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## **The Rewards and Challenges of Export-Led Strategies**

By Hany H. MAKHLOUF<sup>†</sup>

**Abstract.** The economic achievements of post- WWII Japan and Germany, the success of the Asian Four Tigers in the 1970s and 1980s, and the impressive growth of China, after adopting an export-led strategy in 1978, have caused many nations to view the export-led model as the fastest route to economic growth and financial stability. As a result, many governments started to promote and protect their countries' exports, and mix politics, diplomacy and trade as well as seek greater access to friendly countries' markets. Export-led development strategies, however, carry some risks, such as increased dependence on foreign markets and political forces that are beyond the exporters' control. Global market forces, at times, cause export-dependent countries to have a sudden decline in their export revenues as the oil exporting countries have been experiencing as a result of a sharp decline in the world price of crude oil since 2014. This paper examines the main benefits, costs, and risks associated with export-led strategies, particularly as adopted by developing countries. It further explores the motives and risks faced by individual companies as they sell some of their products outside their home markets.

**Keywords.** Import substitution, Trade liberalization, Infant industries, Export promotion, Foreign investment, Export infrastructure.

**JEL.** F10, F16, F17, F41.

### **1. Introduction**

The impressive export-led growth of Japan and Germany after their economies were shattered in WWII; subsequently the export-led growth of the Asian Four Tigers (Taiwan, Hong Kong, S. Korea, and Singapore) in the 1970s and 1980s, and of China following its 1978 economic reforms, have caused other nations to view export promotion as the fastest path to economic growth and financial stability (Johnston, 2016). Some have become export dependent, partly due to their small domestic market demand for the goods and services they produce or can produce (The Economist, 2009, March 25, p. 1). Some scholars like Ronit & Divya (2014) wonder, however, whether a rise in exports leads to economic growth or economic growth leads to an increase in exports (p. 135). Yang (2008) observes that exports and GDP growth seem to accompany or feed each other, although in a study of 71 episodes he has found that "37 of them are consistent with the exports driven growth model, (and) most of the remaining .... are more likely to be characterized by (economic) growth driving exports" (p. 1).

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This paper further explores export-led strategies and their implications. It looks into the opportunities and costs created by such strategies. Furthermore, it compares the benefits and risks incurred by companies that adopt export-oriented strategies as a way to grow beyond the home markets.

### 2. Patterns of Exports and GDP Growth

Considering the question of which comes first -Exports growth or GNP growth-one can envision multiple scenarios. With productivity and entrepreneurial growth taken into account, at least six scenarios may be developed, as indicated below:

Productivity growth	→	GNP Growth	→	Exports Growth
Productivity Growth	→	Exports Growth	→	GNP Growth
GNP Growth	→	Exports Growth	→	Sustained Growth
Exports Growth	→	Productivity Growth	→	GNP Growth
Entrepreneurships	→	GNP Growth	→	Exports Growth
Entrepreneurships	→	Exports Growth	→	GNP Growth

### 3. Contributions of Exports to the Domestic Economy

Since Adam Smith, many scholars have advocated the removal of trade barriers so as to have an international division of labor in which case every nation would produce only what it can produce best, and trade to obtain whatever else their people need or want. International organizations like the World Trade Organization (WTO) were created to promote free and fair trade. Also the IMF and the World Bank advocate liberalization of foreign trade and foreign investment as a part of a package of reforms that may help in economic development and financial stability. The rest include fiscal reforms, reduction of government expenditures, tax reforms, realistic exchange rates that reflect market rates, privatization of state-owned enterprises, government regulations reforms, and protection of private property rights (Rodrik, 2006; Domenechetti & Fiorentini, n. d. ,p.973-987).

The benefits associated with exports that make export-led strategies appealing include:

1. Generating revenues that improve the country's balances of trade and payments.
2. Creating and sustaining jobs in export-active industries and sectors. For example, U.S. merchandize exports in 2013 (about 2.3 trillion) supported 11.3 million American jobs (U.S. International Trade Administration, 2014, May 13, p. 2).
3. Attaining economies of scale by expanding production capacity and output and maintaining efficiency so as to be competitive in both the domestic and foreign markets.
4. Acquiring and absorbing modern production technologies to achieve and maintain competitive advantage.
5. Raising product quality to meet international export standards.
6. Accelerating growth in export-related and export supportive sectors.
7. Accelerating GDP growth (Yelwa & Diyoike, 2013).
8. Increasing tax revenue.
9. Improving quality of life in communities that can benefit from improvements in the export infrastructure (e.g. roads, ports, etc.).
- 10.Reducing potential of some political disputes with trading partners, including border tensions (the world peace through world trade idea).

#### **4. The Shift from Import- Substitution to Export-Led Strategies**

Many developing countries tried in the 1960s and the 1970s to reduce their dependence on the importation of manufactured products from the industrialized countries by adopting import -substitution strategies (Zambakari, 2012). The marginal success of these strategies that were accompanied by the imposition of protectionist measures to support the new infant industries and reduce competition from imports, and the lessons learned from the Asian Tigers, have caused some of those countries to shift to export-led strategies as a part of their overall approach to economic development. As Palley (2002), points out, low competition due to import barriers, and subsidization of inefficient infant industries, resulted in unhealthy economic distortions that contributed to investment and production inefficiencies (p. 1). Palley (2002) further observes that “many developing countries that had (initially) prospered under regimes of import-substitution began to experience slower growth and accelerated inflation” (p. 1). Import-substitution, thus, started to be viewed as a cause of many developing countries’ economic stagnation, and steady decline in the inflow of foreign investment that could bring modern technology and new managerial know-how.

#### **5. The Role of Government in Export –Led Strategy Implementation**

Some governments engage directly in exporting through their state-owned enterprises, as is the case of China that has a large number of state-owned enterprises. Others provide an indirect support to exporters such as:

1. Developing the export facilitating infrastructure and services like roads, ports, security, reliable power and water supply, etc.
2. Simplifying export procedures
3. Extending credit to exporter
4. Training potential exporters
5. Strictly enforcing adherence to international quality standards
6. Engaging in export promotion activities like trade fairs
7. Simplifying international banking procedures
8. Setting realistic foreign exchange rates
9. Negotiating free trade agreements with trading partners
10. Allowing the import of needed raw materials
11. Helping exporters to attain and sustain their competitive advantage through support for their R&D and the lowering of taxation and fees
12. Encouraging the inflow of export promoting foreign investment.

#### **6. Determining Which Industries to Support**

Determining which industries and products to target for government support and export promotion is important for the success of export-led strategies. Support for any sector, however, should depend on its actual or potential export success within a reasonable period of time. Thus, the choice from alternative industries or sectors that are to qualify and receive export incentives and extra government services should be based on such criteria as:

1. actual or potential competitive advantage in targeted foreign markets,
2. production capacity and capability,
3. size of actual, or potential foreign market demand,
4. impact on the country’s fiscal health, and its balances of trade and payments,
5. Impact on the environment, and

6. Contribution to employment.

## 7. Conditions for Sustained Net Gains from Exports-Led Strategies

The following conditions are required for sustained gains from export-led growth strategies:

1. Fast absorption of modern technology in export-related sectors and education systems.
2. Gaining access to major foreign markets through trade agreements.
3. Having reliable and low-cost foreign sources of raw materials that are not available locally at internationally competitive prices.
4. Having skilled and well-trained labor force.
5. Reducing reliance on primary goods exports and the extractive industries through vertical integration, and diversification into manufacturing and other high-value production and service operations (UNDP, 2011, p. 34).
6. Improving the investment climate to encourage entrepreneurship and the inflow of exports-enhancement foreign direct investment.
7. Improving and expanding the export-facilitating services and infrastructure.
8. Providing training for beginners on the identification of export opportunities and the process and procedures of exporting.

## 8. Limitations of Export-Led Growth

The export-led model increased in popularity in the 1970s, as many developing countries have reconsidered the practicality and overall effectiveness of the import-substitution model (Johnston, 2016). In some cases, their small domestic markets made the import-substitution model impractical since they could not benefit from economies of scale, and avoided the efficiency enhancing foreign competition by hiding behind high tariff walls and other import barriers. Import-substitution may, thus, have perpetuated inefficiency in production and economic stagnation, particularly in small countries.

Palley (2002) criticizes the attempts by many countries to become net export gainers. He also indicates that the export-led model suffers from “a fallacy of composition whereby it assumes that all countries can grow by relying on demand growth in other countries” (p. 2). He further argues that not all nations can have trade surpluses and that exporters would eventually crowd each other out of major foreign markets since demand in those markets may not be growing fast enough to absorb all of the new supply from abroad. This is evidenced by the Four Tigers getting crowded out of the American, and some other markets, by China (p. 2). The premise behind Palley’s (2002) argument is that if all nations try to export similar products of equivalent value to the same markets, that particularly may have substantial foreign debt and are not growing by much like some EU members, there would be an inevitable crowding out effect. He clarifies his argument further, stating that if all countries try to maximize their exports to the same group of rich markets, there would be export displacement since “import growth from one country may be negatively impacted by import growth from a rival” (p. 8) Thus, what exporters do to protect their market share may be suppressing wages, financially squeezing suppliers, neglecting workplace conditions, and lowering safety regulations. The end result also could be an increase in income inequality as wages in the export sector would stagnate (Palley, 2011).

## 9. Risk of Economic Dependence

Export dependence frequently connotes dependence on markets in the largest and richest countries since those in low-income countries are usually less lucrative. Export dependent countries, therefore, end up becoming dependent on market developments in a small number of high per capita income countries. For example, as a result of the slowdown in some EU markets, due to fiscal and sovereign debt problems as already mentioned, Europe's imports from China slowed down, causing a chain effect because the export dependent Chinese economy began to face a significant slowdown. This, in turn, has caused a reduction of china's raw material imports from Africa and other exporters of primary goods. Thus, these economies, therefore, slowed down as well due to their large dependence on their exports to China.

Sustaining revenues from exports, accordingly, depends, in part, on the state of the economies of importing countries. It also depends on political and foreign policy considerations, as some importing nations may impose trade restrictions or sanctions due to foreign policy disputes or other reasons. A developing or a small country's economy that is export- dependent can be ruined if its major export markets are suddenly closed or sharply reduce their demand for imports.

## 10. Sustaining Competitive Advantage

Sustaining a competitive advantage, which is needed for protecting export markets, requires a determination and a culture that values innovation, cost efficiency, and steady increase in productivity. In a study about the German revitalization of its economy and export capability, for example, Dustmann et al. (2014) wonder how Germany has transformed itself from being labeled as "the sick man of Europe" in the 1990s to "an economic superstar in less than a decade", with its exports amounting to about half of its GDP (p. 118). They conclude that changing labor laws to contain costs and raise competitive advantage had a great deal to do with that. The change in labor relations in Germany led to a decline in union membership and a reduction of labor cost (p. 168). Dustmann et al. (2014) further report that "from the early 2000s onwards, median real wages started to fall" (p. 184), and along with that attempts to raise productivity and competitiveness have succeeded (p. 184).

## 11. Exports at the Individual Company Level

Individual businesses often regard exporting as a stage in their natural growth. If they start as domestically-oriented firms, they may eventually decide to grow horizontally by getting into one or more foreign markets. Keegan & Green (2005) indicate that the success of a company's entry into one or more markets, outside the home country, depends on a company's resources, its managerial mind-set, and the kind of opportunities, challenges, and risks encountered (p. 9).

Exporting may also be viewed as a way to attain higher returns on the investment and on expenditures on R&D, and reduce the risk of dependence on one market. The benefits from exports often justify the added risk, and occasionally the added cost of modifying the products to ensure their acceptance by foreign consumers. In addition, exporting helps companies retain their experienced labor force. As Thomas Donohue (2016), the CEO of the US Chamber of Commerce, estimates, "exports support approximately 6 million US factory jobs – roughly half of all manufacturing jobs" (p. A15).

## 12. Conclusion

In this age of globalization, many nations adopt trade and financial liberalization policies in order to attain greater integration in the world economy. Many of them also adopt export-led growth strategies due to disappointment with import-substitution as means to diversify their economies and accelerate their economic growth objectives. One of the export-led model's negatives is increased dependence on the state of the economies of trading partners. In the case of many developing countries also attaining and sustaining competitive advantage in a dynamic and highly competitive world market is a major challenge that is difficult to overcome. Thus, export-led strategies are not universally successful in attaining and sustaining economic stability and growth, particularly in smaller and developing countries.

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