



ADDITIONAL TOPICS CHAPTER 19

Inward-looking versus outward-looking economic policies

One of the problems that developing countries face in trying to improve their growth rate is how to integrate their economies with the world economy. The basic question is whether they should encourage international trade with other countries or focus more on producing goods that substitute for international trade. There are two approaches.

In one approach, called the import substitution strategy, the developing country attempts to replace products that are imported from industrialised countries with products produced at home. This strategy tends to be inward-looking; laws limiting imports coming from abroad are passed, and these are supplemented by subsidies to domestic industries. Taxes on imports — tariffs — are high. Firms may lobby their government to maintain or increase the subsidies or the tariffs which protect the firms from competition; such special interest lobbying is called *rent-seeking* by economists. An important example of this type of import substitution is the development of the steel industry in Brazil in the 1950s. The Brazilian Government put tariffs on the import of foreign steel so that the Brazilian steel industry would have less competition. In Australia, the One Nation Party entered the 1998 general election advocating policies like these. Other political parties have shown tendencies to defend such policies (for example, the car industry), but they are less rigorous and extreme in their calls.

An alternative way to increase growth is the export-led strategy. Under this strategy, the government of the developing country encourages international trade by expanding exports. Hence, the strategy tends to be outward-looking. Growth occurs through the manufacture and sale of products to other countries. The aim of export-led growth is to increase trade rather than reduce trade. Although many countries that have followed export-led strategies have also had high tariffs on some commodities, such as agricultural goods, their strategies have been much more outward-looking than those of the import-substitution countries.

Table 19.1 shows the difference in economic growth in countries that have tried the import-substitution strategy compared to those that have tried the export-led growth strategy.

The table compares four countries: Brazil, Colombia, South Korea and Tunisia (all developing countries) over a 23-year period. Brazil switched from an import-substitution strategy to an export-led growth strategy and saw increased economic growth. By the 1970s, economic growth in Brazil was in double digits, much higher than in the 1950s and early 1960s. The change was also dramatic in Colombia. The most dramatic change has been in South Korea. The Korean success story, which began in the 1970s, seems related to the switch from an import-substitution strategy to one relying on trade and export growth. The same basic phenomenon is apparent in Tunisia as well as many other countries.

TABLE 19.1

*Growth rates for
different trade
strategies in four
countries, 1953–76*

(real GDP growth rate
in per cent per year)

COUNTRY	PERIOD	TRADE STRATEGY	GROWTH RATE
Brazil	1955–60	Import substitution	6.9
Brazil	1960–65	Import substitution	4.2
Brazil	1965–70	Export-led	7.6
Brazil	1970–76	Export-led	10.6
Colombia	1955–60	Import substitution	4.6
Colombia	1960–65	Import substitution	1.9
Colombia	1970–76	Export-led	6.5
South Korea	1953–60	Import substitution	5.2
South Korea	1960–65	Export-led	6.5
South Korea	1970–76	Export-led	10.3
Tunisia	1960–70	Import substitution	4.6
Tunisia	1970–76	Export-led	9.4

This experience indicates that a better strategy for increasing economic growth is to be outward-looking rather than inward-looking. A country's chance of catching up is greatly increased if it can adopt technology and use investment from abroad. By engaging in international trade, countries are able to learn more about technologies in other countries. For example, as South Korea's exports of electronic equipment grew, the Koreans learned more about technology for producing electronic goods.

More countries appear to be changing their policies from inward-looking to outward-looking, based on this experience. Mexico, for example, lowered its restrictions on imports in the mid-1980s and joined the United States and Canada in a free trade area in the 1990s. This approach to fewer restrictions on international markets parallels the developments that are removing restrictions on markets within the former centrally planned countries from Poland to China. Australia and New Zealand have achieved some sort of free trade in commodities following the upgrade of the Closer Economic Relations (CER) agreement in July 1990.