

International Trade and Policy

WEEK 7 – Trade, Growth and Development

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Lecture Structure

- Introduction & Core Concepts
- Trade as an Engine of Growth (Theory & Evidence)
- Import Substitution vs. Export Promotion
- The Infant Industry Argument (Pro & Contra)
- Trade and Economic Development (Empirical Links)
- Role of the WTO in Development

Part 1: Introduction & Core Concepts

Why This Topic Matters

- Global trade has grown 50x since 1950.
 - Yet, some countries remain poor.
 - Trade policy choices have deep consequences for jobs, industrialisation, and inequality.
 - **Core tension:** Open markets vs. strategic protection.
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Key Definitions

- **Economic Growth:** Increase in GDP/capita (quantity).
 - **Economic Development:** Broader improvement in health, education, living standards, and freedom (quality).
 - **Trade-led growth:** Using exports as a driver of productivity and income.
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Historical Backdrop

- Pre-industrial era: Trade for luxury goods (spices, silk).
 - Colonial trade: Extraction and plantation economies.
 - Post-WWII: Rise of development economics.
 - 1990s–present: Globalization & Washington Consensus.
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Part 2: Trade as an Engine of Growth

Structure of the Lecture

- Engine of Growth Hypothesis
 - Import substitution vs. export promotion
 - Infant industry argument (classic & modern)
 - Trade's impact on development outcomes
 - WTO's role in development
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The “Engine of Growth” Hypothesis

- Coined by Dennis Robertson and Ragnar Nurkse (1950s).
 - Idea: Trade stimulates growth through:
 - ✓ Specialisation (comparative advantage)
 - ✓ Economies of scale
 - ✓ Technology transfer
 - ✓ Competition & innovation
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How Trade Drives Growth – The Classical View

- **Adam Smith:** Extent of the market limits division of labor
→ trade expands markets → productivity rises.
 - **David Ricardo:** Comparative advantage → countries gain even if weak in everything.
 - **Result:** Higher global output & cheaper goods for consumers.
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Dynamic Gains from Trade

Static Gains	Dynamic Gains
Once-off production efficiency	Long-run growth rate increases
Lower prices	Capital accumulation
	Learning-by-doing
	Technology spillovers

Evidence from East Asia (1960-1990)

- **Four Tigers:** S. Korea, Taiwan, Singapore, Hong Kong.
 - Rapid export growth → high investment → productivity convergence.
 - Real GDP per capita growth: 6-8% annually for 30 years.
 - Trade-to-GDP ratio doubled.
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When the Engine Sputters – Sub-Saharan Africa

- Many countries remained commodity-dependent.
 - Terms of trade shocks (e.g., oil, copper, cocoa).
 - Poor infrastructure & trade logistics.
 - Conclusion: Trade alone is insufficient; complementary policies matter.
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De-industrialisation Risk

- Openness can lead to premature de-industrialization.
 - Developing nations import manufactures → destroy local industry → stuck in raw materials.
 - **Example:** Latin America in 1990s under Washington Consensus.
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Engine Metaphor – Reassessment

- ✓ **Yes:** Trade can be an engine, but it needs fuel (investment, education, institutions).
 - ✓ **No:** Automatic benefits – gains depend on initial conditions.
 - ✓ **Modern view:** Trade as a *potential* catalyst, not a guarantee.
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Part 3. Import Substitution vs. Export Promotion

Two Competing Strategies

Import Substitution Industrialization (ISI)	Export Promotion (EP)
Protect domestic manufacturing	Encourage production for world markets
High tariffs, quotas, subsidies	Low trade barriers, currency undervaluation
Focus on internal market	Focus on external demand

ISI – Logic & Instruments

- **Infant industry** justification.
 - Replace imported manufactures (textiles, cars, electronics).
 - Tools: Tariffs, import licenses, overvalued exchange rates.
 - **Famous example:** Pre-1991 India, 1950s-70s Latin America (Brazil, Argentina).
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ISI – Why It Often Failed

- High-cost, inefficient industries.
 - No export discipline → low quality.
 - Overvalued currency hurt non-traditional exports.
 - Rent-seeking & corruption.
 - Balance of payments crises → debt.
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EP – Logic & Instruments

- Exploit comparative advantage (initially labor-intensive goods).
 - Export subsidies, special economic zones.
 - Often combined with undervalued currency.
 - **Examples:** S. Korea (1960s-80s), China (1980s-2000s), Vietnam.
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Core Empirical Finding

- Systematic reviews (e.g., Krueger, 1978; World Bank, 1993):
 - ✓ Export-promoting countries grew faster than ISI countries.
 - ✓ EP countries had higher productivity growth & lower poverty.
 - **Exception:** Large economies (India, Brazil) could not rely on exports alone initially.
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Modern Synthesis

- No pure ISI today.
 - Many successful countries used *strategic* protection + export push.
 - **New consensus:** Neutrality + export dynamism + selective infant industry support.
 - **Example:** China's "dual track" – protect some, liberalise others.
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Part 4: The Infant Industry Argument

Classic Infant Industry Argument

- Alexander Hamilton (1791) & Friedrich List (1841).
 - Argument: Temporary protection allows new industries to learn, scale up, and become competitive.
 - Once mature, protection is removed → net gain for society.
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Logical Conditions for Success

- **Learning curve** is steep (costs fall with cumulative output).
 - **Positive externalities** (knowledge spillovers to other sectors).
 - **Capital market imperfection** (bank won't lend long-term to new industry).
 - **Time-bound & conditional** protection.
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Classic Success Stories

- **USA (19th c.):** High tariffs on textiles and steel → Industrial Revolution.
 - **Japan (1950s-70s):** Protected auto & electronics behind tariffs → later global leaders.
 - **S. Korea (1970s):** Heavy & chemical industry push with protection.
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Why Infant Industry Often Fails

Problem	Result
Protection becomes permanent	Never faces competition
Choose “national champions” politically	Inefficient subsidized firms
Lack of export discipline	No pressure to improve
Overvaluation due to protection	Exports uncompetitive

Modern Version – Strategic Trade Policy

- Industries with scale economies & first-mover advantages.
 - **Examples:** Airbus (subsidised vs Boeing) and semiconductors.
 - For developing countries: Green technology, agri-processing.
 - **Risk:** Retaliation & WTO constraints.
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Policy Conclusion – How to Do It Right

- **Sunset clause** (e.g., 5-7 years).
 - **Performance requirements** (e.g., export targets).
 - **Clear exit strategy.**
 - **Competition in domestic market** (not monopoly).
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Part 5: Trade and Economic Development

Trade – Direct Channels to Development

Income effect: Higher GDP → more resources for health & education.

Poverty reduction: Export jobs for low-skill workers (e.g., Bangladesh garments).

Access to medicines & technology through imports.

Women's employment in export manufacturing.

Trade and Inequality – Kuznets Redux

- Short-term: Increased inequality? (Stolper-Samuelson theorem)
 - ✓ In skill-scarce countries, trade may hurt unskilled if imports are labor-intensive.
 - Long-term: Rising education & mobility may reduce inequality.
 - Evidence is mixed – it depends on complementary policies.
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Environmental & Social Concerns

- **Race to the bottom?** Weak labor/environmental standards to attract FDI.
 - **Resource curse:** Commodity export dependence → volatility & weak institutions.
 - **Solution:** Trade agreements with sustainable development clauses.
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Role of Complementary Policies

If trade openness without...	Result
...investment in education	Persistent low-skill trap
...credit for small firms	Uneven benefits
...social safety nets	Adjustment costs concentrated
...infrastructure	Cannot access global markets

Bottom Line on Trade & Development

- Trade is not a panacea.
 - Developmental impact depends on:
 - ✓ Initial inequality
 - ✓ Industrial structure
 - ✓ State capacity
 - ✓ International market access
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Part 6: Role of the WTO in Development

WTO – What It Is & What It Does

- **World Trade Organisation** (1995, replacing GATT).
- 164 members (2024).
- Functions:
 - ✓ Negotiate trade rules
 - ✓ Dispute settlement mechanism
 - ✓ Trade policy reviews
 - ✓ Technical assistance



Source World Trade Organisation. (n.d.). Development. Retrieved [April 24, 2026]; Retrieved from https://www.wto.org/english/tratop_e/devel_e/devel_e.htm

Special & Differential Treatment (S&DT)

- Core principle for developing countries:
 - ✓ Longer time to implement agreements
 - ✓ Preferential market access (e.g., Everything But Arms for LDCs)
 - ✓ Technical assistance
 - **But:** Many S&DT provisions are “best endeavor” (non-binding).
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Criticisms of WTO from Development Perspective

Criticism	Counter-argument
TRIPS limits access to medicines	Doha Declaration on Public Health (2001)
Rich countries' agricultural subsidies hurt poor farmers	WTO dispute settlement has partially reduced subsidies
Enforcement too harsh on poor nations	LDCs rarely taken to dispute settlement
Development round stalled (Doha)	Indeed – Doha Development Agenda dead since 2015

Conclusion – Trade Governance for Development

- WTO provides **rules-based** system (less power-based).
 - But development requires:
 - ✓ Policy space for industrial policy
 - ✓ Flexibility in intellectual property
 - ✓ Lower rich-country barriers in agriculture & textiles
 - **Future**: Reform S&DT, finish e-commerce/services negotiations, aid for trade.
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Key Takeaways

- Trade *can* be an engine of growth, but needs favorable conditions.
 - Import substitution largely failed; export promotion succeeded in East Asia.
 - Infant industry protection works only if temporary & performance-based.
 - Trade helps poverty reduction but may worsen inequality without safeguards.
 - WTO offers rules but must evolve to give true policy space for development.
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Thank you!