NBER WORKING PAPER SERIES

TRADE POLICY AS AN INPUT TO DEVELOPMENT

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Working Paper No. 466

NATIONAL BUREAU OF ECONOMIC RESEARCH
1050 Massachusetts Avenue
Cambridge MA 02138

April 1980

I am indebted to James M. Henderson for helpful suggestions on a first draft of this paper. The research underlying the paper was supported in part by the National Science Foundation, under grant no. NSF/SOC 77-25776. This research reported here is part of the NBER's research program in International Studies. Any opinions expressed are those of the authors and not those of the National Bureau of Economic Research.

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ABSTRACT

This paper examines the relationship between a developing country's policies with respect to its trade and payments regime and its rate of economic growth. Developing countries have generally adopted either an inward-looking set of policies, restricting imports and encouraging the growth of domestic import-substitution industries, or they have adopted vigorous export-promotion policies. The latter have been far more conducive to rapid economic growth. Several alternative hypotheses for why there should be such large differences are examined.

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TRADE POLICY AS AN INPUT TO DEVELOPMENT

My topic is the question: what difference does the set of commercial policies chosen by a developing country make to its rate of economic growth? Space limitations preclude anything more than a brief consideration of the salient points, which are, I think, three. First, in its present state, trade theory provides little guidance as to the role of trade policy and trade strategy in growth. Second, the empirical evidence overwhelmingly indicates that there are important links between them. Third, a number of hypotheses as to the reasons for these links have been put forward, but there is not as yet sufficient evidence to enable us to estimate their relative importance.

Turning first to theory, there are many static propositions but few useful theorems about the effects of alternative trade policies on growth. Clearly, there are gains to be achieved through trade in the development process. Even the trade-and-growth models along Corden-Johnson lines are based upon differential rates of change in capital-labor ratios in two-country, two-commodity worlds under assumptions of free trade. They provide little indication of quantitative importance of trade as a contributor to growth, and still less insight into the probable orders of magnitude of the losses in attainable growth rates that may be incurred with departures from free trade.

To be sure, once the assumption that there are only two goods is abandoned, theory suggests that activity in production of tradables should be undertaken to the point where the international marginal rate of transformation (IMRT) equals the domestic marginal rate of transformation (DMRT), with no production in lines where domestic opportunity cost exceeds the international price ratio. An allocation of resources satisfying this criterion would be optimal in the absence of any dynamic considerations.

Theory does not, however, indicate how many activities are likely to be undertaken. Nor does it suggest the relative importance of exporting and import-

section have been pooled, so that deviations of countries' growth rates from their trends have been estimated as a function of the growth of export earnings (Krueger, p. 271ff). In all of these specifications, rate of growth of exports has turned out to be a highly significant variable. While the "success stories" of Korea, Taiwan, and Brazil are well known, there are enough other observations, both for different time periods in the same country (as for example Turkey and the Philippines) and of countries (including on the positive side Ivory Coast, Colombia and Malaysia and on the negative side India, Argentina and Egypt), so that there is little doubt about the link between export performance and growth rates.

Moreover, it seems clear that export performance is a function, in large part, of governmental policies. While an export promotion strategy will not always be successful in generating more export growth (especially if policies affecting the domestic market are inappropriate), certainly policies adopted to encourage import substitution, especially when they include overvalued exchange rates and quantitative restrictions upon imports, retard the growth of exports. Moreover, in instances where exports have fortuitously risen (as for example through favorable terms of trade changes as in Chile in the mid 1960s) or where other sources of foreign exchange such as foreign aid (as in Egypt) have grown, economic performance has not matched that attained when exports have grown rapidly.

The central question, then, is why such a difference in growth performance should be associated with export promotion contrasted with import substitution. There are three major hypotheses, and each undoubtedly contains some explanatory power. Their relative importance probably varies from country to country and, of course, they are not entirely independent. Elaboration of these hypothesis provides an indication of the many ways in which the choice of trade strategy and its implementation can significantly affect the rate of economic growth. In

ologopolistic or monopolistic market structure. As import substitution proceeds, new activities are increasingly capital-intensive and inefficiencies from below-minimum-efficient size increase. On the positive side, so the argument runs, export promotion permits entrepreneurs to base their plans on whatever size plant seems appropriate: size of domestic market is no longer a virtually binding constraint (as it is when activity is profitable only because of very high rates of effective protection). Moreover, monopoly positions arise less frequently under export promotion, as exporters face competition from abroad as well as from other domestic producers.

Export promotion may also be more efficient in permitting rapid expansion of profitable activities. By contrast, under import substitution, most activities are constrained to expanding at approximately the same rate: inefficient firms and sectors expand approximately as rapidly as efficient ones. In this view, potential export lines consist of a number of industrial products - girls' sneakers, wigs, tennis rackets, engine parts, plywood, and so on - and it is as much a matter of the right entrepreneur, and the right specialized product, as choosing the "right industry" that is necessary for rapid growth. To be sure, factor proportions and comparative advantage may result in greater profitability of relatively labor-using industries, but the basic notion is that there are thousands of industrial products, and that, among relatively labor-intensive activities, the ones which will develop into exports will be those in which there are firms with good management and an ability to utilize factors of production efficiently.

A final aspect of the technology-related view of the advantages of export promotion has to do directly with factor proportions. Given the vast disparity in capital-labor ratios of the industrial sectors of the developed and developing countries, the opportunity for trade represents a means for shifting the demand for labor outward more rapidly than the import-substitution strategy permits.

techniques of allocating import licenses were employed which prevented competition among domestic firms and rewarded entrepreneurs for license-getting abilities rather than their cost-minimizing performance; and excessive and detailed quantitative controls were employed over many aspects of economic activity. One of the costs was the failure of export earnings to grow as much as they would have under "better" import-substitution policies; that, in turn, led to "stop-go" patterns with their attendant costs. Simultaneously, the emerging "foreign exchange bottleneck" had both direct and indirect impacts upon the structure and growth of the economy. In particular, efforts at import-substitution stopped being geared toward development of economic new industries, and became focused upon "foreign-exchange saving", often in highly irrational and indiscriminate ways, which further distorted the system.

The third view denies the need for any bias toward exports and implicitly or explicitly asserts that growth would be optimal in the absence of intervention. A bias toward exports is therefore better than one toward import-substitutes only because policies are less distortive. In this view, an export-oriented strategy imposes constraints on policy makers, both in what they can attempt to do, and in making them aware of the costs of mistakes. Policy makers receive feedback in a relatively short time-period as to the costs of their policies. Simultaneously, it is infeasible to rely upon quantitative controls: the international price, at least, cannot be administered and to that extent, more generalized forms of incentive, including a relatively realistic exchange rate, must be employed. Indeed, it is argued that incentives cannot be as biased toward export promotion as they can be toward import-substitution. This is precisely because to do so would require either export subsidization (whose costs would be immediately evident through the drain on the budget) or such a degree of currency undervaluation that a current account surplus would absorb much of the country's savings potential.

contrasted with size of markets in LDCs, and also about the determinants of politicians' and bureaucrats' behavior. Moreover, it is certain that the primary sources of growth are internal, and that there is no magic formula, or single policy change, that can by itself account meaningfully for differences in economic performance.

Nonetheless, experience has clearly demonstrated the importance of access to international markets in providing a means of permitting more rapid growth than would otherwise be feasible. Given the enormous difficulties and costs of achieving the institutional and other changes that economic growth requires, it is probable that trade policy changes have a higher rate of return to LDCs than most other policy switches that are feasible. It is, of course, to be hoped that protectionist pressures in the developed countries do not result in fewer opportunities for the LDCs. Even if they do, such measures will lower the rate of return to moving toward more outward oriented trade strategies, but for the foreseeable future, will still leave it distinctly above that resulting from persisting with inner-oriented growth.

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