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Trade and industrialization in developing economies

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Abstract

This paper examines the impact of international trade on the allocation of production across sectors in developing countries. Estimates from a panel of 92 developing countries in the period 1960–2000 suggests that an increase in openness to trade leads to an increase in the industrial value added share of production, at the expense of the agricultural share. Therefore, trade leads the developing countries to industrialization, in contrast to what the infant industry argument would imply.
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1. Introduction

In a free trade world, each country is expected to export the products in which it has a comparative advantage. This implies that if some sectors of production are growing faster than other sectors, countries with a comparative advantage in the slow growing sectors will grow slower than countries with a comparative advantage in the fast growing sectors. This concern has been a cornerstone of most theories supporting trade protection in developing economies, including the infant industry argument.[1] Many of these economies followed import substitution policies in the past, in particular before the 1980s, in order to develop their non-primary sectors of production, which were considered as the fast growing sectors, and to discourage specialization in agriculture, which was considered as the slow growing sector.

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[1] Bardhan (1970).

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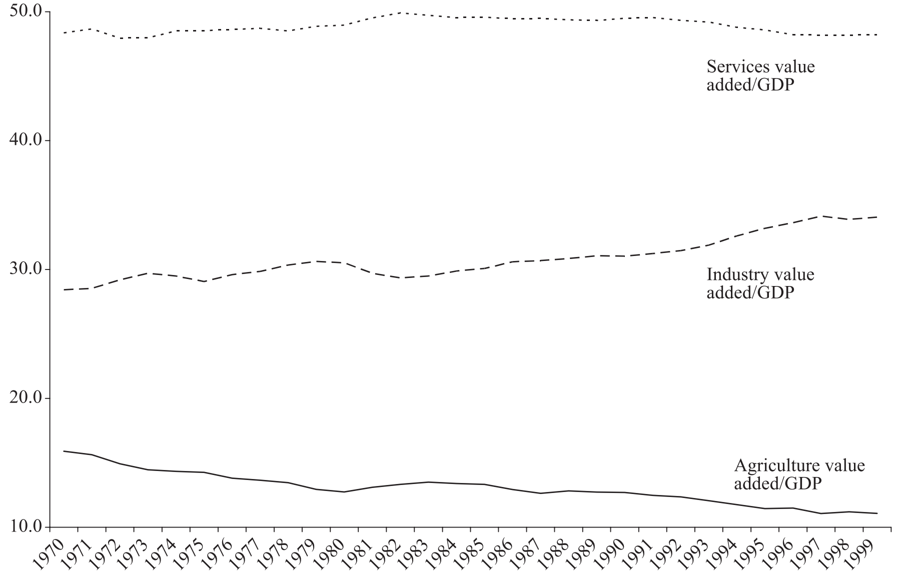

Fig. 1. Real world shares of production, 1970–1999.

Empirical evidence confirms that the agriculture sector is a slow growing sector, and that the industry and services sectors grow considerably faster. Over the period 1970–1999, world agriculture value added grew by an annual average of 2.8% in real terms, compared with 4.8% for world industry value added and 4.1% for world services value added.[2] As Fig. 1 shows, during this period and in real terms, the world share of agriculture value added in production followed a declining trend—from 16% in 1970 to 11% in 1999—the world share of industry value added in production followed an increasing trend—from 28% to 34%—while the world share of services value added in production remained broadly constant (at about 48%). The average share of agriculture value added in developing countries is considerably higher than in developed countries—it was 21% in the second half of the 1990s compared with 2% for the OECD countries—which could justify concerns that trade may lead to even higher production shares in agriculture at the expense of the non-agricultural sectors.

Even though many developing countries have abandoned protection policies in recent years (see Vamvakidis, 2002), protection in developing countries is still higher than in developed countries. Developing countries have a lower trade share on average, as shown in Fig. 2. The Spearman rank correlation coefficient of the trade to GDP ratio (each deflated by its own deflators) and the real GDP per capita during the 1990s is equal to 0.2 with a *t*-statistic of 2.0. This is driven in part by higher tariffs in developing countries. Fig. 3 shows a negative correlation between the real GDP per capita and the duties to imports

[2] World value added includes all countries with available data for all years in the period 1970–1999 in the World Development indicators (World Bank, 2002). It is possible to extend the period to 1960–2000, as done in the empirical section of the paper, but the sample of countries is smaller.

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