

# International Political Economy (SOCS-SHU 222)

TRADE AND DEVELOPMENT I:

IMPORT SUBSTITUTION INDUSTRIALIZATION

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# IKA Torino

**“Argentina’s National Car”**





# Trade and Development I:

# Import Substitution Industrialization

READING ASSIGNMENT:

Oatley Chapter 6

## **Part 1:**

# **Interests & Institutions explanation for ISI**

# Interests & Coalitions

- Up through WWI, developing countries had liberal trade policies
- By late 1950s, developing countries turn protectionist
- 2 questions:
  - *Who were the winners from globalization?*
  - *Did they have political power?*
- Trade politics in developing countries dominated by urban-rural cleavage

# Things Began to Change...

- **Latin America:**
  - Government rationing of goods and primary commodities in the United States and Europe
  - Falling commodity prices
- **India:** The global economic collapse of the 1930s forced India to become increasingly self-reliance.
- **Pacific Asia:** Decolonization (imperial Japan) & land reforms.
- **Africa:** Decolonization, independence

Who wins & Who loses?

Generally, developing countries are abundantly endowed with **land** and poorly endowed with **capital**...

Agriculture is the \_\_\_\_\_-\_\_\_\_\_ sector  
EXPORT ORIENTED SECTOR

Manufacturing is the \_\_\_\_\_-\_\_\_\_\_ sector  
IMPORT-COMPETING SECTOR

So, land-owners should be \_\_\_\_-free-trade  
PRO-

Owners of capital should be \_\_\_\_-free-trade  
ANTI-

# Let's Go Back to the Factor Model

Rogowski, Ronald. 1987. Political Cleavages and Changing Exposure to Trade. *American Political Science Review* 81 (4):1121-1137.  
(suggested reading, Class 5)

3 factors: land-labor-capital

- Considers the land-labor ratio
- High land-labor ratio → land-abundant, labor-scarce
- Low land-labor ratio → labor-abundant, land-scarce
- Define “advanced” economies as capital-abundant



Figure 1. Four Main Types of Factor Endowments

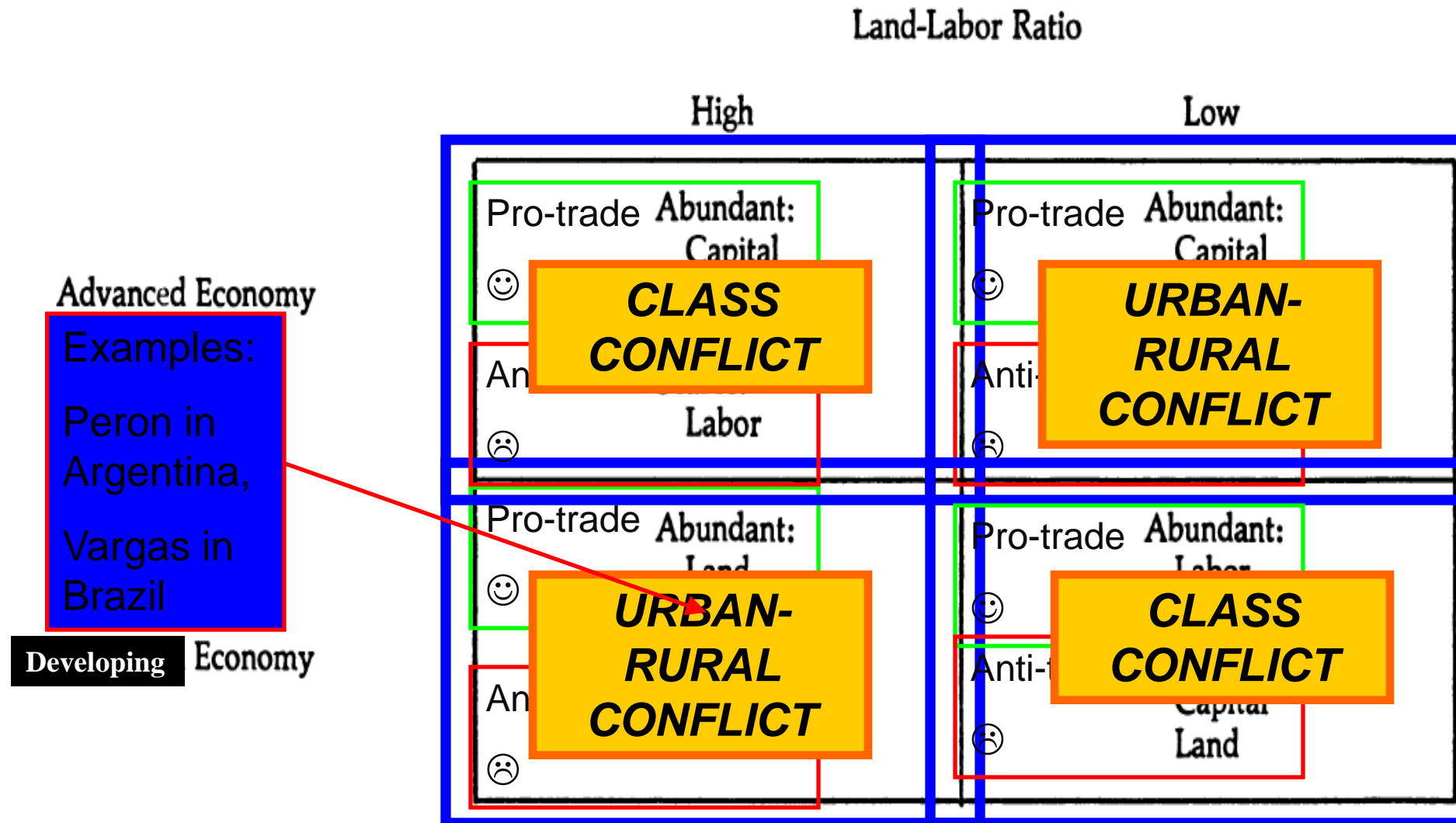


Figure 3. Predicted Effects of Declining Exposure to Trade

		Land-Labor Ratio	
		High	Low
Advanced Economy		Class cleavage: Labor gains power. Land and capital lose. (U.S. New Deal)	Urban-rural cleavage: Land gains power. Labor and capital lose. (Western European Fascism)
Developing Economy		Urban-rural cleavage: Labor and capital gain power. Land loses. (South American Populism)	Class cleavage: Land and capital gain power. Labor loses. (Asian & Eastern European Fascism)

## **Part 2:**

# **Intellectual justification for ISI**

# Structuralism

- What do states want? → Economic Development
- How to achieve that? → Manufacturing & Industrialization
- What does **structuralism** argue:
- The shift of resources from ***agriculture*** to ***manufacturing*** would not occur unless the state adopted appropriate **industrial policy**

# International Anti-Trade Stance

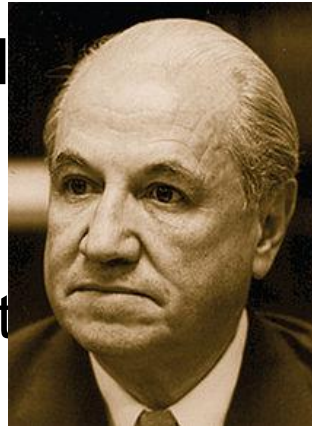
- Haberler Report:

- Von Haberler – Harvard economist (Austrian origin)
- Reports a decline in the “terms of trade” for primary producers
- From 1955: commodity prices fell by 5%, industrial prices rose by 6%



- 1964 North Atlantic Conference on Trade and Development (I

- (V...er...an that there was a systematic long-term (secular) ...de. He left Harvard in 1971 for American Enterprise



- ➔ Singer–Prebisch Theory (Intellectual justification for ISI):

- Participation in GATT will make it harder for developing countries to industrialize

# Terms of Trade

- Relates the price of a country's exports to the price of its imports
- “Improvement” in the terms of trade:
  - Price of exports is rising relative to the price of imports
- “Decline” in the terms of trade:
  - Price of exports is declining relative to the price of imports



# Summarizing:

## Why did governments adopt ISI?

### 1. *Interests*

- Losers from globalization gain power during the Great Depression
- (Globalization dries up, so the “winners” lose substantial income)

### 2. *Ideas*

- Some economists (legitimized by the United Nations) argued against free trade

# **Part 3: What is ISI?**

# Import Substitution Industrialization

- Industrialize by substituting domestically produced goods for manufactured items previously imported
- Typically called “ISI”
- 2 stages:
  - “Easy” ISI
  - Secondary ISI

# Easy ISI

- Develop domestic manufacturing of simple consumer goods
- Soda, beer, apparel, shoes, furniture

*What do you mean by “easy”? Easy how? How is it easy?*

- Large domestic demand preexisting
- Requires “Low-Tech” machines
- Requires “low-skilled” labor

# Asia & Latin America

- Both practiced “easy” ISI
- But then Asian countries switched to an EXPORT-ORIENTED STRATEGY:
  - Producing manufactured goods that can be sold in international markets
  - EXPORT rather than produce exclusively for the domestic market
- Latin America moved to “SECONDARY ISI”...

# Secondary ISI

- Production of consumer durable goods, intermediate inputs, and the capital goods needed to produce consumer durables
- E.g., automobiles (Argentina, Brazil, Chile)
- Begin by importing auto pieces and assembling them domestically
- Gradually, increase the % of locally produced parts



# Government Policies to Promote ISI

- Investment in activities the private sector would not produce:
  - Roads, transportation networks, electricity, telecommunications
  - Large-scale operations – steel plants, auto plants
- State-owned Enterprises (& mixed-owned)
  - Chemical, telecommunications, electricity, railways, metal fabrication
- Trade barriers (tariffs)
- **Tax policies:**
  - “Taxed” agricultural exports through “Marketing Boards”
  - Marketing Board – purchased crops from farmers at below-world market prices, then sell them on the world market at world market prices

# Reforming the International Trade System

- Developing countries pressing for GATT reforms
- United Nations Conference on Trade and Development (March 1964)
  - Group of 77
- Generalized System of Preferences (GSP)
  - Manufactured exports from developing countries gained preferential access to advanced industrialized countries' markets
- New International Economic Order
  - Attempt to create an international trade system whose operation was subordinate to development needs of the world's poor countries
  - Inspired by the Organization of Petroleum Exporting Countries (OPEC) – used their control of oil to improve their terms of trade in the early 1970s

# Thank You!



# Take-away

- Political motivation for ISI:
  - Losers from trade in Latin America (urban sector) gain political power
- Intellectual justification for ISI:
  - Declining terms of trade for primary products
- Asia & LA both practice “easy” ISI
- LA moves to Secondary ISI