

structures of production costs and prices. Barriers of the latter nature are, in turn, largely the result of the exaggerated pursuit of "import substitution" as a means of promoting industrial development.

COSTS OF EXCESSIVE IMPORT SUBSTITUTION

A developing country has some room for choice in orienting its new industries toward replacing imports rather than expanding exports. Initially, the emphasis is likely to be on the former course, since imports attest to a market already in being at home and susceptible of being reserved against foreign competition. Most and perhaps all developed countries have followed this course in the early stages of their growth and, indeed, still cling to protection even though with little basis any more for invoking the "infant industry" argument. Within limits, this course is consistent with the "overspill" view of exports, since, if the industries chosen for protection are well suited to a country's potentials, substitution for imports in its home market may set the stage for competition in export markets later on.

These limits, however, can be quickly exceeded. A less developed country's imports typically embrace a far greater variety of goods than its exports. The difference is all the more striking if one considers not merely final goods but also the materials, parts, and capital equipment entering into their production. Import substitution may therefore soon spread a country's resources too thin over numerous small and insufficient enterprises, and extend to types of production ill suited to its conditions, with the unfortunate result of raising costs even in industries in which it should otherwise be able to compete. A further consequence is to deny the economy the stimulus to efficiency and innovation which exposure to competition in domestic and foreign markets can provide.

In other words, "backward and forward linkages" with other industries may prove to be a burden rather than a blessing if the industries selected for promotion are not well suited to a country's capabilities and size. This may happen even in the largest of the less developed countries.

Considerable caution would therefore seem to be warranted with respect to the various internal and external economies which have frequently been invoked in favor of capital-intensive industries at early stages of economic development.

The frustrations of import substitution were the subject of an urgent warning by Raúl Prebisch in his advance message, as Secretary General, to the United Nations Conference on Trade and Development. Based largely on his close observation of the Latin American countries, he found that the "easy phase" of import substitution had about reached its limit in the countries which had followed that course, and that it could not go farther without considerable waste. He also found that high tariffs to protect narrow national markets had "encouraged the establishment of small uneconomical plants, weakened the incentive to introduce modern techniques, and slowed down the rise in productivity."

"Thus," Prebisch continued, "a real vicious circle has been created as regards exports of manufactured goods. These exports encounter great difficulties because internal costs are high, and internal costs are high