

Chapter 10

Trade policies in developing countries

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(Chapter 11 of the textbook)

Dr. Vu Thanh Huong
Faculty of International Business and Economics, UEB - VNU

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+ Introduction

10-2

- Which countries are “developing countries”?
- The term “developing countries” does not have a precise definition, but it is a name given to many low and middle income countries.

+ Preview

10-3

Import substituting industrialization

Trade liberalization since 1985

Export oriented industrialization

+ Import Substituting Industrialization

10-4

- From World War II until the 1970s, many developing countries adopted Import Substituting Industrialization (ISI).
- The policy aimed to accelerate their development by limiting imports of manufactured goods, in order to foster a manufacturing sector serving the domestic market.

+ Infant Industry Argument

10-5

The principal justification of this policy was/is the *infant industry argument*:

The developing countries have a potential comparative advantage in some manufacturing industries (infant industries), but these industries can not initially compete with well-established industries in developed countries.

To allow these manufacturing industries to establish themselves, governments should temporarily support new industries until they have grown strong enough to compete internationally.

+ Infant industry argument (cont.)

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The principal justification of this policy was/is the *infant industry argument*:

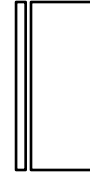
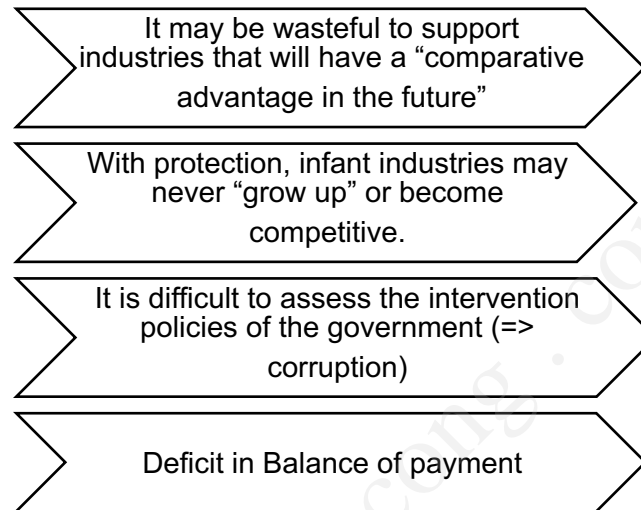
Developing countries should use tariffs or import quota as temporary measures to get industrialization started.

Historically, some of the world's largest market economies began their industrialization behind trade barriers:

- US had high tariff on manufacturing in the 19th century
- Japan had extensive import controls until 1970s.

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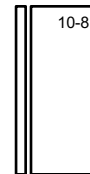
Problems With the Infant Industry Argument



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Import Substituting Industrialization in practice

- Latin American countries (Brazil, Chile, Mexico, Argentina...) in the 1950s and 1960s.
- After WW 2, some Latin American got political dependence. ISI was an appropriate policy to help them to achieve multiple objectives
 - Economic Dependence
 - Promote economic growth and development
Some Asian countries in 1960s, 1970s
- As a strategy to encourage manufacturing industries, import substituting industrialization



+ ISI - What policies

- Encourage domestic production for substitution of imports
- Use import-restricted policies
 - High tariff rates
 - Import quotas
 - NTB
- Controlled monetary policy (maintain high value of the domestic currency for importing high-tech machines and instruments)

10-9

+ Table 11-2: Effective Protection of Manufacturing in Some Developing Countries (percent)

Mexico (1960)	26
Philippines (1965)	61
Brazil (1966)	113
Chile (1961)	182
Pakistan (1963)	271

Source: Bela Balassa, *The Structure of Protection in Developing Countries*, 82. (Baltimore: Johns Hopkins Press, 1971).

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+ ISI – Results

ISI promoted economic growth?

Slower
economic
growth rates

Infant
industries did
not gain
comparative
advantages

Debt crisis in
1982

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+ Preview

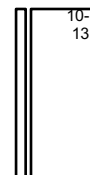
Import substituting industrialization

Trade liberalization since 1985

Export oriented industrialization

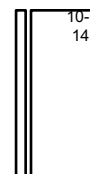
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+ Changes in viewpoints



- Problems of ISI
- Changes in viewpoints of economists and international organizations (WB, IMF...)
- Advantages of free trade:
 - There is some evidence that low and middle income countries which had relatively free trade had higher average economic growth than those that followed import substituting industrialization.
 - But this claim is a matter of debate.
- By the mid-1980s many governments had lost faith in import substituting industrialization and began to liberalize trade.

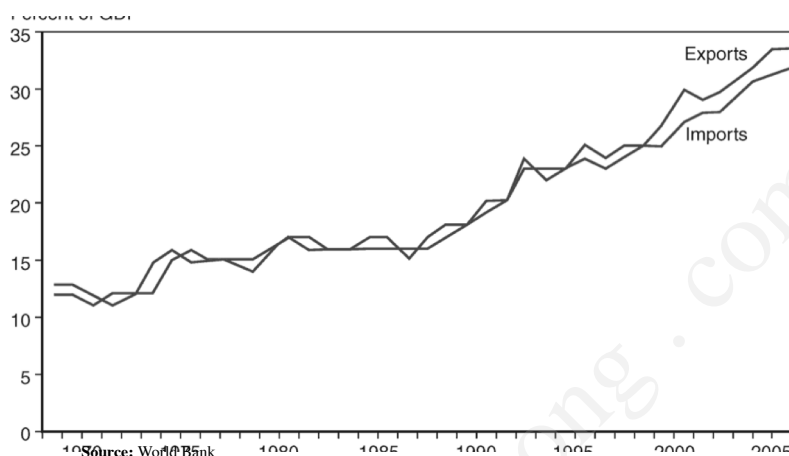
+ Table 11-3: Effective Rates of Protection for Manufacturing in India and Brazil



	India	Brazil
Late 1980s	126	77
Late 1990s	40	19

Sources: Marcelo de Paiva Abreu, "Trade Liberalization and the Political Economy of Brazil Since 1987," Working Paper, Inter-American Development Bank, 2004; Dani Rodrik and Arvind Subramian, "From 'Hindu Growth' to Productivity Surge: The Mystery of the Indian Growth Transition," International Monetary Fund Working Paper, 2002.

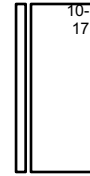
+ Fig. 11-1: The Growth of Developing-Country Trade



+ Trade Liberalization - results

- Has trade liberalization promoted development?
 - The evidence is mixed.
 - Growth rates in Brazil and other Latin American countries have been slower since trade liberalization than they were during import substituting industrialization
 - But unstable macroeconomic policies and financial crises contributed to slower growth since the 1980s.
 - Some economists also argue that trade liberalization has contributed to income inequality, as the Heckscher-Ohlin model predicts.
 - Other countries like India have grown rapidly since liberalizing trade in the 1980s, but it is unclear to what degree liberalized trade contributed to growth.

+ Preview

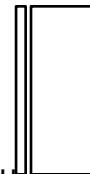


Import substituting industrialization

Trade liberalization since 1985

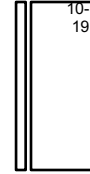
Export oriented industrialization

+ *EOI - what policies?*



- Chiến lược công nghiệp hoá hướng vào xuất khẩu
- Promote exports
- Attract foreign investment (ODA, FDI and other investment) to serve export orientation.
- Economic zones, export processing zones, free trade areas.

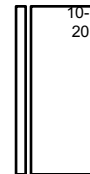
+ Table 11-4: Average Rates of Protection, 1985 (percent)



High performance Asian economies	24
Other Asia	42
South America	46
Sub-Saharan Africa	34

Source: World Bank. *The East Asian Miracle: Economic Growth and Public Policy* (Oxford: Oxford University Press, 1993), p. 300.

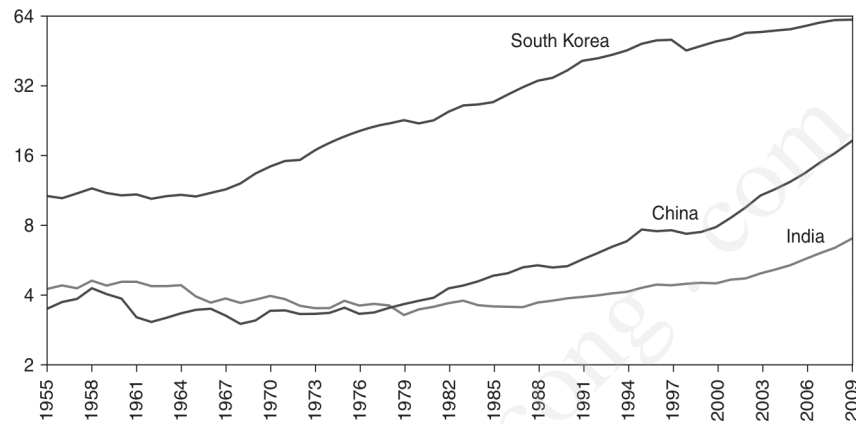
+ Export Oriented Industrialization by high performance Asian economies



- Instead of ISI, several countries in East Asia adopted trade policies that promoted exports in targeted industries.
 - Japan, Hong Kong, Taiwan, South Korea, Singapore, Malaysia, Thailand, Indonesia, and China are countries that have experienced rapid growth in various export sectors and rapid economic growth in general.
 - These economies or a subset of them are sometimes called “high performance Asian economies.”
 - The Asian takeoff

+ The Asian takeoff

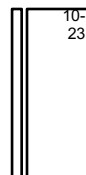
GDP per capita as % of U.S. level



+ Export Oriented Industrialization by high performance Asian economies (cont.)

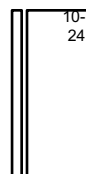
- The questions raised is why the Asian countries have high economic performance?
- EOI => These high performance Asian economies have generated a high volume of exports and imports relative to total production - "open economies." => results to high economic growth.
- 2 debatable issues

+ Export Oriented Industrialization by high performance Asian economies (cont.)



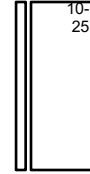
- 1st debatable issue: it is debatable to what degree these economies established “free trade.”
 - Although evidence suggests that these economies did have less restricted trade than other low and middle income countries, **some trade restrictions were sometimes still in effect.**
- 2nd debatable issue: It is also unclear if the high volume of exports and imports *caused* rapid economic growth.
 - Some economists argue that the cause of rapid economic growth was **high saving and investment rates**, leading to both rapid economic growth in general and rapid economic growth in export sectors.
 - In addition, almost all of the high performance Asian economies have **experienced rapid growth in education**, leading to high literacy and numeracy rates important for a productive labor force.

+ Industrial Policies in East Asia



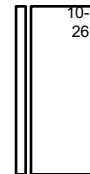
- The other reasons for high performance in Asian countries is industrial policies.
- Some East Asian economies have implemented **industrial policies**: policies intended to promote certain industries.
 - Examples of industrial policies include not only tariffs, import restrictions, and export subsidies for import-competing industries and export industries,
 - but also policies like subsidized loans for industries and subsidized research and development.

+ Industrial Policies in East Asia (cont.)



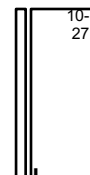
- But it is unclear to what degree this policy contributed to or hindered overall economic growth (Cont.)
 - Not all high performance Asian economies implemented these policies, and the ones that did had a wide variety of policies.
 - There is little evidence that countries with industrial policies had more rapid growth in the targeted industries than those that did not.
 - There is some evidence that industrial policies failed: chemicals, steel, automobiles were promoted by the South Korean government in the 1970s,
 - but the policies were later abandoned because they were too expensive and did not produce desired growth.

+ Summary



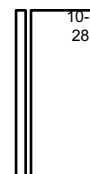
1. Import substituting industrialization (ISI) aimed to promote economic growth by restricting imports that competed with domestic products in low and middle income countries.
2. The infant industry argument says that new industries (ex., in poor countries) need temporary trade protection for growing up in the future
 - Problems of infant industry arguments

+ Summary (cont.)



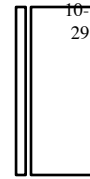
3. Import substituting industrialization was tried in the 1950s and 1960s but by the mid-1980s it was abandoned for trade liberalization.
4. The precise effect of liberalized trade on national welfare is still being debated.
 - Trade helped growth in some sectors, but saying that trade *caused* higher overall economic growth has attracted some skepticism.
 - Some argue that trade has caused increased income inequality.

+ Summary (cont.)



5. Export Oriented Industrialization (EOI): promotes exports, reduce trade restriction
6. Several East Asian economies adopted EOI instead of ISI.
 - High export and import volumes and relatively low trade restrictions were characteristics of this policy.
 - High economic performance
 - But it is unclear to what degree this policy contributed to overall economic growth (2 debatable issues)
7. Some East Asian economies used more general industrial policies as well.
 - High economic performance
 - But it is unclear to what degree this policy contributed to or hindered overall economic growth (3 debatable issues).

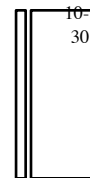
+ Critical thinking



- Two-side effects of import substitution policies
- Two side effects of export oriented policies

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THE END

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