

# Economics 404W

## lecture 21

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Note: Next writing assignment posted

## Next writing assignment

- Middle section of final report:
  - Business climate
  - Labor markets
  - Poverty, inequality
- A below-average essay will simply march out a disjointed list of facts.
- An above-average essay will use all facts introduced to tell a coherent economic story, drawing on lectures and readings.

## Next writing assignment

	Excellent	Strong	OK	Weak
<b>Economic Content:</b> ideas, thinking, understanding, depth of analysis				
<b>Rigor:</b> cause-effect connections, support for claims				
<b>Organization:</b> structure, coherence, focus, guiding the reader				
<b>Language:</b> sentences, wording, voice, tone, clarity				
<b>Mechanics:</b> spelling, grammar, punctuation, proofing, documentation				
<b>Overall</b>				

## Import substituting versus export oriented policies

- Import substituting (IS)
  - high tariffs
  - Lots of non-tariff barriers
  - Relatively heavy government intervention in domestic markets
- Export oriented (XO)
  - Low tariffs
  - Few non-tariff barriers
  - Relatively laissez faire stance toward domestic markets

## Import substituting versus export oriented policies

### Pro-IS

- Trade policy is a good way to offset domestic distortions
  - Unemployment
  - Promotion of sectors with positive externalities

### Pro-XO

- Using trade policy to offset domestic distortions leads to efficiency losses
  - Comparative advantage effects
  - X-efficiency
  - Monopoly pricing
  - Rent-seeking

## Import substituting versus export oriented policies

### Pro-IS

- Countries lose from trade liberalization when scale economies are important
  - At the sector level
  - At the firm level

### Pro-XO

- Losses due to scale economies are more likely to be exacerbated by protection
  - Goods that can't be produced efficiently at home can be imported.
  - Trade will force producers to produce fewer things on a larger scale.

## Import substituting versus export oriented policies

### Pro-IS

- Countries should exploit their monopoly power in world markets
  - Example: OPEC

### Pro-XO

- Most countries don't have monopoly power, and have trouble creating it.
  - OPEC is an exception; cartels usually break down.

## Import substituting versus export oriented policies

### Pro-IS

- Tariffs are a good revenue source.

### Pro-XO

- Tariffs are a very inefficient way to raise revenue.

## Import substituting versus export oriented policies

### Pro-IS

- Declining terms of trade can undermine countries that rely on exports. (“Immizerizing growth”)

### Pro-XO

- Even if terms of trade decline, free trade is the best policy.

## Import substituting versus export oriented policies

### Pro-IS

- Technical progress is facilitated by protection
  - Learning by doing
  - Emergence of an R&D sector
  - Large market shares create large incentives to innovate.

### Pro-XO

- Protection actually reduces innovation
  - Imported capital and intermediate goods embody new technologies.
  - Producers learn new technologies by participating in world markets.

## Import substituting versus export oriented policies

### Pro-IS

- Export price volatility inhibits efficiency and growth.

### Pro-XO

- Volatility due to trade may be damaging, but the gains from trade more than offset this damage.

(Commodity price stabilization funds create their own problems)

## Import substituting versus export oriented policies

### Pro-IS

- Protection allows countries to save scarce foreign currency reserves for critical goods.

### Pro-XO

- Protection is more likely to allow inappropriate exchange rate regimes to continue.
- A better way to avoid foreign currency shortages is to get the exchange rate right.