

# The Trade Policy Debate

## Two Broad Categories

Outward – Looking Development Policies	Inward – Looking Development Policies
Encourage free trade	Encourage self reliance and restrict trade
( free trade)      debat	(Protectionism)
(export promotion)      debat	(Import substitution)

**Export promotion and Import substitution as the best strategy for Industrialization strategies.**

### 1) Primary product exports (primary outward exports)

- encouraging of agriculture and raw material exports:

Five demand factors work against this strategy:

- 1, 2) low income and price elasticity of demand.
- 3) Slow population growth in developed countries.
- 4) Development of synthetic substitution.
- 5) Agriculture protection.

### 2) The export of manufacture goods (for Asian targets)

- rising protection as a barrier against these products.

- The need for south – south trade.

### **Import substitution strategy**

a) Simple consumer goods, which are imported and replace it with domestic production.

b) The second stage involves expanding domestic production to more sophisticated manufactured items, which has linkages to consumer goods.

- A built in demand for the product exists.
- The infant industry argument.
- The role of backward and forward linkage.
- The use of tariffs and Quotas.
- The appropriate exchange rate policy.

(Overvalued exchange rate): why this policy?

- to reduce the cost of imported intermediate and capital goods for

Import substitution industries.

- it could hurt export industries.
- encourage capital intensive production.

### **IS strategy include:**

- Making some imports cheap (price of imported capital goods is artificially lowered )
- while prohibiting others (manufactured goods)

This will encourage capital-intensive production method.

### **\* The reasons for the failure of Import substitution strategy**

- ◆ Limited by domestic market
- ◆ Scale economics may result in monopoly power.
- ◆ Infant industry never grow up.
- ◆ Migration and neglect of the rural sector.
- ◆ fail to improve productivity.

### **\*Export promotion of manufactured goods**

- Response to the failure of Import substitution.
- involves targeting sectors with comparative advantage in world trade to realize economics of scale.
- Trade liberalization considered Export promotion policy because it reduces incentives to produce for home over foreign markets

( south Korea combined IS & EP)

- EP is market based

It forced industries to join on the world market

- It absorbs more labor force.
- earn more foreign exchange.
- Attractive FDI
- prevent bottlenecks in agriculture sector.

Summary  
Trade policy debates  
Export promotion (EP) VS Import substitution (IS)

**Trade  
strategies for development**

\* EP versus IS.

\* Outward – Looking **VS** Inward – Looking

EP = encourage free trade + movement of capital  
( free trade or trade optimistic)

IS = stress the need for embrace special style of development.

\* encourage indigenous manufacture (learning by doing).

\* leads to self reliance & restrict trade

IS: predominate in 1950s and 1960s

EP: gaining the upper hand in 1970s

**by**  
**R&D**

## Import substitution

- 1) LDCs should substitute domestic production of imported simple consumer goods (1<sup>st</sup> stage).
- 2) Substitute domestic production for more sophisticated manufactured industries
- 3) Apply in their policies under (behind) the protection of high tariffs and Quotas.
- 4) In the long run, it will cite dual objectives:
  - a) Greater domestic diversification.
  - b) increase export growth as economics of scale.