Sheet 2:

ISI in Brazil

Contemporary Brazil is still seeing the results of policies formulated by Raul Prebisch (1901-1986), the Argentine economist, and Celso Furtado (1920-2004), Brazil's leading advocate of Dependency Theory. Prebisch and Furtado argued that only those countries performing massive indigenous industrialisation could become the focus of the global economy and therefore trigger their own development.

From the early 1950s, Brazil used import substitution (ISI) to change the DNA of a country historically attached to agriculture and mining. Its most spectacular periods of growth in the 20th Century – President Juscelino Kubitschek's "50 Years in 5" (1956-61) and the "Brazilian Miracle" (1967-73) – were largely the result of ISI. It produced annual growth rates in excess of 10 per cent and indeed converted Brazil into a large industrial economy targeted at a vibrant domestic market.

As a result of import-substitution industrialization, the Brazilian economy experienced rapid growth and considerable diversification. Between 1950 and 1961, the average annual rate of growth of the gross domestic product exceeded 7%. Industry was the engine of growth. It had an average annual growth rate of over 9 percent between 1950 and 1961, compared with 4.5% for agriculture. In addition, the structure of the manufacturing sector experienced considerable change. Traditional industries such as textiles, food products and clothing declined, while the transport equipment, machinery, electric equipment and appliances, and chemical industries expanded.

The strategy also left a legacy of problems and distortions

The growth it promoted resulted in a substantial increase in imports, notably of inputs and machinery, and the foreign-exchange policies of the period meant inadequate export growth.

Between 1981 and 1992, the GDP increased at an average annual rate of only 2.9% and per capita income declined 6%.

Inflation became the major problem for the Brazilian economy. During the mid-80's it stayed at an average of almost 100% and then in the last few years of the decade grew to more than 1000% a year, reaching a record

5000% in 1993.

In general ISI was most successful in countries with large populations and income levels which allowed for the consumption of locally produced products. Latin American countries such as Argentina, Brazil, Mexico, and (to a lesser extent) Chile, Uruguay and Venezuela, had the most success with ISI. This is so because while the investment to produce cheap consumer products may pay off in a small consumer market, the same cannot be said for capital-intensive industries, such as automobiles and heavy machinery, which depend on larger consumer markets to survive. Thus, smaller and poorer countries, such as Ecuador, Honduras, and the Dominican Republic, could implement ISI only to a limited extent.

Academic analysis also suggests that there are costs of ISI policies

First, it leads to misallocation of resources away from sectors in which the economy has a comparative advantage and protection imposes consumer welfare loss.

Second, when protection takes the form non-tariff barriers (NTBs) it imposes much higher costs including rent-seeking activities. NTBs such quotas generate rents to the quota holders. Besides the quota induced high prices, quota licenses fetch a high premium on the markets. Those who are able to procure the quota licenses can sell them at a premium to importers who are unable to procure the licenses. These rents provide incentive for economic agents to lobby for protection and they seek ways and means (including bribery and corruption) to obtain licences once quotas are imposed.

Third, these sorts of activity divert entrepreneurial resources from productive activity. This is what Bhagwati refers to as directly unproductive profit seeking activities (DUP).

Fourth, in addition to such waste of resources the IS strategy also tilts income distribution in favour of the upper income groups and reduces employment opportunities as most of the protected industries tend to be relatively capital intensive.