



ЎЗБЕКISTON RESPUBLIKASI  
OLIIY VA O'RTA MAXSUS  
TA'LIM VAZIRLIGI



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# БУХОРО ДАВЛАТ УНИВЕРСИТЕТИ МАГИСТРАНТЛАР ВА ИҚТИДОРЛИ ТАЛАБАЛАРНИНГ “ТАФАККУР ВА ТАЛҚИН”

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**THE ROLE OF MODERN TREATMENTS OF THE STRATEGIC TRADE POLICY IN TERMS OF THE DEPENDENCY THEORY OF PREBISCH AND SINGER**

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This article theoretically investigates the importance of strategic trade policy comparing with traditional trade policies such as Export Promotion and Import-Substituting Industrialization. The discussion is conducted taking into account the dependency theory of Prebisch-Singer and recent changes in the international policy.

The paper shows that the traditional trade policies have lost the significance since the 1980<sup>th</sup> when ICT revolution occurred especially for developing countries. Instead, the strategic approach to trade policy has dominated recently although critical views exist for developing country-specific approaches to the strategic trade policy.

**Key words:** The Dependency Theory of Prebisch-Singer, Strategic Trade Policy, Export Promotion, Import-Substituting Industrialization.

The dependency theory of Prebisch and Singer appeared according to the different terms of trade in underdeveloped and developed countries, and the most important aspect of this theory is an *unequal income redistribution* due to uneven technical progress between nations (Prebisch (1950), Singer (1950)). Accordingly,



“peripheral” (as labelled by Prebisch (1959)) countries are specialised in producing labour-intensive primary goods and agriculture with low-income elasticity of demand, and developed nations, as industrial “centres”, are mostly specialised in manufacturing capital-intensive industrial products with high-income elasticity of demand. While the prices of primary commodities are inelastic against gradual increases in the prices of industrial goods, exporters of primary commodities are obliged to transfer a part of their profit (equal to sum of decreases in the prices of primary commodities and increases in the prices of manufactured goods) to the rest of the world, especially suppliers of industrial goods (Prebisch (1959)). Such a disparity, according to Prebisch (1959), should be fixed by import substitution implemented by exporter countries of primary commodities. In this line, rejecting market solutions, capital formation, and completely substituting imports from industrial countries seemed to be crucial for underdeveloped countries in the 1950s (Bruton (1998)).

One may wonder whether increasing the productivity in primary activities through, let us say, technical progress helps underdeveloped countries to become developed. Prebisch (1959) argues that such an intention is helpful for exporting sectors but if the technical absorption is extended to other primary sectors that supply mostly domestic market with low-income elasticity of demand, the outcome will be just unemployment. Even for that, industrialisation plays a crucial role to solve the problem of unemployment by absorbing a surplus labour force (Prebisch (1959)).

Experiences in some developing countries confirm that following only ISI is much distortive because supporting import substitution through overvalued exchange rate policy decreases export demand for local goods (Mukherje (2012)). Moreover, protected industrial sector underutilises the capacities of other sectors (Balassa (1971), Bhagwati (1978), Mukherje (2012)).

In most cases, ISI strategy was followed according to mutual interests of MNCs, domestic capital and State, and failed as a result of improper policy approaches (Cherif and Hasanov (2019), Mukherje (2012), SebastiánGaliani& Paulo Somaini (2018)). For instance, in India, local manufacturers enjoyed widespread monopoly rents behind the prohibitive protective measures that guaranteed the safest protection from foreign competition. Moreover, useless and inconvenient regulations required different licences for such manufacturing final goods and intermediates, special products, importing inputs and machinery, securing the foreign exchange, etc. (Cherif and Hasanov (2019)). While domestic producers were highly restricted through a wide range of licenses, most of them globally could not compete because they did not have access to raw materials and intermediate inputs (Krueger (1975)), and pushing them to compete worldwide was not a main priority. As a result, domestic firms were fully insured in the domestic market, causing their disinterest in risky external markets (Cherif and Hasanov (2019)). Therefore, the process of ISI caused benefits to certain groups for short-run at the cost of the rest of national economy and overall national welfare (Mukherje (2012)).

According to Baer (1972), the ISI policy was implemented indiscriminately without concentrating in the concrete industrial sectors with a potential comparative advantage.

Then the process continued further in other sectors that required capital-intensive technologies, and subsequently into relatively complex consumer durables industries in developing countries such as Argentina, Chile, Venezuela. In Brazil, for example, the government took care of both final consumer goods industries and intermediate and capital goods sectors. This case made manufacturers of final consumer goods disagree with developing domestic intermediate and capital goods industries because such inputs would have been sold considerably at higher prices than imported ones (Baer (1972)).

Intentions to favour industries by providing cheap imported inputs through exchange rate mechanisms have damaged agriculture and other primary activities, reducing their exports and the competitiveness of their products in foreign markets (Baer (1972), Balassa (1984)).

In this way, empirical investigations confirm the importance of export performance, especially export sophistication (Cherif, Hasanov and Wang (2018)), for economic growth but the way to this might be not only through free trade but a mixture of infant industry protection (Behuria (2017)), free trade, and export promotion (Chang (2011)).

Stating the learning and knowledge accumulation as essential engines of growth, Bruton (1998) opponents both import substitution as failed and justifications for outward-orientation as being increasingly undermined. Therefore, both export-oriented and import-substituting approaches to industrialisation might not guarantee the transformation of an efficient industrial system (Álvarez and Brando (2019)).

Both trade restrictions and tariff liberalisation for trade growth have lost the significance since 1950 compared with the situation before World War II. According to the fixed effects panel data analysis for 1961-2000 (Nenci (2009, Table 4.6)) tariff barriers have small negative but insignificant causal effect (confirmed by the value of t-statistics) on import growth in the case of developing countries, which means that tariff barriers have lost its significance not only for reducing imports but also for protecting local sectors from imports. However, causation is still relevant for developed nations.

Furthermore, not only trade restrictions, but even trade preferences provided by developed countries for LDCs might not be helpful to promote the development of their export flows, and it is suggested to substitute other policy decisions for tariff barriers (Magrini, Montalbano, & Nenci (2017)).

The recent changes in the international economy through the expansion of international fragmentation of production and appearance of global value chains have caused an alternative for the commonly used development strategies. Taking into account the issues of applying development strategies like import substitution, export promotion, and free trade policies, a group of scientists (Grossman and Richardson (1985), Brander (1995), Krugman & Smith (1994), etc.) suggest a

*strategic trade policy*, which offers both operating in a competitive environment with limited number of entities and at the same time securing an emerging economy from the stiff global competition, as an alternative development policy for especially LDCs.

It is worth noting that the strategic approach to international trade was mentioned in Prebisch (1959) as well. Accordingly, trade between Latin American countries was just 10 per cent of their trade with the rest of the world, and it caused an unintegrated system of Latin American industrialisation, which prevented the specialisation and scale economy. The solution for such a problem could be creating a large regional common market (Prebisch (1959)).

The term, as a recent change in the theory of international trade, initiated to be debated to a considerable extent from the 1980s (Spencer and Brander (2008)). Such a policy can support learning effects, R&D, and consequently domestic welfare providing local firms with additional profit in the expense of foreign firms. As a commonly used instrument of this policy, the export subsidy is approached strategically taking into account the country's comparative advantages and conditions in sectors that strategic trade policy is applied. However, trade barriers and subsidies towards R&D and investment to support firms in the global competition may cause strategic effects as well.

Importantly, a strategic approach to trade policy instead of traditional methods allows enlarging markets raising competition level and benefiting sectors through increasing returns to scale, learning by doing, and R&D.

According to Brander (1995), strategic trade policy is characterised by strategic decisions of mutually interdependent entities that know expected actions of rivals and results caused by its own decision in oligopolistic conditions. Therefore, strategic trade policy does not make sense in perfectly competitive and purely monopolistic environments.

However, as well as strategic trade policy has its critiques warning of the inability of governments to choose proper sectors, inadequate decisions, and problems caused by pressure groups (Rugman & Verbeke (1990)).

To avoid adverse effects, a trade agreement as a basis for eliminating specific government interference is essential (Brander (1995)), and currently operating Free Trade Areas (FTA) as a source of trade regionalisation are based on such trade agreements (Iapadre&Tajoli (2014)).

For instance, the role of developing countries has considerably been increasing in the international trade network due to trade liberalisation, international fragmentation of production, and strategic trade policies according to bilateral and regional trade negotiations. However, even in this case, for the best results from regional trade agreements, the integration of trade regions into the global market is crucial rather than being isolated geographically (Iapadre&Tajoli (2014)).

Therefore, a strategic approach to international trade allows developing countries and LDCs to obtain industrialisation and economic growth by joining existing supply chains specialising only in the most efficient production stages for

themselves rather than striving to create an entire industry in one country, which is frequently observed and inefficient.

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