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Foreign Trade

Determinants of Export Performance

by Professor Heiko Körner, Hamburg *

Comparative advantage, government incentives and entrepreneurial dynamics as determinants of a country's export performance are discussed in this article. The author's particular attention is focussed on the present situation and future perspectives of the less developed countries.

Promotion of a country's exports is not only a question of institutional devices and political incentives. The best set of export promotion policies obviously cannot succeed if we do not know anything about the range of products which a country can hope to export successfully and if there is no response or at least no adequate response on the side of the potential producers of these goods.

International trade in its contemporary development no doubt is a highly complex phenomenon. A good deal goes on in traditional, accustomed lines. Some countries — most but not exclusively the "peripheric countries" — provide the central industrial countries with raw materials, fuel and food stuffs.

The industrial countries in turn deliver investment goods and more or less sophisticated consumption goods to the "peripheric" countries. This section of world trade, in terms of the theory of foreign trade, can be described as following the traditional theorems of Ricardo and Heckscher-Ohlin: Countries are specializing in production lines where they possess absolute or comparative advantages related to natural production conditions or to the endowment with labour and capital. The trade developing between them has to be described as complementary in the sense that each country principally specializes in the production of goods different in nature from the goods which other countries can bring forth.

Increasing "Intra-Trade"

In the last decades there has developed, besides this old fashioned exchange between Ricardo's wine and cloth producing countries, a new type

of international trade, which has been gaining more and more weight. This is the so-called "intra-trade" of the industrial countries themselves, which can be described as being of a substitutive nature. For the development of technical progress in production the marketing of new, highly specialized goods and the growing sophistication of consumption habits and production necessities has led each of the high income countries to produce principally the same range of products, the only difference being the specification related to peculiar tastes or production necessities of the country of origin. Consequently identical goods are exchanged between the countries of the industrial centre, the only — but decisive — difference being the peculiar specification, for instance different brands of cigarettes.

The production of these substitutive goods is not so much dependent on a country's endowment with natural resources or with the quantities of simple labour and capital which are available. Fundamental for the ability to produce these modern goods is the supply of skilled manpower, a steady process of technological innovation and dynamic entrepreneurs apt to create new goods and new markets and to take part in a world wide process of competition described by Schumpeter ¹.

So the production of more sophisticated goods is not so much dependent on the quantity of simple factors of production but their quality: Skilled manpower, availability of adequate technology and entrepreneurial abilities are of crucial importance for the setting up of such industries as the manufacture of road vehicles, machinery as well as electrical and electronic products ². Because com-

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¹ H. Körner, *Dynamische Aspekte der außenwirtschaftlichen Stabilisierung* (Dynamic Aspects of External Stabilization Policy), Göttingen 1970.

² S. Hirsch, *Hypotheses regarding Trade between Developing and Industrialized Countries* (Unpublished paper read at the Kiel Conference of Verein für Socialpolitik / Institut für Weltwirtschaft, Kiel, July 1973).

petition is very strong, high quality standards must be maintained, the service to customers must be guaranteed. Therefore the installation of such industries not only poses the problem of combining factors to produce, but also the often difficult questions of marketing and product promotion.

On the one hand these characteristics of the production of sophisticated goods seem to be very attractive: Not only is the income elasticity of world demand for these goods in general high, so that there supposedly exist good markets for them in all industrialized and rapidly industrializing countries. But it would also be very attractive for many of the developing countries, that production — once begun — generates by itself via "learning by doing" the prerequisite attitudes and abilities.

On the other hand, there are serious obstacles to overcome, if such sophisticated "Schumpeter-goods" are to be produced: The high cost of technology transfer, the scarcity of skilled manpower, the small size of domestic markets measured by per capita income and population, and the problems connected with production according to international standards and tastes in a sometimes backward environment hamper the adoption of these promising goods.

More "Schumpeter-goods" in LDCs

Definitely LDCs do not better by producing exclusively simple goods. For the raw material based intermediate goods and consumption products like textiles, leather, metals and food are — for which we are witnesses now — easily exhaustible: natural resources cannot be renewed. Moreover, these resources are exposed to the competition of substitutes and to the working of Engel's Law, so that no country can rely on the fact that the range of simple goods which are produced and exported will survive in the long run, even if cheap labour is abundant.

Therefore, developing countries should try to become citizens in the modern world of Schumpeter. This does not mean that the traditional lines of production should be given up immediately and once for all. On the contrary: Out of these productions grow differentiated, new qualities of labour, of capital (the so-called human capital) and of technical and managerial knowledge.

Some of the more expanding developing countries have taken up the production of modern goods with considerable success³, even if this produc-

³ For instance Spain, Israel, Brazil, Colombia, Mexico, Hong Kong, Singapore, Taiwan and Greece are today prominent in manufacturing and exporting a wide range of industrial products, such as vehicles, machinery, chemicals, and optical products.

tion proves to be capital intensive. We should not worry about this, for the real developmental bottleneck is not the scarcity of physical capital, which is often used only inefficiently and which at least can be quickly imported, but the lack of human capital. Human capital can only be acquired by learning. Learning begins with the building up of the production of mature Schumpeter-goods, and it does not end with it, it widens and deepens the knowledge until a country has reached the capacity to compete in the creation of new goods with the old industrial countries.

Under such auspices Government and entrepreneurs of a country beginning to expand exports should embark on a twofold action: To consolidate the range of more or less simple export goods manufactured on the basis of domestically available raw material and of comparatively simple labour and capital by expanding into higher stages of production, at the same time refining the qualities of these goods, and accommodating them to the tastes of customers. Not only will the position in foreign markets be conserved by this. Also the domestic value added will be expanded by substituting manufactures ready for pretentious consumption or as industrial inputs for the more simple goods hitherto exported, which means a rising benefit for the exporting country.

In doing so the first step is also taken towards the development of the ability to produce and export more sophisticated goods. In this respect, entrepreneurs and Governments are confronted with problems of acquiring the relevant knowledge and abilities, mainly technical know how and marketing.

Tasks of the Entrepreneurs

Entrepreneurs which are actively competing in the markets of the industrial centre must be ready to meet the particular requirements of these markets. One of the most outstanding features of modern marketing strategies is product differentiation. This means that entrepreneurs create new products measured by the product's consumption utility or by its technical specification. Entrepreneurs do not incur this trouble of finding new goods or varieties of known goods without need: In most cases they react to the signs of the markets which in turn reflect new consumer's wants or new technical needs. But in producing new goods entrepreneurs at the same time actively create new markets or penetrate into markets of inferior competitors. And they have to defend their markets vis-à-vis the competition of imitators and can do this only, if they constantly seek to improve the quality of their products, to develop other varieties or to produce new goods.

So the most fundamental precondition of the modern entrepreneur's success is his ability to innovate in products and markets⁴. And this innovation does not extend to national economies alone: in most cases it is geared from its beginning also to the world market. International trade in Schumpeter-goods then arises to be an extension of domestic marketing.

This fact is a decisive one. For international trade in traditional unsophisticated goods (other than tropical raw materials) in most instances began on a vent-for-surplus basis: Entrepreneurs went across the border only when the domestic markets temporarily were too narrow. Out of this in some cases more or less stable foreign trade relations developed. But this does not have to happen necessarily. In such cases exporting remains a matter of chance and circumstances. In the case of modern goods, the opposite is the rule. From the beginning entrepreneurs define the world market as their relevant market. Consequently they are striving to fulfill the exigencies of this extended market, to develop marketing research, service and production in conformity to international standards.

For countries which try to engage in these activities difficult but not insurmountable tasks will arise. They have to acquire the relevant technologies, finance and know how in exporting marketing. Their production has to be cheap by using all possibilities of the country's peculiar factor endowment and all possibilities of internal and external economies and they have to improve the productivity of labour by inducing learning processes mainly with respect to the development of skilled manpower. Furthermore, the administration has to back all modern, dynamic activities by an adequate set of economic incentives⁵.

But there remains the question whether it is economical to do all at one's own cost and on the basis of one's own resources. There are examples for countries which heavily rely in this respect on the potential of the big multinational enterprises. These enterprises not only have the relevant know how ready at hand and are able to develop technologies and economic knowledge in large dimensions. They also know international markets like their own pockets and possess a wide range of products which have been successfully introduced on the world markets⁶. It is certain that these

companies have their problems, in particular arising when their own interests collide with those of the host country. But we can suppose that in many respects these interests are identical and that these companies become more and more identified with the national interest the more a powerful national economy develops.

Therefore, why not join efforts and invite more international companies to participate in the country's export drive? If some socio-political devices are installed in order to safeguard that these companies will not ruin the national entrepreneurs by their competitive power but will induce a healthy climate of progress and learning, there will be enough possibilities also for a little country with a limited range of physical and human resources to develop an ever expanding chain of modern, sophisticated exportables. Last not least the activities of the large international corporations will modernize the general economic climate of a country, induce the prevalence of modern habits of thinking and production, bring with it the development of an environment that is conducive to the constant process of innovation which *per se* is the precondition for participation in the modern Schumpeter-markets.

Governmental Export Promotion

We all know that we do not live in a world of economic *laissez faire*. And this is true not only with respect to official intervention into the internal economic affairs of a country to preserve stability and generate growth. But this is confirmed also, if we look at the foreign trade activities of a country: Even one of the more liberal industrial countries like the Federal Republic of Germany is known to have sustained the performance of its exports — and be it only with the help of deliberate but hidden structural subsidies.

Why should not Governments in a newly exporting country play their part in export promotion? Official export promotion covers a large set of devices and measures⁷: In the *first* place, one can see as a field of governmental action the wide range of official technical assistance for national exporters: Official or semi-official institutions serving to facilitate the transfer of relevant technologies and knowledge about foreign markets and their possibilities will do a lot to supply national exporters with all knowledge they must have to be able to compete successfully in foreign trade.

Secondly the Government should help national exporters in covering the overhead costs of export

⁴ H. Körner, Die unternehmerische Dynamik als Faktor der Welthandelsentwicklung (Entrepreneurial Dynamics as a Factor of World-wide Trade Expansion). In: WIRTSCHAFTSDIENST (Hamburg), Vol. 51 (1971).

⁵ A. Maddison, A. Stavrianopoulos, B. Higgins, Foreign Skills and Technical Assistance in Greek Development. Paris (OECD) 1966.

⁶ G. K. Helleiner, Manufactured Exports from Less Developed Countries and Multinational Firms. In: The Economic Journal, Vol. 83 (1973).

⁷ A. Hone, The Role of Foreign Trade in Manufactured Products and Fuels in the Economic Development of Developing Countries. In: UNIDO: Development of Industrial Exports. Papers presented at the Training Course organized by UNIDO and the UNCTAD / GATT International Trade Centre . . . Zagreb, 1968, New York 1970.

promotion which result mainly from advertising expenses, market development and market penetration costs, perhaps also from transport costs and expenses devoted to the acquisition of foreign know how. These subsidies should principally be open for all would-be exporters to avoid a premature discrimination. For in the first stages of an export drive it is difficult to see whether a particular entrepreneur will be successful or not.

The same is true in all official activities aiming to overcome the lack of credit financing and insurance coverage which often notoriously hamper would-be exporters. At this stage also all administrative procedures of complicated export documentation and the like should be streamlined so that no entrepreneur would be discouraged who feels the ability to embark in the field of international trade.

The most prominent area of Government intervention lies in a *third* field of instruments of the general economic policy, which aim at export promotion. In this respect Government activities normally develop along two lines. The first extends to all branches of general developmental policy securing the preconditions of successful participation in foreign trade. There are three very important points to stress in this connection:

☐ General economic policy should aim to secure general price stability and a good business climate.

☐ Structural policy has to promote industries with a high foreign trade potential. If we remember that successful penetration into the international Schumpeter-markets has as a precondition the development of modern skills and methods of production, then the most urgent requirements of industries at the official promotion schedule are specialization of production (and consequently co-operation with complementary industries), standardization of products and production processes and finally the weeding out of marginal producers and products.

☐ Manpower policy has to develop a large basis of technical, organizational and economic knowledge and abilities which are fundamental for the expansion of the productivity of labour and the accumulation of human capital.

Fiscal and Exchange Rate Policy

The other field of economic policy embraces all measures of special fiscal policy designed to export promotion, notably the granting of tax concessions and duty-free importation of capital goods (and perhaps of critical minimum inputs).

This is the stage of export promotion where the Government should actively discriminate between

successful and inefficient exporters. Only those entrepreneurs showing a stable and vigorous export expansion should benefit from the relevant measures. The rationale of this is that in many countries the indiscriminate proliferation of tax concessions and exemptions from import restrictions not only serve as an inducement for the development of socially unproductive lines of export trade and as a byproduct lead to windfall profits on the side of those producers who do not have to rely on these subsidies. Also the necessity to bring a minimum effectiveness into fiscal policy at least from time to time has led to the growth of a jungle of special regulations which at the end prove to be most cumbersome for the administration and its customers⁸. Moreover, we must not forget that fiscal export promotion can be a very costly thing. A recent analysis of the very successful export promotion by fiscal incentives in Colombia shows that the opportunity costs of the Colombian tax exemption system are considerable⁹. The direct costs of the system have been growing sharply along with the rapid growth of non-traditional exports. But to be sure, the heaviest burden for the budget has arisen from the indirect effects of import duties forgone. The authors of this analysis come to the conclusion that the last years the combined direct and indirect effects of the export promotion system have amounted, on the average, to about 10 p.c. of the Central Government's revenues and to about 30 p.c. of the current account surplus on a cash basis.

This proves to be a heavy burden for an industrializing country which means that the respective resources cannot be devoted to the pursuit of other objectives of social and economic development.

The question remains, if the exchange rate policy should not play a much more prominent part in official export promotion policy. But this advice cannot be pursued without due consideration of a country's special situation: Possibly, in a small country the internal price effects connected with a devaluation could turn out to be much more serious than the budgetary effects of fiscal action.

We must not forget that everything has its price to pay. This remains also true for export promotion. So we always have to ask not only for the comparative effectiveness of different sets of promotion systems but also for the economic justification of export promotion itself vis-à-vis other targets of national economic policy.

⁸ I. Little, T. Scitovsky, M. Scott, *Industry and Trade in Some Developing Countries. A Comparative Study*. Paris, London 1970, esp. chaps. 5 and 6.

⁹ J. D. Teigeiro, R. A. Elson, *The Export Promotion System and the Growth of Minor Exports in Colombia*. In: *Staff Papers*, Vol. 20 (1973).