

Econ 340

Lecture 19

International Policies for Economic Development: Trade

News: Nov 18-24

- Huawei given 90-day reprieve by US -- NYT: [11/18](#) | [Canvas](#) | FT: [11/18](#) | [Canvas](#)
 - The Trump administration extended for 90 days permission for some US companies to do particular kinds of business with the Chinese telecoms company, Huawei. This is the latest of several such extensions that have been intended to minimize harm to US firms and their customers that rely on Huawei.
 - Huawei had been put on a blacklist by the US on the grounds that Huawei devices might threaten US national security by giving the Chinese government access to US data and secrets.
 - The ban had limited both exports to Huawei and imports from Huawei, the company that currently leads the world in advancing 5G technology for phones.
- Swiss watch exports to Hong Kong shrink -- Bloomberg: [11/19](#) | [Canvas](#)
 - Disruption in Hong Kong, as protests accelerate against Chinese rule and police respond, have dented the demand there for luxury goods. One result is that exports of watches from Switzerland to Hong Kong have declined.
 - For the first time in 30 years, mainland China imported more Swiss watches than did Hong Kong. Until the recent decline, Hong Kong also surpassed the US in imports of Swiss watches. But exports to China have increased, and exports of watches by Switzerland world wide have continued to grow.
 - Why the decline in Hong Kong? Fewer are being sold to tourists, and "Even Hong Kong locals are afraid of coming out onto the street," according to a spokesman for a watch retailer.
- Nigeria's closed borders stop smuggling but raise prices -- FT: [11/24](#) | [Canvas](#)
 - Nigeria tightened control of all its land borders, completely stopping trade there, both exports and imports. The objective was to "curb smuggling, boost local production and achieve food security."
 - The result has been a huge reduction in both legal and illegal trade, as well as an increase in tariff revenues through Nigeria's ports. But the result has also been extreme hardship for those who engaged in legal trade, and also a steep rise in prices to consumers of food staples. The closing is also hard on Nigeria's neighbor, Benin, through which much of Nigeria's smuggled imports flowed.
 - Nigeria's foreign minister says it will only reopen its borders when its neighbors "properly enforce existing rules of origin within the regional trading bloc."

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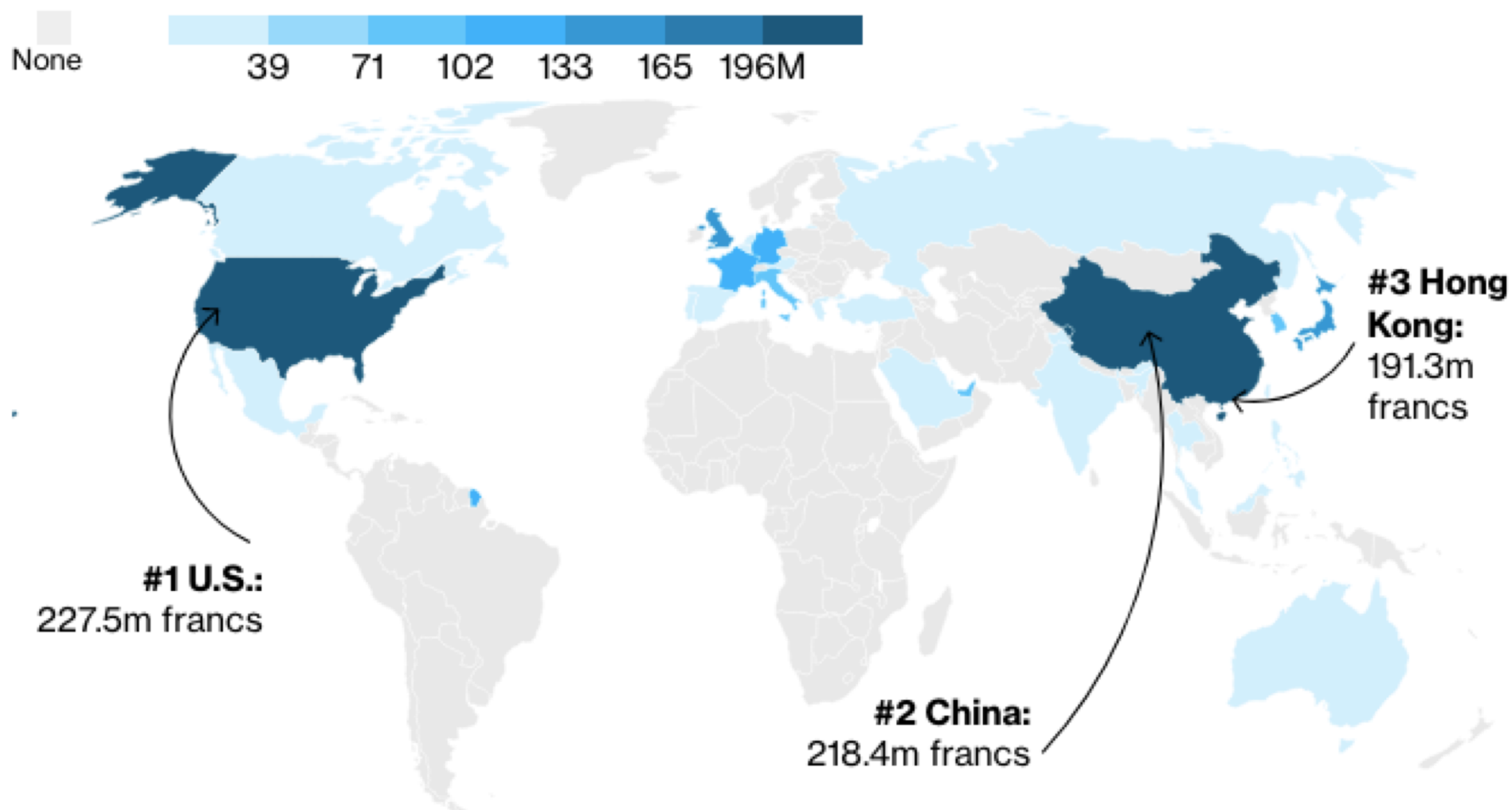
Huawei, one of China's most visible tech companies, has become a bargaining chip in the president's trade war. Patricia De Melo Moreira/Agence France-Presse — Getty Images

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Swiss Watch Shipments

Exports to mainland China surpass those to Hong Kong for the first time



Source: Swiss Watch Industry, October 2019 exports

Note: Colors reflect values in Swiss francs

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The price of rice, Nigeria's most important staple, has roughly doubled since the border closed © Afolabi Sotunde/Reuters

Exam 2 Curve

Second Midterm Exam:
Median: 76

Curve

85-100 A

70-84.5 B

58-69.5 C

48-57.5 D

0-47.5 E

Outline: International Policies for Economic Development: Trade

- The Main Issues of Development
- The Washington Consensus
- Special Problems of Developing Countries
- Pros and Cons of Tariffs Used by Developing Countries
 - The Infant Industry Argument
 - Primary-Product Specialization
 - Growth and Exports / Import Substitution
- Pros and Cons of Subsidies Used by Developed Countries
- Policy Recommendations

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- Policy Recommendations

The Issues

- The Two Main Issues:
 - Should developing countries be open to international trade?
 - Should developing countries be open to international capital movements?
(both financial and FDI)
- Answers are not easy and obvious
 - Even though the standard advice of IMF, World Bank and most economists today is:
YES to both

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The Washington Consensus

- This is a list of policies and institutions that were said to be pushed upon developing countries by
 - The IMF
 - The World Bank
 - United States agencies that deal with developing countries
 - USAID (US Agency for International Development)
 - US Treasury Department
- The name “Washington Consensus” was coined by economist John Williamson in 1989
 - He intended it “to refer to the lowest common denominator of policy advice being addressed by the Washington-based institutions to Latin American countries as of 1989.”

The Washington Consensus: The Policies

1. Fiscal Discipline
Don't spend too much
2. Public Expenditure Priorities
Spend intelligently
3. Tax Reform
Lower marginal tax rates and broaden tax base
4. Financial Liberalization
Allow financial markets to function competitively
5. Exchange Rates
Have a competitive (not overvalued) exchange rate

The Washington Consensus: The Policies

6. Trade Liberalization

Reduce tariffs and NTBs

7. Foreign Direct Investment

Let it in

8. Privatization

Turn state-owned enterprises into private firms

9. Deregulation

Remove unnecessary regulation of industries

10. Property Rights

Define and enforce clear property rights

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Special Problems of Developing Countries

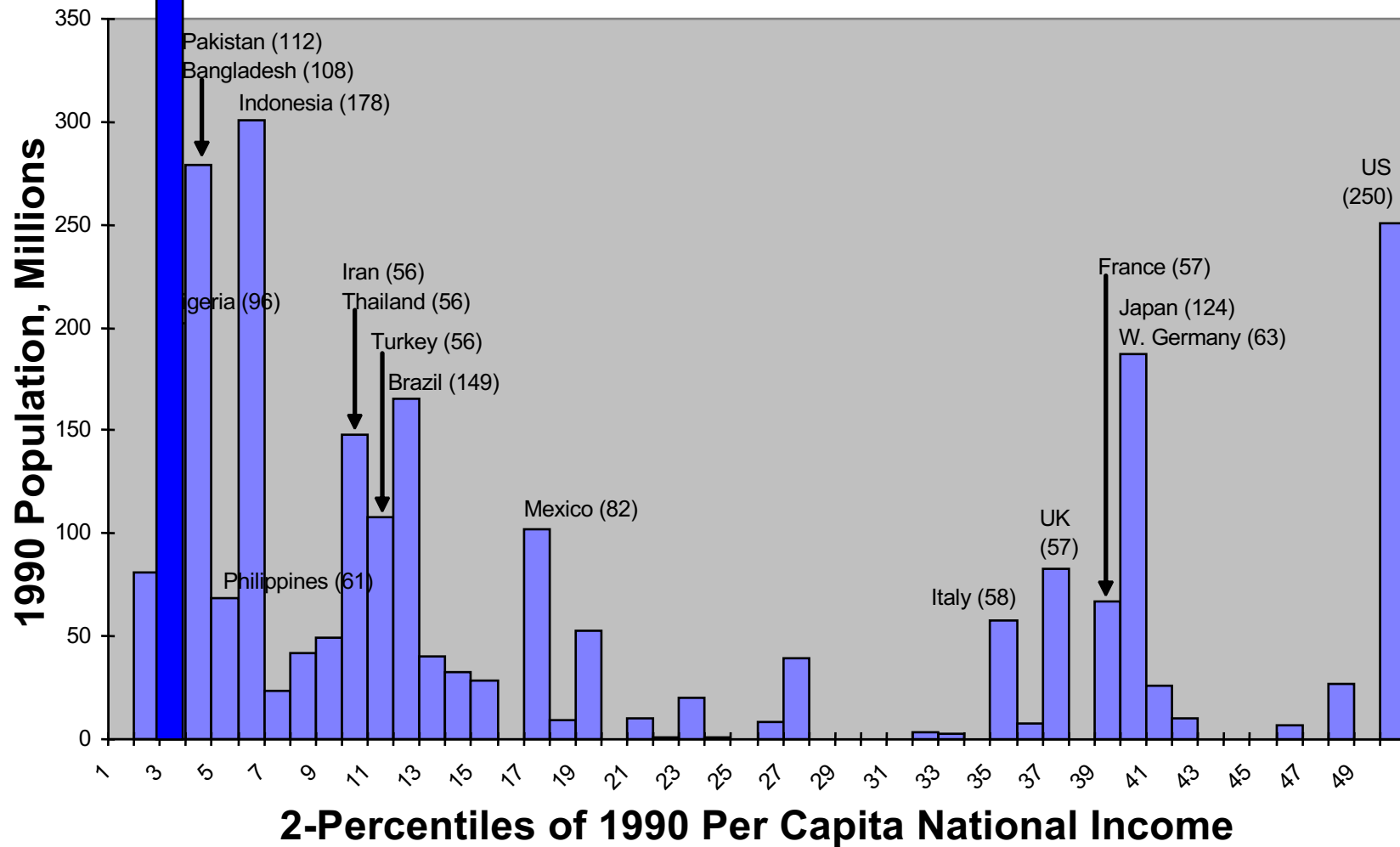
- First, what to call developing countries
 - “LDCs” used to be = Less Developed Countries
 - “LDCs” now also = “Least Developed Countries”
 - Poorest of the poor
 - On a list of 47 at the United Nations (as of November 2019)
 - Developing Countries (a more optimistic name)
 - Emerging Markets (even more optimistic)
 - LICs = Low Income Countries (vs. MICs, HICs = Middle, High Income Countries)
 - Third World (slightly obsolete)
 - (Used to be called “backward” countries)

Special Problems of Developing Countries

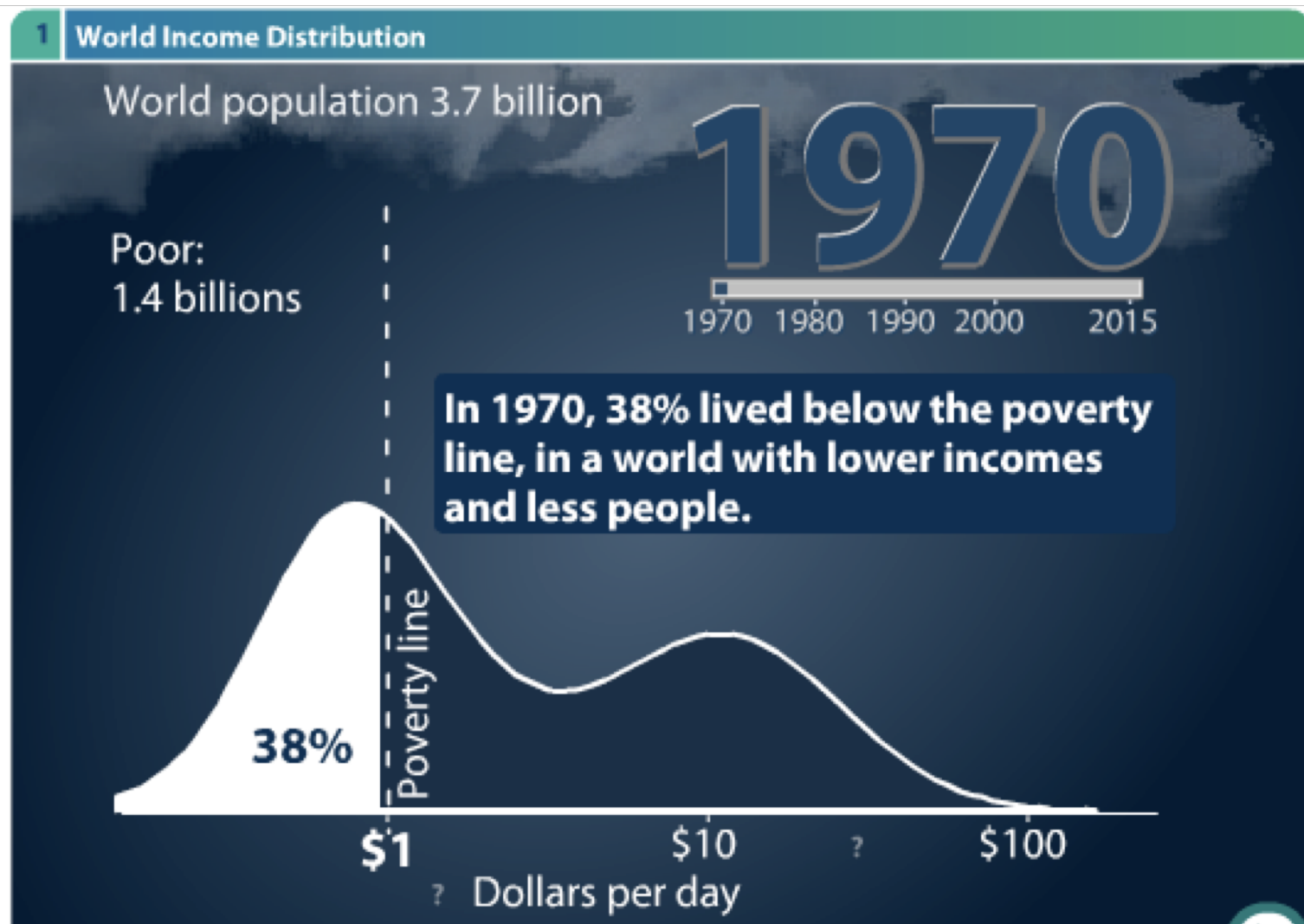
- The defining and most basic problem of developing countries: Low per capita income (low GDP per person)
 - Compared to US in 1990
(the data I happen to have)
real per capita incomes were only
 - 7% in China, India, Pakistan, Bangladesh
 - Even less in much of Africa
 - Less than 15% in Brazil, Turkey, Thailand, etc
 - There were hardly any countries in the “middle,” between the poorest and Europe/US

↑ China (1134) + India (850)

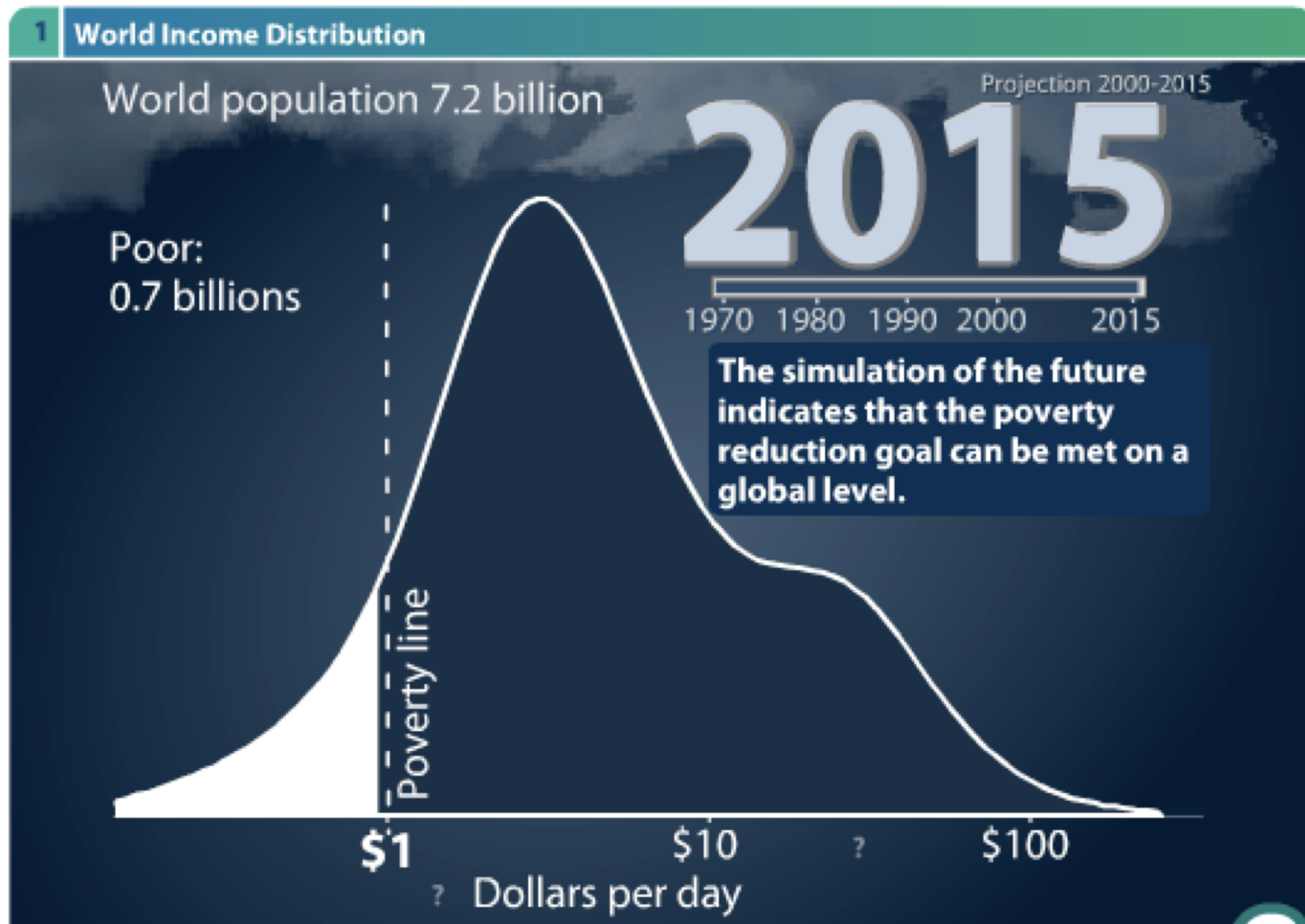
1990 Population Distribution of Per Capita National Income



Data from Gapminder.org



Data from Gapminder.org



Special Problems of Developing Countries

- Developing countries tend not to have
 - Physical Capital
 - Technology
 - Human Capital
 - Infrastructure
 - Markets (especially markets for capital)

Special Problems of Developing Countries

- Developing countries also tend not to have
 - “Economic Freedoms”
 - Rule of law (property, contracts)
 - Sound money
 - Open markets
 - Transparent & accountable government regulations

Special Problems of Developing Countries

- Developing countries do not have enough
 - “Intangible Capital ” (See Bailey)
 - Combines human capital and value of institutions
 - Components:
 - trust among people in a society
 - efficient judicial system
 - clear property rights
 - effective government
 - Contributions to explaining intangible capital:
 - Rule of law 57%
 - Education 36%

Special Problems of Developing Countries

- Developing countries do tend to have
 - Overpopulation
 - Poor health and sanitation
 - Corruption

Clicker Question

Which of the following is not one of the recommendations of the Washington Consensus?

- a) Restrain government spending
- b) Reduce tariffs
- c) Avoid having an over-valued exchange rate
- d) Define and enforce clear property rights
- ✓ e) Limit speculative capital flows

Clicker Question

How poor is poor? That is, what level of per capita income is often used as the “poverty line,” below which poverty is considered extreme?

- a) \$0.10 per day
- ✓ b) \$1 per day Or sometimes \$1.25 per day
- c) \$10 per day
- d) \$1000 per year

Clicker Question

Which of the following is not one of the components of Intangible Capital according to Bailey?

- ✓ a) Infrastructure
- b) Efficient judicial system
- c) Effective government
- d) Trust among people in a society
- e) Clear property rights

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Pros and Cons of Tariffs Used by Developing countries

- Con: Same advantages of free trade as for developed countries
 - Efficiency gains from exploiting comparative advantage
 - Improved competition, variety, scale economies, productivity
 - Trade may promote growth through exports
- Pro: Developing countries are “behind” and therefore “can’t compete”

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Infant Industry Argument

- The argument
 - Developing country firms
 - lack experience,
 - thus are not productive,
 - therefore cannot survive in world markets
 - So they need protection in order to
 - give them time gain experience and to learn
 - to become more productive and competitive

Infant Industry Argument

- Is it valid?
 - Yes, when there really is “learning by doing”
 - AND if capital markets are imperfect
 - Otherwise firms could borrow to cover their losses while they become competitive (just as firms in developed countries routinely do)
 - OR if the learning accrues to workers who then
 - Leave their firms
 - And become competitors

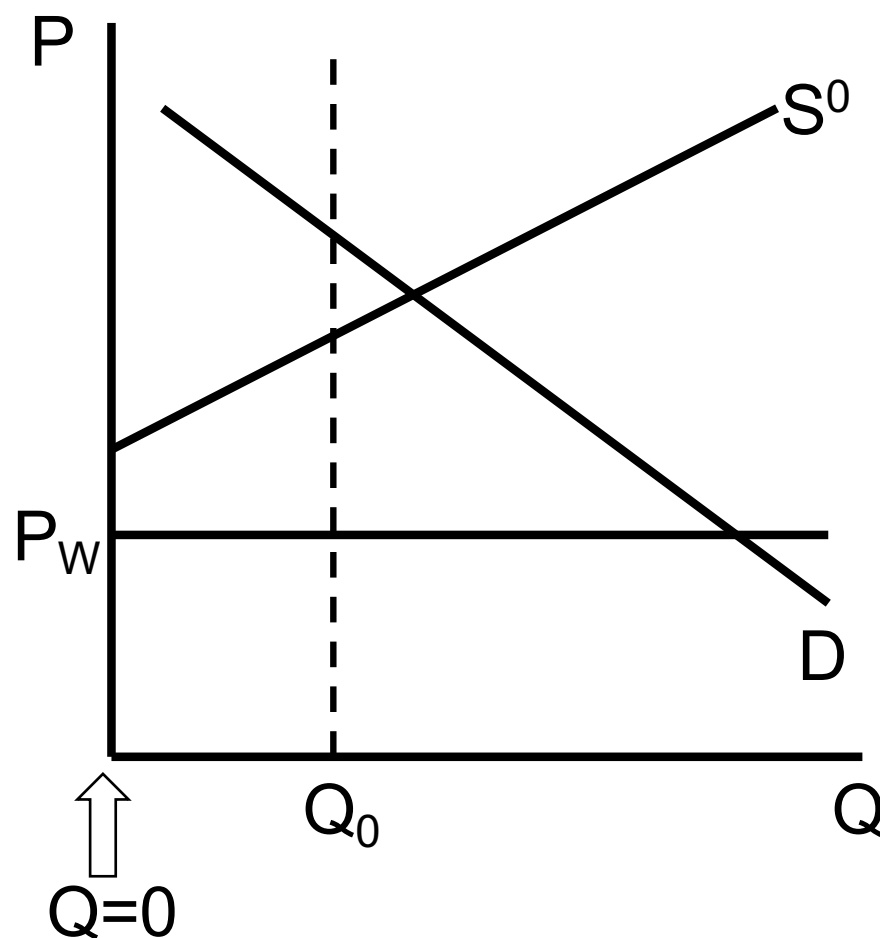
Infant Industry Argument

- Problems (even if these conditions are met)
 - Protection should be temporary
 - But that's very hard to do
 - Protected industries don't willingly give it up
 - Protection is second best
 - It would be more efficient (and thus better for the country) to use a more direct policy instead of a tariff:
 - Subsidize production
 - Subsidize loans

Infant Industry Argument

- Example
 - Suppose that costs are so high that, at world price P_W , country does not produce at all.
 - So with free trade, $Q=0$.
 - But that by sustaining production at Q_0 for 3 years ...

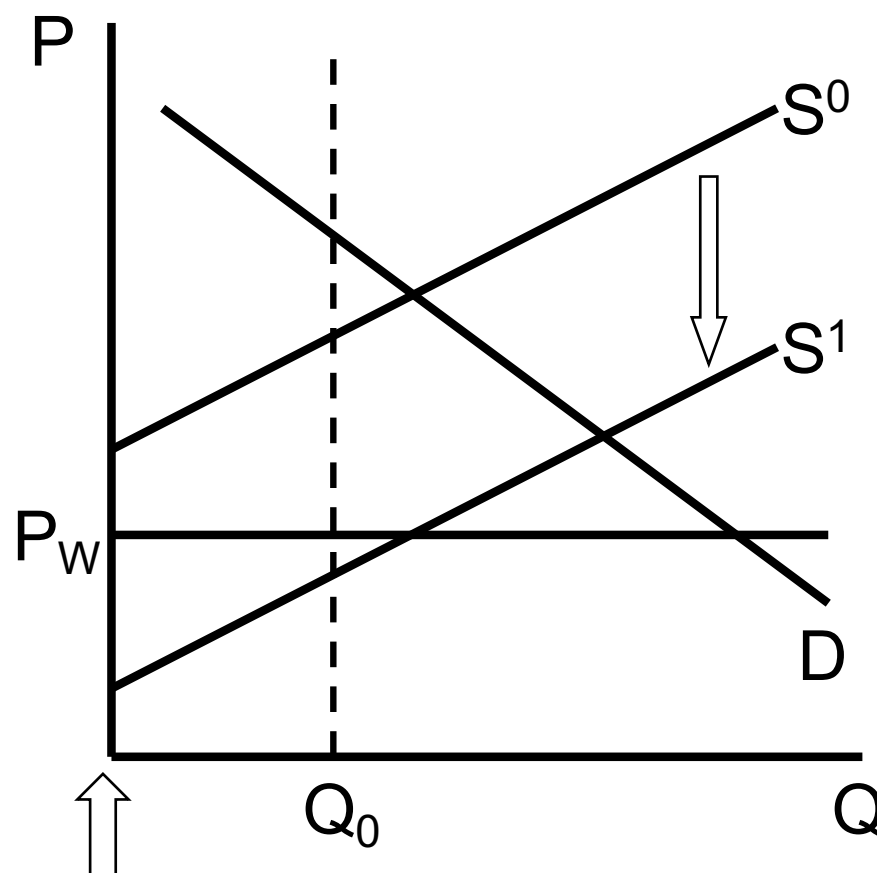
Domestic Market in LDC



Infant Industry Argument

- Example
 - ... by sustaining production at Q_0 for 3 years,
 - Costs will fall from S^0 to S^1 for 30 years

Domestic Market in LDC

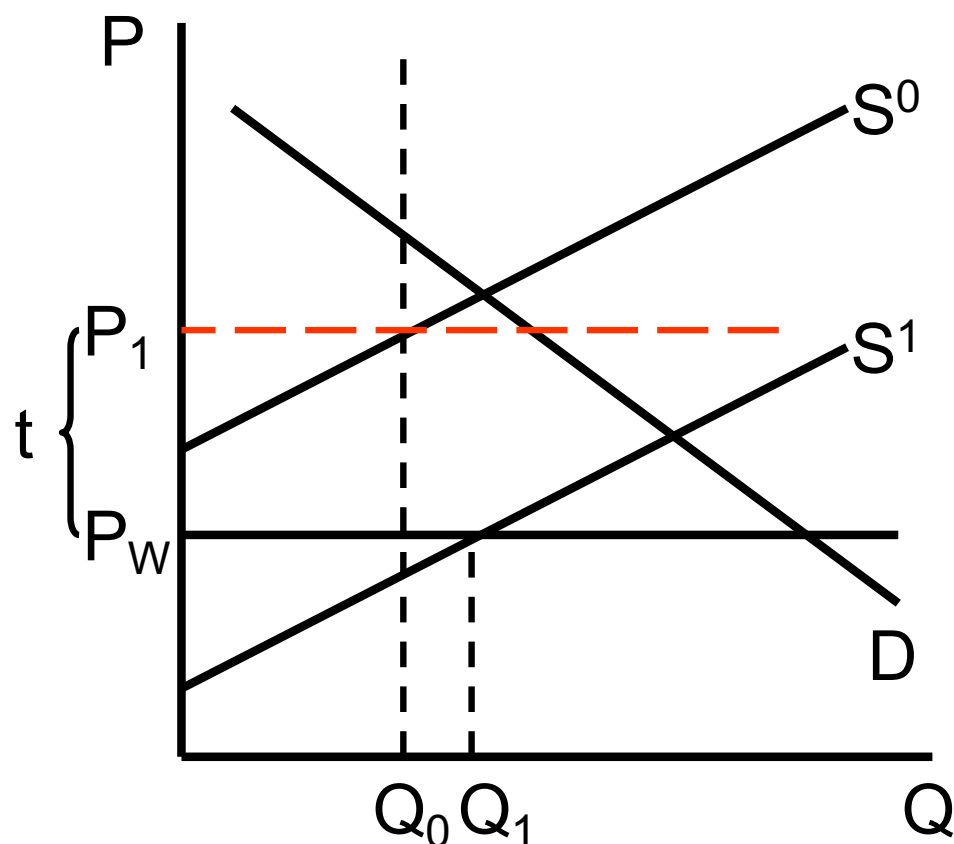


Infant Industry Argument

- Example

- By raising price to P_1 using a tariff t for only 3 years
- Output is Q_0 for 3 years
- and then, because S shifts down, output is Q_1 for 30 years

Domestic Market in LDC

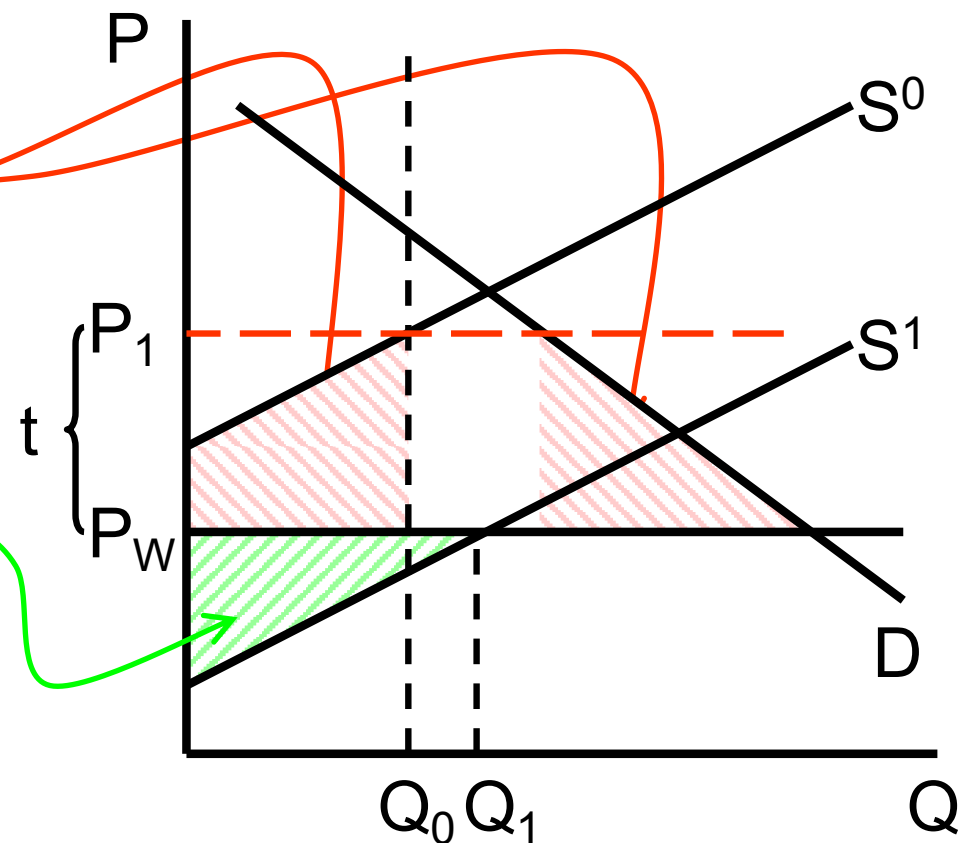


Infant Industry Argument

- Example

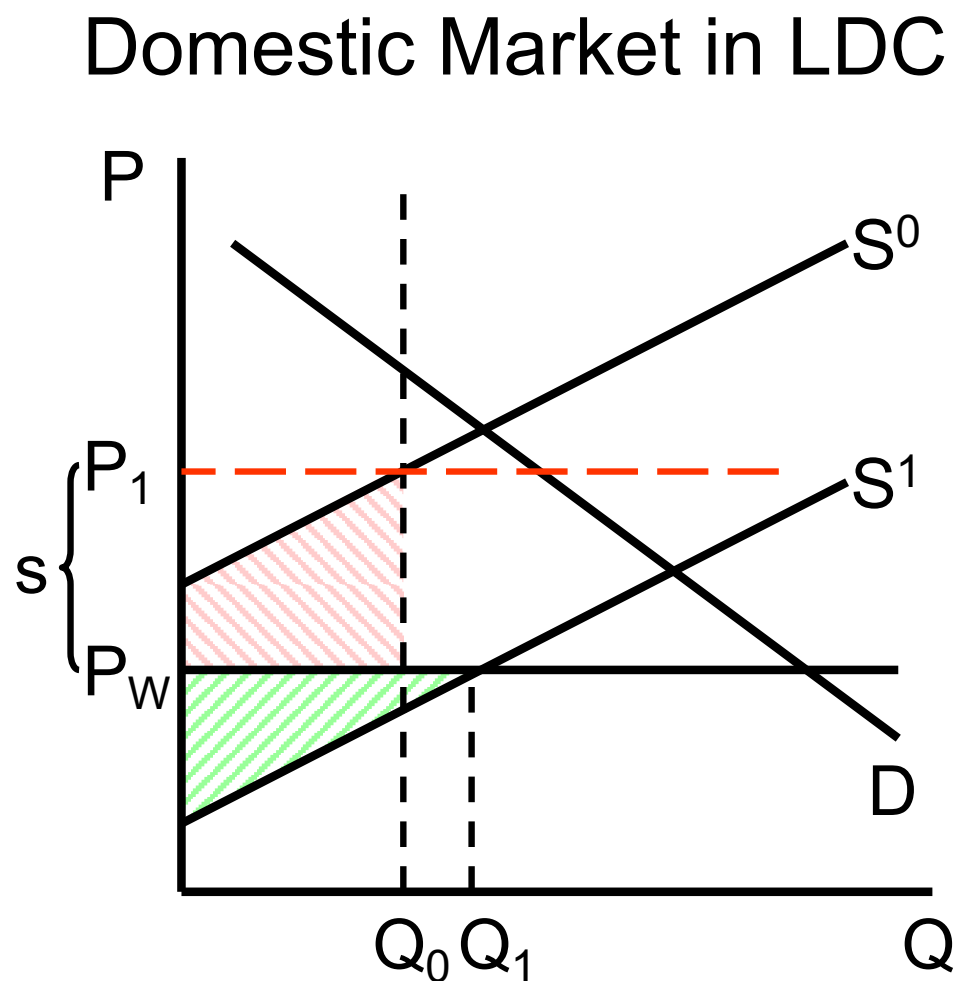
- Cost: Usual **Dead Weight Loss** from tariff for 3 years
- Benefit: **Producer surplus** for 30 years
- Combination of these may be positive

Domestic Market in LDC



Infant Industry Argument

- Example
 - But subsidy $s=t$ achieves same result without raising price to demanders
 - Thus cost is smaller but benefit is the same



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Other Objections to Free Trade in Developing Countries

- Countries are forced by trade (comparative advantage) to specialize in Primary Products
 - These are (it is argued)
 - Low-tech (thus no future)
 - Competitive (thus no profit)
 - Subject to competition from synthetic substitutes
 - Of low “demand elasticity”
 - Unclear what this means, but presumably income elasticity
 - » So that demand rises little as world income rises
 - Claimed implication: demand rises less rapidly than demand for manufactures
 - Thus prices fall

Other Objections to Free Trade in Developing Countries

- Countries are forced by trade to specialize in Primary Products
 - Supposed conclusion: Declining Terms of Trade
 - This has sometimes been true, but not always
 - Primary product prices rose in middle 2008
 - Prices have fallen since then
 - Overall, it does look like primary product prices do tend to fall over time

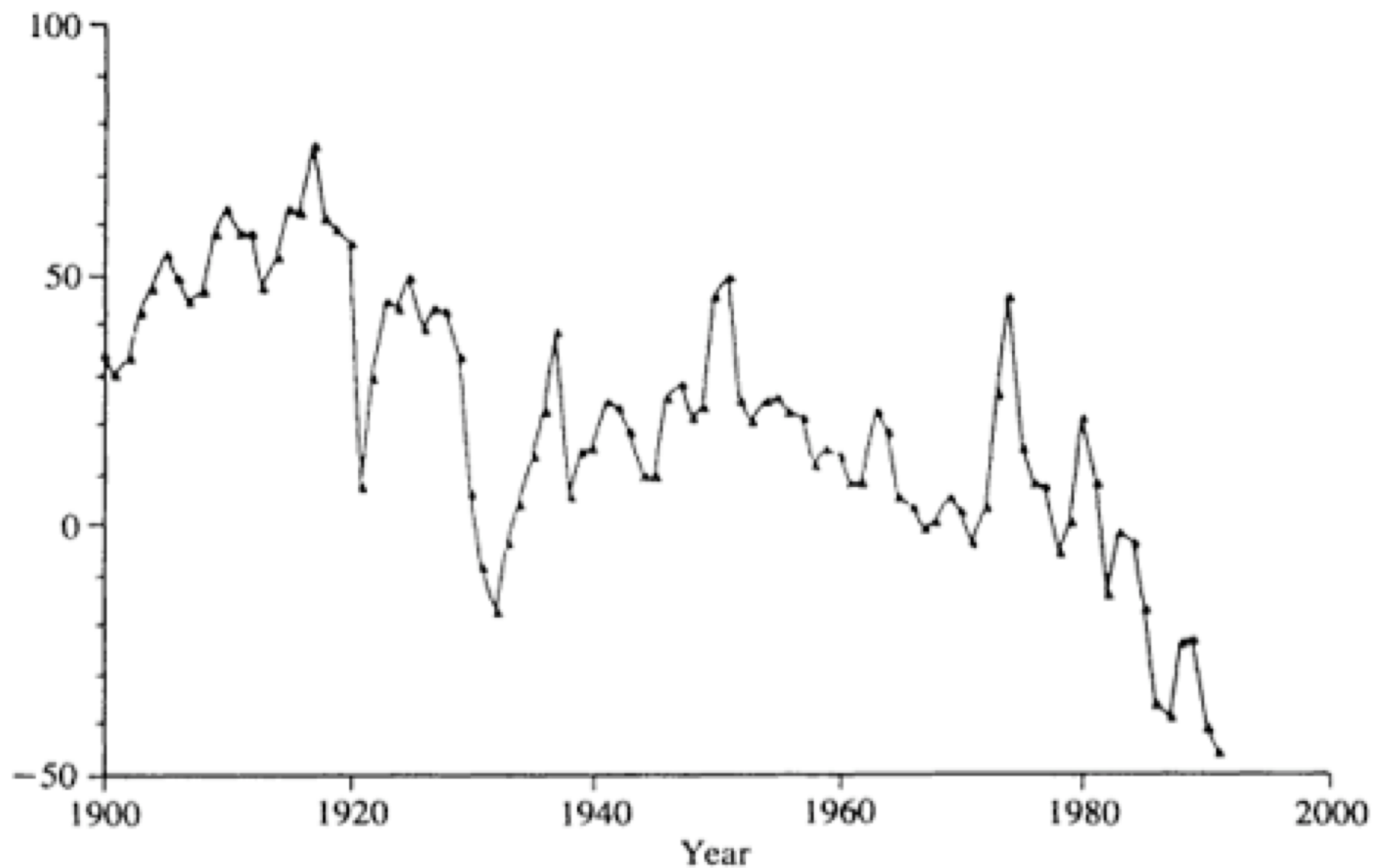
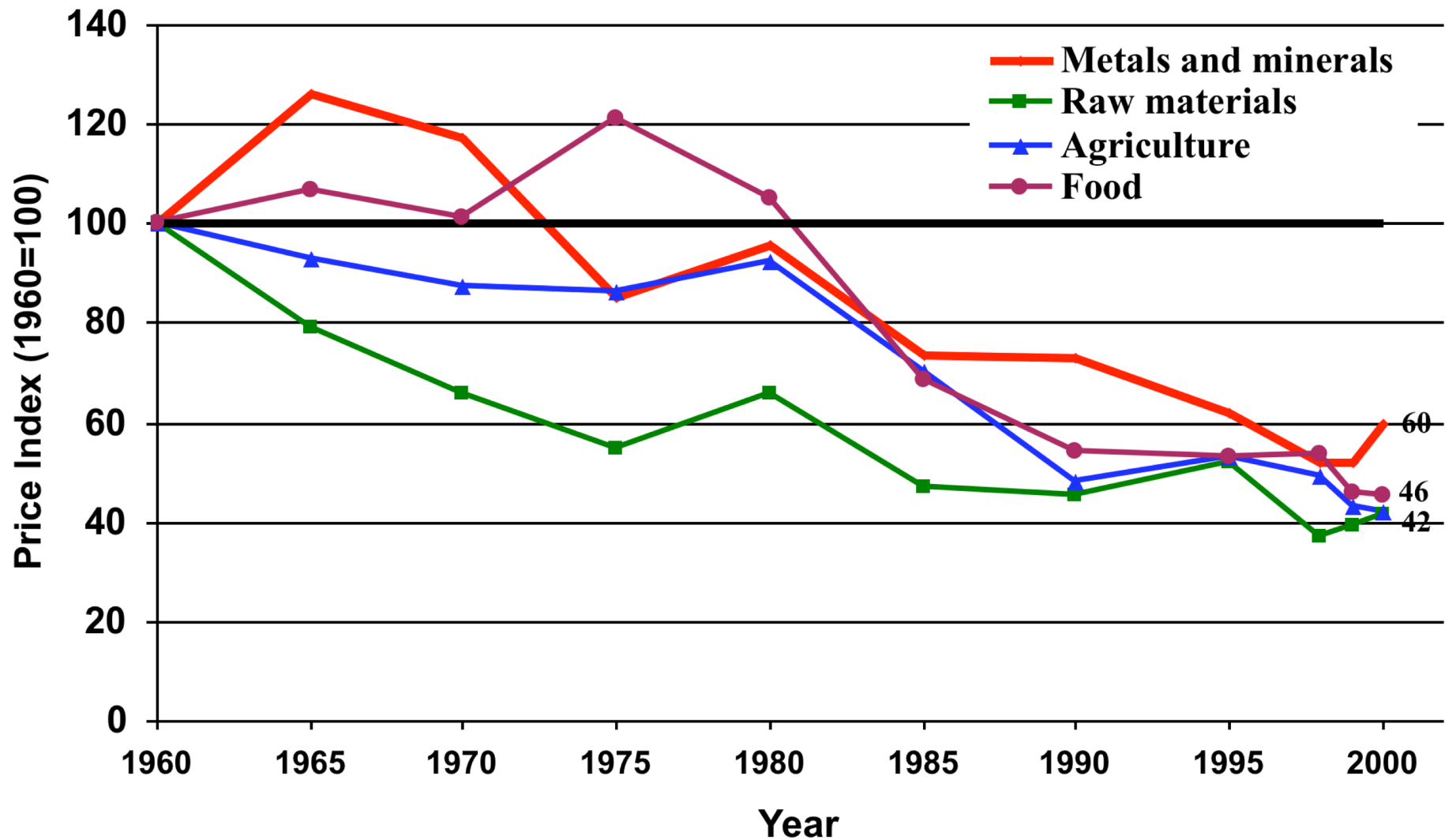


FIG. 1. Relative price of primary commodities 1990-91 (in logs)

World Commodity Prices, 1960-2000

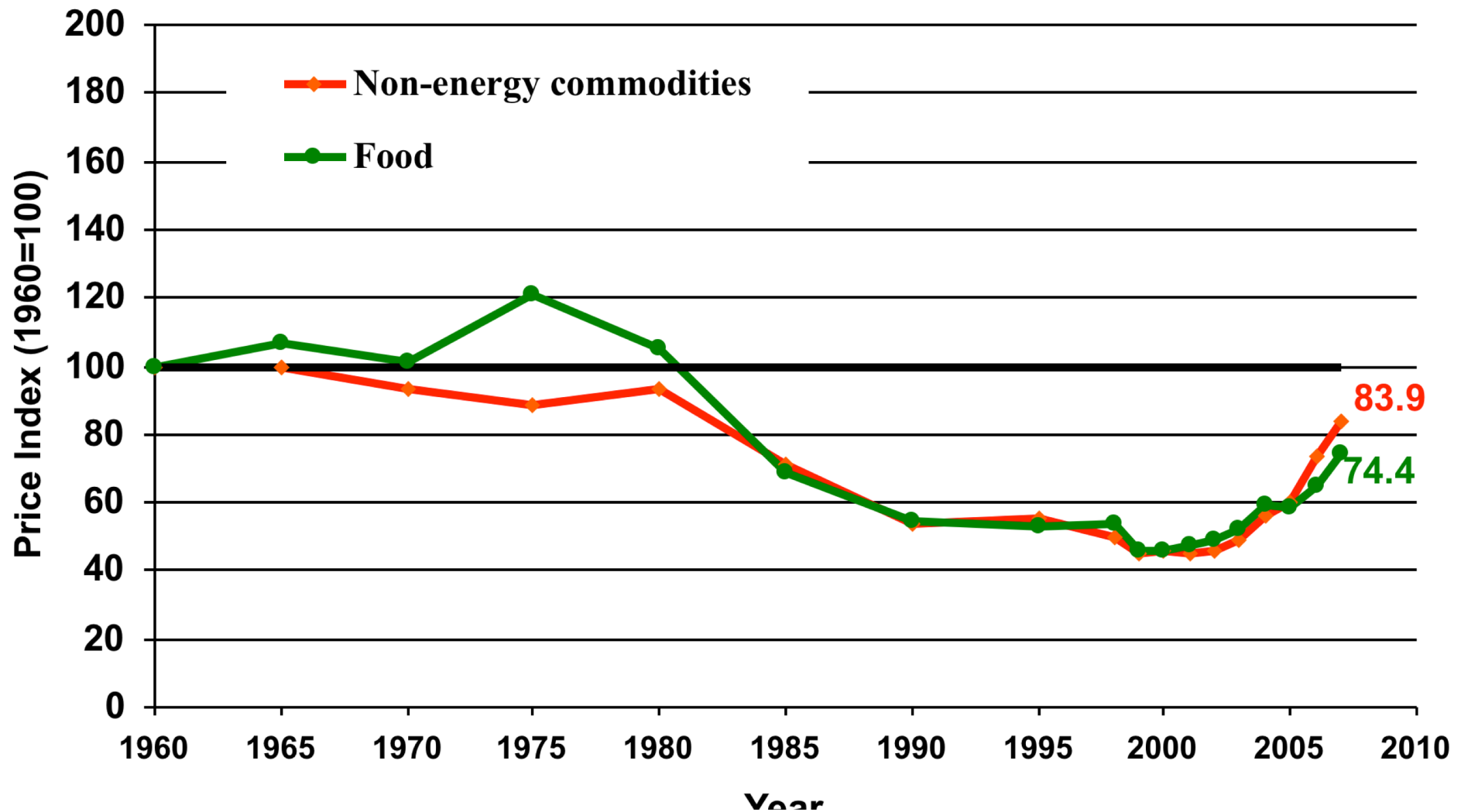
(Index, 1960=100, 3-year moving averages)



Source: World Bank, World Development Indicators, 2001

Petroleum and Non-energy Commodity Prices, 1960-2007

(Index, 1960=100)

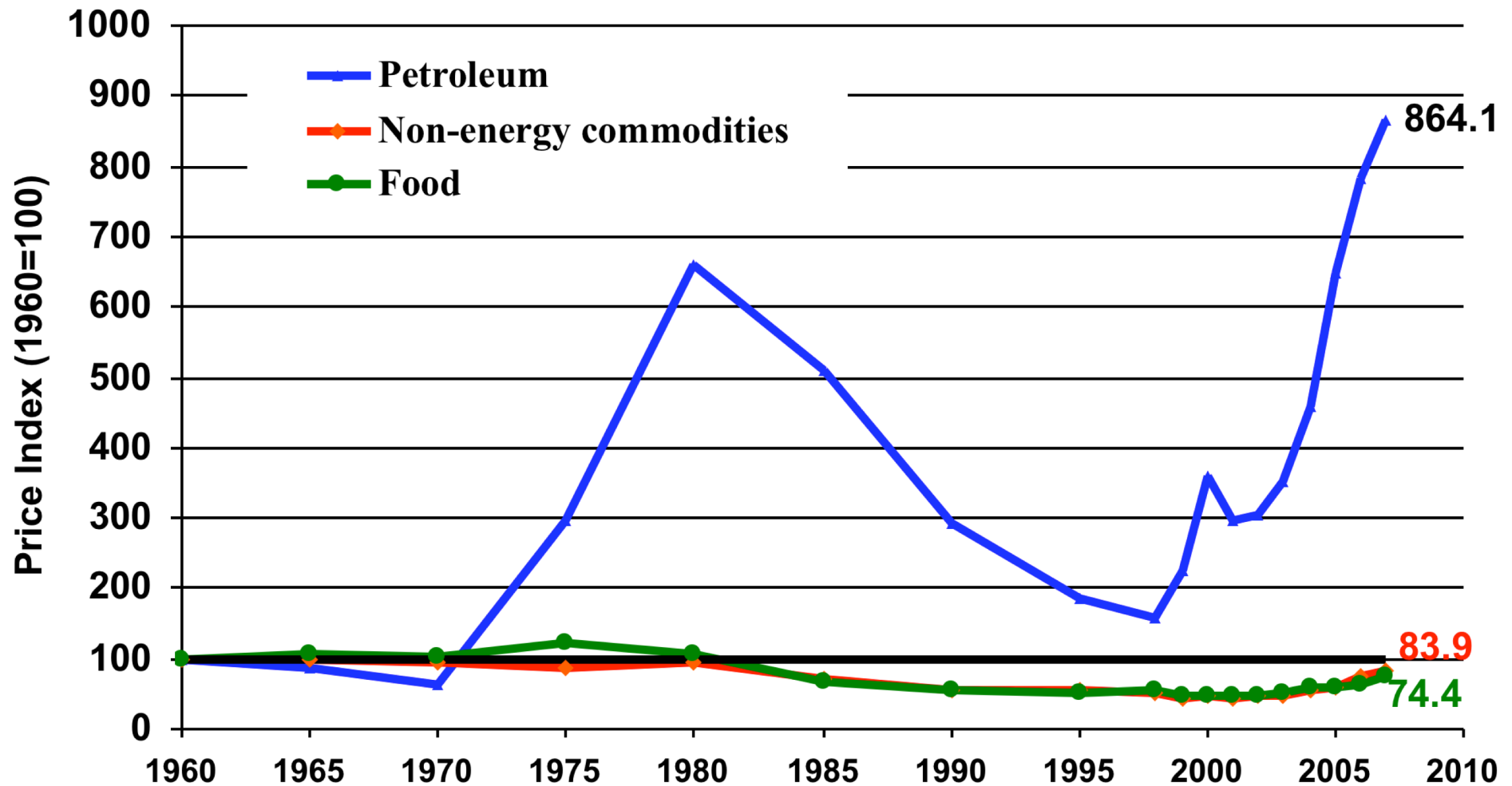


Source: World Bank, World Development Indicators, 2001; IMF commodity prices

Development Trade

Petroleum and Non-energy Commodity Prices, 1960-2007

(Index, 1960=100)



Source: World Bank, World Development Indicators, 2001; IMF commodity prices

Development Trade

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Exports and Growth

- How exports may help growth
 - Economies of scale: Produce for world market to achieve higher scale
 - Stimulate adoption of international best-practice technologies
 - Not necessary for firms protected by tariff
 - Finance imports of higher-tech capital goods
 - Encourage inward FDI to produce for export – bringing capital and technology

Track Record of Import Substitution

- In 1950s, two opposing strategies were perceived:
 - “Import Substitution”: Use tariffs and NTBs to protect industries, substituting for imports
 - “Export Promotion”: Free trade and other policies to encourage exports
- Most developing countries, and their economist advisors, favored Import Substitution

Track Record of Import Substitution

- Early examples of Import Substitution
 - That did well
 - United States in 19th century
 - Japan after World War II
 - That did poorly
 - India
 - South America

Track Record of Import Substitution

- Examples of Export Promotion
 - The “Four Tigers” all did well
 - Hong Kong
 - South Korea
 - Taiwan
 - Singapore
 - Later examples also did well until crisis of 1997:
 - Thailand
 - Indonesia
 - Philippines
 - ...
- } And most recovered rapidly after 1997.

Clicker Question

In order for a tariff to be potentially justified by the infant industry argument, which of the following must be true?

- a) The tariff must be temporary.
- b) The protected industry is subject to “learning by doing.”
- c) Capital markets are absent or inadequate.
- ✓ d) All of the above.
- e) None of the above.

Clicker Question

How do developing countries often view exporting primary products?

- a) Because they come late to markets, they fear being unable to sell them.
- b) They worry about the environmental harm that producing them may cause.
- c) They lack comparative advantage in primary products.
- d) The world's supply of primary products will decrease over time.
- ✓ e) The relative prices of primary products will fall over time.

Clicker Question

Which country is not one of the “Four Tigers”?

- a) Hong Kong
- ✓ b) Japan
- c) Singapore
- d) South Korea
- e) Taiwan

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Pros and Cons of Subsidies Used by Developed Countries

- Many developed countries subsidize agriculture
 - Economists agree that this usually hurts them more than it benefits their own farmers
 - But the issue here: How does it affect developing countries?
 - Examples
 - US and EU
 - Cotton, Sugar

Pros and Cons of Subsidies Used by Developed Countries

- Foreign Effects of Subsidies: Recall from Lecture 6 on Nontariff Barriers
 - Export subsidies
 - Push down world prices, and thus
 - Help foreign consumers
 - Hurt foreign competing producers
 - Help other countries that are net importers
 - Hurt other countries that are net exporters
 - Production subsidies have the same effects abroad as export subsidies

Pros and Cons of Subsidies Used by Developed Countries

- Cotton Subsidies
 - Countries whose exports were more than 50% cotton in 2001 (& GDP/capita 2005):
 - Benin (\$1100)
 - Burkina Faso (\$1200)
 - Chad (\$1400)
 - Mali (\$1200)
 - Togo (\$1600)

Pros and Cons of Subsidies Used by Developed Countries

- Cotton Subsidies (See FAO)
 - Costs of production in West Africa are among the lowest in the world
 - Costs in US are 3 times higher than Africa
 - US cotton farmers get about \$4 billion a year in subsidies
 - From 1998 to 2001,
 - US cotton production grew 40%
 - US cotton exports doubled
 - World cotton prices fell to record lows

Pros and Cons of Subsidies Used by Developed Countries

- Africa opposes US and EU farm subsidies
 - Cotton is just one example
 - Rich-country subsidies in many products hurt poor farmers throughout Africa
 - It was African countries, especially cotton exporters, who derailed the Doha Round negotiations in Cancun

Pros and Cons of Subsidies Used by Developed Countries

- But it's not that simple: Consumers benefit from subsidies
 - Many developing countries are primarily consumers, not producers, of many subsidized agricultural products
 - The poor in these countries will be hurt if subsidies are removed (See Baker)

Clicker Question

The US and EU both provide large subsidies to agriculture. Who gains and who loses in developing countries from these subsidies?

- a) Consumers and farmers both lose.
- b) Consumers lose and farmers gain.
- ✓ c) Consumers gain and farmers lose.
- d) Consumers and farmers both gain.
- e) Neither gain or lose, as US and EU farm products are neither produced nor consumed in developing countries.

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Policy Recommendations to Assist Developing Countries

- Developed countries:
 - Remove tariffs on developing country exports
 - See Copenhagen Consensus
 - Completing the Doha Round would have done this and more
 - High on their list of policies because costs are political, not economic
 - But some say gain is small (See Baker)

Policy Recommendations to Assist Developing Countries

- Developed countries:
 - Remove subsidies?
 - Most developing countries want this
 - But need to watch out for developing country consumers of subsidized products

Policy Recommendations to Assist Developing Countries

- Developing countries:
 - Reduce tariffs?
 - Yes, in most cases
 - Possible exceptions: infant industries, if conditions are met and subsidy not available
 - Subsidize exports?
 - Not clear
 - Countries that did this successfully were usually just offsetting overvalued exchange rate

Policy Recommendations to Assist Developing Countries

- Other trade-related policy recommendations:
 - Curtail Anti-Dumping
 - See Prusa on spread of AD to developing countries
 - Relax intellectual property protection
 - WTO TRIPs Agreement hurts developing countries (See Baker)
 - Need more flexibility to assist them

Clicker Question

Which of the following policies used by developed countries should also be adopted by developing countries?

- a) Protect producers with anti-dumping duties.
- b) Enforce laws on patents and copyrights.
- c) Subsidize farmers.
- ✓ d) Reduce import tariffs.

Next Time

- International Policies for Economic Development: Financial
 - Choice of Exchange Rate Regime
 - Pros and Cons of Free Capital Movements and Capital Controls
 - (How) Should Others Help?