Chapter 7

INFANT INDUSTRY ARGUMENTS FOR ASSISTANCE TO INDUSTRIES IN THE SETTING OF DYNAMIC TRADE THEORY

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I. INTRODUCTORY

The aim of this paper is to survey the protectionist arguments which have been commonly put forward in relation to the economic development of the under-developed countries. I shall begin in Section II with a brief account of the traditional ‘infant industry’ and kindred arguments for protection. In Sections III and IV I shall consider a number of more recent arguments for protection, first on the cost side and next on the demand side of the question, which claim to deal with the broader structural and dynamic problems of economic development of the under-developed countries. In Section V we shall consider some of the difficulties of pursuing an effective protectionist policy in the setting of the present-day under-developed countries, which suggest a conflict, at the practical level, between such a policy and the commonly adopted form of over-all economic development planning involving an all-round restriction of imports.

II. THE TRADITIONAL INFANT INDUSTRY ARGUMENT

The theory of comparative costs is a branch of welfare economics and, in so far as the free trade argument is based on it, the logically acceptable cases for protection may be regarded as the deviations from the optimum due to a divergence between social and private costs. This is how free trade theorists like Professor Haberler would regard both the infant industry case and the related case of external economies and diseconomies which need not be associated with decreasing costs. ‘Social as well as private costs may be increasing, and the underlying situation may therefore be quite stable and still there may be a deviation between social and private...
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costs due to external economies or diseconomies, i.e., due to certain cost-raising or cost-reducing factors which would come into play if one industry expanded and another industry contracted — factors which for some reason or other are not, or not sufficiently, allowed for in private cost calculations.\(^1\) Given a wide enough divergence between the two, private comparative costs may lead a country into a ‘wrong’ pattern of international specialization, say exporting commodity \(B\) and importing commodity \(A\), while the true social transformation ratio between the two commodities would require the opposite pattern with the given international price ratio. This can happen even if both \(B\) and \(A\) are working under conditions of increasing costs. Thus the ‘infant industry’ argument, which further postulates that the neglected industry \(A\) may enjoy decreasing costs as its output expands, can therefore be regarded as a particular case (although a highly dramatic one) of the divergence between social and private costs.\(^2\)

Having conceded the logical possibility of this divergence, the free trade theorists would, however, maintain that ‘as a rule the ratios of private money costs do reflect the true social real cost ratios’, and that ‘the burden of proof is on those who maintain that the exceptions are numerous, persistent, large and, last but not least, practically recognizable and calculable’.\(^3\) They would also stress that in order to make a valid case for protecting an ‘infant industry’ with potential decreasing costs, the following rather restrictive conditions have to be fulfilled. \((a)\) The economies should

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2. Diagrammatically, it is possible to have two variants of the ‘infant industry’ argument. Firstly, we may depict increasing returns in industry \(A\) as in Figure I, by a shift in the production possibility from \(BA\) to \(BA_1\), as the output of \(A\) is increased. This is the version adopted by Haberler (loc. cit. p. 239).

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![Fig. I](image1)

![Fig. II](image2)

Secondly, we may depict increasing returns in industry \(A\) on the same production possibility curve by a change in the curvature as in Figure II. Here, if at a given international price ratio specialization takes place at point \(P\), the country has not attained a full optimum position, because although the marginal conditions are fulfilled, what Professor Hicks described as ‘total conditions’ are not fulfilled. Full optimum will be attained only by complete specialization at point \(A\). This is Tinbergen’s suggested version of the Graham argument (J. Tinbergen, International Economic Co-operation, Amsterdam, 1945, Appendix I).


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