Sessions 13-15. Government intervention and economic development and growth strategies

7. Government intervention: policy and strategy
    7.1 Revisiting the case for free trade
        7.1.1 Based on cost-benefit analysis: gains from trade, increased social welfare, no dead-weight loss
        7.1.2 Based on efficiency grounds: cost of trade protection, economic integration, economies of scale; long-term dynamics resulting from liberalization
        7.1.3 Political economic argument: policy making process captured by special interests results in use of trade policy rather than domestic policy
    7.2 Case against free trade (or for government intervention)
        7.2.1 Theoretical conditions under which H-O-S model applies do not hold in practice: theory of 1st best: P_W = MC = MB and private MC = social MC and private MB = social MB is violated (through cases of imperfect competition, externalities, market failure)
        7.2.2 Theory of 2nd best: government intervention can improve domestic welfare through policy intervention (but which policy response is most appropriate: e.g. trade policy or domestic policy in cases of externalities or market failure in goods or factor markets)

8. Strategic policy intervention, by country type
    8.1 Developing strategies in some developed countries: 3 interrelated arguments for intervention
        8.1.1 Factor market failures: presence and consequences of a dual economy
        8.1.2 Import substitution industrialization (ISI): risk and uncertainty in agriculture (Prebisch-Singer hypothesis revisited)
        8.1.3 Infant industry argument: externality from too little manufacturing
    8.2 East Asian export-led development (Japan, S. Korea, dragon economies, China)
        8.2.1 Comparison of Asian trade and industrial policy with ISI in Latin America
        8.2.2 Asian economic miracle: capital accumulation and export-led growth
        8.2.3 Asian financial crisis
            [1] Capital accumulation, marginal productivity of capital and total factor productivity
            [2] Middle-income trap hypothesis; information-communications technology
            [3] Reliance on capital inflows, TOT implications, over-investment and capital flight
            [4] Macroeconomic imbalances and structural economic problems (very large firms; non-competitive domestic markets; firms slow to respond to market signals; large firms with access to capital crowd out small/medium enterprises)
            [5] Political argument: state-owned firms, government-business relations too close
    8.3 Policy intervention in developed economies: use of subsidies and/or trade policies
        8.3.1 Infant industry argument for high value-added sectors: R&D, patent protection
        8.3.2 Externality argument applied to de-industrialization from North-South trade
        8.3.3 Externality argument applied to agricultural sector
        8.3.4 Imperfectly competitive international markets

<u>Key concepts (sessions 11-15)</u>: import/export quotas, quota rents, tariff-quota non-equivalence; export tax, Lerner symmetry condition; subsidy, export subsidy, beggar thy neighbor, spillover effects; case for and against free trade; private and social marginal cost/benefit; externality, market failure, dual economy, infant industry argument, import substitution industrialization; export-led growth; middle income trap hypothesis, de-industrialization

<u>Review questions:</u> What are various reasons given by opponents of free trade for government intervention and use of trade policy? What are the objectives of a government for the trade policies that it uses? When is trade policy an appropriate policy response? What is meant by the policymaking process being captured by special interests? Why might trade policy be considered a politically easier policy response than enacting a domestic policy equivalent? What are the net social welfare implications of policy intervention under large- and small-country scenarios? What are the economic, trade and social welfare effects of a trade policy? Why is the administration of a quota important? Why should countries be concerned with an exporting country that restricts exports?

<u>Key concepts (sessions 16-18):</u> imperfect competition and large-country trade situations; economies of scale, monopoly, oligopoly, monopolistic competition and implications for H-O-S model; product differentiation and intra-industry trade; capital; foreign direct investment, intra-firm trade; internationalization strategy

<u>Review questions:</u> How does imperfect competition from economies of scale affect the predictions and conclusions of the H-O-S model? How is imperfect competition under a homogeneous product different than under a heterogeneous product? How does international factor mobility affect the predictions and conclusions of the H-O-S model?