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May 7th 2009

From The Economist print edition

Imports can be as useful to developing countries as exports are

Illustration by Jac Depczyk



PAUL KRUGMAN, who won last year's Nobel prize in economics for his work on trade, wrote in 1993: "What a country really gains from trade is the ability to import things it wants. Exports are not an objective in and of themselves; the need to export is a burden that a country must bear because its import suppliers are crass enough to demand payment."

This view does not dominate the public debate. Most are thrilled by the idea of export growth, but cower at the prospect of more imports. Such prejudice certainly prevailed in India in 1991, when the IMF foisted tariff cuts on the economy as one of the conditions attached to a \$2.5 billion bail-out package. Pessimists fretted that a flood of imports would destroy Indian industry.

For a group of American economists*, however, that sudden trade liberalisation has provided an unusually clear lens through which to study the way that commerce affects the economy. This is precisely because it was externally imposed. That the government had to hew to the IMF's diktats and slash tariffs across the board gave industries little scope to jockey for exemptions. This made the researchers confident that tariff cuts, and not differences in industries' ability to lobby the government, were responsible for changes in India's trade patterns after liberalisation.

As part of those reforms, India slashed tariffs on imports from an average of 90% in 1991 to 30% in 1997. Not surprisingly, imports doubled in value over this period. But the effects on Indian manufacturing were not what the prophets of doom had predicted: output grew by over 50% in that time. And by looking carefully at

what was imported and what it was used to make, the researchers found that cheaper and more accessible imports gave a big boost to India's domestic industrial growth in the 1990s.

This was because the tariff cuts meant more than Indian consumers being able to satisfy their cravings for imported chocolate (though they did that, too). It gave Indian manufacturers access to a variety of intermediate and capital goods which had earlier been too expensive. The rise in imports of intermediate goods was much higher, at 227%, than the 90% growth in consumer-goods imports in the 13 years to 2000.

Theory suggests several ways in which greater access to imports can improve domestic manufacturing. First, cheaper imports may allow firms to produce existing goods using the same inputs as before, but at a lower cost. They could also open up new ways of producing existing goods, and even allow entirely new goods to be made. All this seemed to hold in India. For example, its prolific film industry had continued to make some black-and-white films into the 1970s, in part because of the difficulty of importing enough supplies of colour film. But proving whether the theory applies in practice requires more detailed data, not just about how much firms produced but what they produced, and how all this changed over time.

Most attempts at addressing these questions have foundered because such information is not available. But with India, the researchers were helped, perversely enough, by highly restrictive industrial policies that the country had introduced in the 1950s. These included rules that required companies to report to the authorities every little tweak to their product mix—a burden for firms, but a gold mine for researchers. Happily, the economists found that the data backed up the theory: lower import tariffs did lead to an expansion in product variety through access to new inputs. They found that about 66% of the growth in India's imports of intermediate goods after liberalisation came from goods the country had simply not bought when its trade regime was more restrictive. These new inputs caused the price of intermediate goods to fall by 4.7% per year after 1989. And detailed data linking inputs to final goods showed that the imports led to an explosion in the variety of products made by Indian manufacturers; the average firm made 1.4 products before liberalisation, but by 2003, this had increased to 2.3. The increases in variety were largest for industries where the input tariffs were cut most, and these industries also saw increased spending on research and development. Overall, the new products that Indian companies introduced were responsible for 25% of the growth in the country's manufacturing output between 1991 and 1997.

Slash and churn

But one aspect of India's experience after trade liberalisation did not conform to what the researchers had expected. Normally, as new products are introduced, some older ones stop being made. This "churn" in the market is part of what makes people uncomfortable about lower trade barriers, because it may cause difficult adjustments for some workers or companies. But the Indian variant of creative destruction seemed unusually benign. The researchers found that firms rarely dropped products. One reason for this may be the diversity of India's economy: there is always a segment lower down the economic pecking order which is happy to buy products that richer consumers scoff at.

This may be unique to countries like India where many levels of development co-exist. But Penny Goldberg, one of the authors, thinks that the methods used in the studies on India can be applied to many other countries where trade has been similarly liberalised and which have good data on firms, such as Colombia and Indonesia. She notes that one of her co-authors, Amit Khandelwal, visited a Coca-Cola bottling plant in China, and noticed that all the machinery was either Japanese or German. China, of course, is known as a big exporter. But it may never have achieved this success without access to a range of imports.

* "Multi-product firms and Product Turnover in the Developing World: Evidence from India", by Penny Goldberg, Amit Khandelwal, Nina Pavcnik and Petia Topalova. (Forthcoming in the Review of Economics and Statistics.) Other papers available at <http://www.princeton.edu/~pennykg/>