffusion" programme and Export Development Fund (Gallagher and Shafaeddin, 2010, based on Li and Xia, 2008).

Chinese firms also cooperated with TNCs, particularly in R&D. In the case of Mexico, FDI was negatively correlated with R&D. *Maquiladora* (foreign) firms provided few linkages with, and technological spillovers to, domestic firms (Pizarro and Shafaeddin, 2010). Further, a large number of Mexican

firms were closed down as a result of their inability to compete with TNCs. For example, in the IT industry alone 13 important domestic firms were closed (Gallagher and Shafaeddin, 2010: Table 13, based on Woo, 2001 and Rivera Vargas, 2002). In the case of China, TNCs have become increasingly involved in R&D as they were provided incentives and initially made to engage in participation with national firms (Walsh, 2003). Eventually, many TNCs established R&D facilities in China; the number of foreign firm R&D centres is estimated to have reached anywhere between 120 and 400 in 2003 (Walsh, 2003: xiv).

As the capabilities of the Chinese domestic firms were enhanced, in contrast to Mexico, FDI crowded in domestic investment. But FDI was basically managed not only by directing it to targeted industries, but also by other means. For example, initially, licensing FDI was conditioned on transfer of technology. In 2001 this condition was dropped, but various incentives were provided to TNCs to get them engaged in R&D.

The IT industry was designated as a "pillar" strategic industry of China in 1988 (MOST, 2006). Top TNCs in the IT industry (IBM, HP, Toshiba and Compaq) were invited to form joint ventures with local firms such as Legend, Great Wall, Tonture and Star. The condition was that the TNCs transfer technology to the joint venture and engage in training. Further, the government decided to invest over $120 billion in the IT industry by the end of 2005 (Walsh, 2003: 71). As a result, around 2005, the IT firms engaged in R&D in China included four foreign-owned, 22 joint-venture and 13 privately owned domestic firms and SOEs (Gallagher and Shafaeddin, 2010: Table 12). As domestic firms developed their own capabilities, supported directly by the government, the TNCs became more willing to transfer technology. By 2000, Legend emerged as the biggest seller of PCs in the Asia-Pacific region and China. After acquiring IBM's PC business in 2005, it became the world's third largest PC maker (Spooner, 2005). Domestic manufacturers together have dominated 70% of the domestic PC market (Walsh, 2003: 108). Founder, Datang and Huawei became giant firms in laser typesetting and electronic publishing, 3G (TD-SCDMA) technology, and

telecommunications, respectively. China has developed its own brand of mobile phone and high definition disc players (see Fan, Gao and Watanabe, 2007). IT products have become major exports; in 2007-08, electronic products constituted the country's top three export items.[8]

9 Concluding Remarks and Policy Implications

MEXICO and China have followed different approaches to trade liberalization and industrialization. Mexico, following the neoliberal approach, relied on market forces and has been regarded as a champion of trade liberalization. In particular, the government believed in learning technological development mainly through trade and relying on TNCs. By contrast, China has attempted a gradual and experimental approach to trade liberalization, and meanwhile has continued nurturing technological development through measures and policies to develop the technological capabilities and skills of domestic firms. It has targeted IT and a number of other industries, embarked on institutional development and created a national system of innovation for technological development. Thus it has managed to increase domestic value added in these industries which started, like in Mexico, through assembly operations. China also continued its rapid growth of exports, MVA and GDP after joining the WTO. By contrast, Mexico has achieved little in building up the capabilities of domestic firms, increasing value added in exports and growth of MVA and GDP. Furthermore, the country has become more vulnerable to external factors than China, as was evident during the recent financial crisis, despite the fact that its exports-to-GDP ratio (28.5) in 2008 was far smaller than that of China (37.8).[9] In 2005, Mexico depended on the US market for over 85 per cent of its exports and 54 per cent of all its imports. Since the early 2000s many TNCs have been relocating their plants from Mexico to China.

The performance of China is consistent with the literature on capability building theory and the views of proponents of neo-developmentalism (e.g.,

Wade, 1990; Amsden, 2000; Paus and Gallagher, 2008; Chang, 2005.a; Shafaeddin, 2005.a; Lall, 2004).

Can the experience of China be replicated by other countries?

China's impressive success in enhancing the capabilities of its domestic firms raises the question of whether its experience can be replicated by other developing countries. Although development policy is country-specific as the socio-economic features of various countries are different and the experience of a country cannot be generalized, certain lessons can be learned from China's experience as compared with that of Mexico. Firstly, trade policy cannot be considered in isolation from industrial and other development policies of a country. In particular, there is a need for industrial policy (Lall, 2004; Rodrik, 2004 and 2007; Wade, 1990 and 2007; Shafaeddin, 2006.b; Di Maio, 2008).

Secondly, capability building of domestic firms is crucial for industrialization, but the market alone is not capable of developing such capabilities in various categories of developing countries as well as within one country over time. Developing countries can be classified into three categories: those with little industrial capacity, such as low-income African and other least developed countries; those with some industrial capacity developed during the import-substitution era, such as Brazil; and those with a considerable industrial base which have also successfully penetrated the international market, such as the East Asian NIEs. The main problem of the first group is to establish production capacities; that of the second group is to make existing production capacities efficient and penetrate international markets. The burning issue for the third group is to upgrade their industrial structure. Market forces alone are not adequate to deal with any of these issues. The capabilities of government should be developed to formulate and implement policies for capability building at the firm level.

Thirdly, trade and industrial policies should be not only development-oriented and country-specific, but also selective, mixed, flexible, performance-linked,

Table 6: Evolution of average tariffs for various groups of industries at different phases of industrialization

Phase	RB&LI	LT	MT	HT	Manufactures (Average)
I	20	0	0	0	5
II	10	40	0	0	12.5
III	0	30	50	0	20
IV	0	20	40	40	25
V	0	10	30	40	20
VI	0	0	15	25	10
VII	0	0	5	15	5
VIII	0	0	0	0	0

Source: Akyüz (2005: 27).

Notations: RB: Resource-based industries
LI: Labour-intensive industries
LT: Low-technology-intensive industries
MT: Medium-technology-intensive industries
HT: High-technology-intensive industries

dynamic and predictable (Shafaeddin, 2005.c). The flexibility and dynamism of trade policy can be exemplified by changes in the structure of tariffs during the course of industrialization, as shown in the self-explanatory Table 6.

Trade and industrial policies should also be supplemented by the development of what I call "non-price factors" (see below), and development of agriculture in order to enhance the supply of wage goods. Further, provision of incentives should be linked to the satisfaction by firms of performance requirements, i.e., incentives should be provided in exchange for performance, and support should be temporary and time-bound. In addition, FDI should be managed and targeted to areas which can contribute to meeting the development objectives of the host country.

Fourthly, regarding "non-price factors", the process of industrialization requires "COU-Ps-INs" (Shafaeddin, 2005.c and 2010.b). COU stands for:

Create capacity, Operate it efficiently and Upgrade the industrial structure. To do so incentives are necessary but not sufficient. There is a need for a number of INs and Ps. The INs include INvestment, INput, INfrastructure (not only transport and communication but also other facilities such as marketing channels, distribution network, etc.), INstitutions, INnovation and INformation (Streeten, 1987). We use "information" here in the wide sense of the term, which includes knowledge, science, R&D as well as market information which requires investment in human resources through education, skills development and training.

The Ps stand for Political stability, Predictability of policies, Participatory Politics, Pressure for Performance, Public-Private Partnership, respect for Property rights and, last but not least, Production capabilities of local firms in the value chain and Productivity. Here, we use "production capabilities" in a wider sense than supply capabilities; thus it includes also such factors as organizational issues, which also contribute to productivity, marketing, etc.

There are also two INs which are to be avoided. These are instability in exchange rates and inflation, which are largely related to agricultural development, control of capital flows and macroeconomic policies.

Development of food production and other wage goods is essential, particularly during the early stages of industrialization, in order to ease the pressure on the balance of payments and inflationary tendencies, thus contributing to the competitiveness of manufactured goods in the internal and international markets.

Of course, implementation of the trade policy framework outlined above is constrained by WTO rules. However, there is still some room to manoeuvre under the WTO rules, particularly for least developed countries. This is so, provided developing countries do not lose their remaining policy autonomy through bilateral and regional agreements (Rodrik, 2004; Di Maio, 2008; Amsden, 2000), including EPAs, and do not submit to conditionalities of IFIs and excessive liberalization proposals put forward by developed countries

in the Doha Round NAMA (non-agricultural market access) negotiations on trade in manufactured goods and in the EPAs (Shafaeddin, 2010.a). “What constrains sensible industrial policy is largely the willingness to adopt it, not the ability to do so” (Rodrik, ibid.: 32).

There is nevertheless a need for some changes in the WTO rules to make them development-friendly. For this purpose, as well as in the EPA, NAMA and other trade negotiations, developing countries should follow a bottom-up rather than a top-down approach. In other words, instead of agreeing with some issues in such negotiations without having been clear about their own trade and industrial policies (as was the case during the earlier Uruguay Round trade talks), they should be clear about their trade and industrial policies before going to the negotiating table (see Shafaeddin, 2005.c for details). The aftermath of the recent global economic crisis, which saw intensive intervention of developed countries in the market, provides a good opportunity for developing countries to bring up the limitations of market forces in the process of industrialization and development and argue in favour of different trade and industrial policies, and thus a different international trading system. Neither the WTO rules nor the theory of static comparative cost advantage is god-given.

Endnotes

1. This and the following chapter are based mainly on Shafaeddin (2005.a: 156-162).

2. This chapter is based mainly on Shafaeddin (2006.c and 2009).

3. See also various literature by the World Bank and IMF, particularly World Bank (1987 and 1993). For a brief survey see Shafaeddin (2006.a).

4. For a survey see Shafaeddin (2006.a).

5. It is interesting to note that in an unusual recent paper, a staff member of the IMF also has concluded that out of 71 "so-called" export-led growth episodes, 24 cases "are more likely to be characterized by 'growth driving exports'" (Yang, 2008: 1).

6. Based mainly on Gallagher and Shafaeddin (2010).

7. The total number of people engaged in this activity increased from 804,000 in 1996 to 1,152,617 in 2004, and the share of the business community in the number of personnel engaged increased from 46 per cent to 60 per cent over the same period (UNESCO, online database on R&D expenditure).

8. Based on UNCTAD, *Handbook of Statistics 2009*, Table 3.2.D.

9. Based on UNCTAD, ibid., Table 8.3.1.

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TRADE LIBERALIZATION, INDUSTRIALIZATION AND DEVELOPMENT: THE EXPERIENCE OF RECENT DECADES

In this paper, the author analyzes the experience of countries in trade liberalization in the light of the debate between neoliberals and neo-developmentalists. The latter regard selective and gradual trade liberalization as necessary at a certain level of development and industrialization. The former group advocates universal, across-the-board and rapid liberalization by developing countries, irrespective of the level of development and industrialization of the country concerned.

The historical evidence from the early industrialization period, the author finds, does not support the claims of the advocates of universal and across-the-board free trade. More recent experience from the last quarter-century also bears this out, with developing countries which had undertaken full-blown trade liberalization facing de-industrialization or becoming locked in low-value-added manufacturing based on natural resources and assembly operations.

The paper also specifically compares the recent performance of China and Mexico, two economies which share similarities but which have followed different approaches to trade liberalization and industrialization. Mexico has been following policies recommended by the neoliberals, while the Chinese government has pursued an experimental and developmentalist approach, implementing policies for building the capabilities of domestic firms while also gradually liberalizing international trade. Their contrasting experiences, it is argued, point to developing countries' need for a dynamic and flexible trade policy that not only eschews premature liberalization but also operates in tandem with a development-oriented industrial policy.

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