



Import Substitution Strategy of Development

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Abstract

Import Substitution refers to substitution of imported goods by those produced within the country. It implies change in the composition of domestic production in a manner such that we ourselves start producing goods which are imported from rest of the world. Imports can be slashed through two sets of measures: (i) fiscal measures in terms of customs duties or import tariffs, and (ii) quantitative controls in terms of imports of quotas for the stipulated imports. Import Substitution has been accepted as an important component of 'development strategy' and 'international trade strategy' in India right from the inception of Five-Year Plans.

The first stage of Import Substitution entails the replacement of the imports of non-durable consumers goods such as clothing, shoes, and household goods, and of their inputs such as textile fabrics, leather and wood, by domestic production, since these commodities suit the combination existing in developing countries that are at the beginning of industrialization process. The commodities in question are intensive in unskilled labour. Second stage of Import Substitution involves the replacement of imports intermediate goods and producers and consumers durables by domestic production. The production of these goods require highly capital intensive techniques. Economists are not unanimous as to how far Import Substitution policy will be instrumental and helpful in promoting economic development. Indeed, these quantitative studies confirm the usefulness of Import Substitution to economic development. Question arises, would it be expedient for the Government to promote Import Substitution indiscriminately in all spheres of production? It is difficult to answer.

Keywords: Strategy of development, parameters, import substitution

Introduction

Countries that aspire for economic development through foreign trade applies two important measures (1) Export Promotion and (2) Import Substitution. Export Promotion aims at increase in exports. On the other hand import substitution aims at reducing current imports by making some of them at home and use the saving in foreign exchange to import the desired goods. The policies relating to export promotion constitute the outward aspect and those relating to Import Substitution constitute the inward aspect of economic development. In the words of Streeten, "Outward looking policies encourage not only free trade but also the free movement of capital, workers and enterprises. On the other hand, inward looking policies lead to protection and stress the need of self reliance."

Meaning of Import Substitution

Import Substitution refers to substitution of imported goods by those produced within the country. It implies change in the composition of domestic production in a manner such that we ourselves start producing goods which are imported from rest of the world. It includes both capital goods (like plant and machinery) and consumer goods (like computers, TVs and cameras). The emphasis of course is on the consumer goods, the production of which does not require complex technology or huge investment funds. Capital goods (requiring huge investment and complex technology), may not be within the ambit of Import Substitution in a country relying on conventional technology. Import Substitution has been accepted as an important component of 'development strategy' and 'international trade strategy' in India right from the inception of Five Year Plans.

Two Parameters of Import Substitution

Two Parameters of Import Substitution are:

- a. Cutting the import of goods sought to be domestically produced, and
- b. Horizontal and vertical expansion of the domestic industry producing 'substitutes' of imported goods.

Imports can be slashed through two sets of measures: (i) fiscal measures in terms of customs duties or import tariffs, and (ii) quantitative controls in terms of imports of quotas for the stipulated imports. Both the fiscal measures as well as quantitative controls imply a high degree of protection to the domestic industry. Indeed, the Indian Industry continued to enjoy a high degree of protection in the domestic market, staving off competition from the international producers. This policy was vigorously pursued till 1991 when New Economic Policy was unveiled and import restriction were slashed to the minimum. The very fact that import retraction were slashed implied that these restrictions failed to yield the expected results. The expected results were that (i) investment in the domestic industry would pick up and be diversified, and that (ii) domestic substitutes of imported goods would combat negative BoP status of the Indian Economy. Over time we observed that domestic production did not expand to the extent desired, and negative BoP status only tended to surge over time. Ironically, Imports have tended to rise faster than exports adding to the mounting BoP deficit.

Types of Import Substitution

There are two kind of Import Substitution

1. Simple Substitution: Under this kind of substitution, almost an imitation of import good is sought to be produced in the country. There is very little variation in shape and functioning from the imported good. Production of cycles, foodgrains, soda ash, electric motors, etc are the example of simple Substitution
2. Alternative Substitution: In this case, the Substitutes produced indigenously vary in shape and function from the imported product. But its working is more or less the same. Several example can cited, such as, use of copper tubes in sugar making machines, use of plastic sheets in place of steel sheets in cooler industry, etc. Such Substitutions entail lot of research.

Stages of Import Substitution

There are two stages of Import Substitution

The first stage of Import Substitution

The first stage of Import Substitution entails the placement of the replacement of the imports of non-durable consumers goods such as clothing, shoes, and household goods, and of their inputs such as textile fabrics, lather and would, by domestic production, since these commodities suit the combination existing in developing countries that are at the beginning of industrialization process. The commodities in question are intensive in unskilled labour: The efficient scale of output is relatively low and costs do not rise substantially at lower output levels; production does not involve the use of sophisticated technology and network of suppliers of parts, components and accessories is not required for efficient operation. Then relative advantage of developing countries in these commodities explains the frequent reference made to this stage of Import Substitution. It is also called; "Easy stage of Import Substitution" to the extent that the domestic production of these commodities generates external economies in the form of labour training, the development of entrepreneurship, and the spread of technology. In the course of first stage Import Substitution, domestic production will rise more rapidly than domestic consumption, since it not only provides for increases in consumption but also replaces imports.

Second stage of Import Substitution

According to Raul Prebiseh, in the second stage of Import Substitution the undeveloped countries expand their manufacturing industries oriented towards domestic market. This purpose is said to be served by industrial protection that is said to bring additional benefit through improvements in terms of trade. Second stage of Import Substitution involves the replacement of imports intermediate goods and producers and consumers durables by domestic production. The production of these goods require highly capital intensive techniques. They are subject to important economies of scale with efficient plant size being large compared to the domestic needs of most developing countries and costs rising rapidly at lower output levels. Moreover the margin of processing is relatively small and organizational and technical inefficiencies may contribute to high costs.

Objectives of Import Substitution

Import Substitution and export promotion are the basic plans of the foreign trade of each developing country. Need of Import Substitution has increased very much in underdeveloped countries, in view of the following:

1. Unfavorable balance of trade.
2. Devaluation of rupee
3. Shortage of Foreign Exchange
4. Declining Foreign aid
5. Political change
6. India mostly imports foodgrains, Petroleum, Fertilizers, Machinery, metals and Chemical Products. To achieve the objective of self- sufficiency their substitution is inevitable.
7. Developing nations have been experiencing the shortage of many important goods like Petrol, Fertilizers etc. and it has to pay a very high price for their import. The production and substitution of these goods are, therefore, very essential

The main objectives of Import Substitution policy are

1. Import of raw materials, spare parts etc. should be substituted by domestic products.
2. Reduction of import components in each of domestic output
3. Production of Chemical Goods by domestically produced raw materials.
4. To explore alternatives of imported goods and seek their domestic production.
5. To increase the domestic production of such imported items as foodgrains, fertilizers, etc. so that the dependence on imports is minimized.

Method of Import Substitution

Following methods have been adopted to make Import Substitution a success:

1. Tariff Policy

Heavy import duties have been imposed on foreign imports so as to make their prices prohibitive in comparison with domestic goods. Import of non-essential goods or such goods as can be produced in the country, has been completely banned.

2. Increase in production

Industrial policy as well as agricultural policy of underdeveloped countries aims at more production, so that dependence on imports is minimized. Agricultural production has also increased substantially by establishing in the wake of "Green Revolution"

3. Research

To find out the alternatives of import, great stress is being laid on research. Many laboratories at the national level have been set up in the public sector for the purpose. Private sector has also been evincing keen interest in this respect. Government of India has established in 1974 an Import Substitution Award Board. The board gives awards to encourage new inventions and techniques with regard to Import Substitution. The board gives award twice in a year, viz. on the occasion of Republic Day and Independence Day. In January 1991, as many as 489 firms were honoured with the awards. As a result of new inventions and research, foreign exchange worth Rs. 526 Lakh is likely to be saved.

4. Swadeshi Spirit

The biggest hurdle in the way of Import Substitution is the craze for foreign goods on the part of the people. The producers and consumers of underdeveloped countries prefer foreign goods to indigenous goods. This attitude needs to be changed. Efforts should be made to re-ignite the Swadeshi Spirit among the masses.

Evaluation or Result of Import Substitution

Economists are not unanimous as to how far Import Substitution policy will be instrumental and helpful in promoting economic development. Cheneri, Sheeshayee and Ghatankey undertook econometric study of industrial progress in Japan from 1914 to 1954 and concluded that Import Substitution contributed 40 percentage of industrial development throughout these four decades. In India also Import Substitution is of great significance for industrial development. According to the quantitative study conducted by Jalil Ahmid, of the total increase in industrial production in India 1950-51 and 1965-66 one-fourth was the result of Import Substitution. So far as increase in capital goods industries is concerned about one-half was due to Import Substitution. Indeed, these quantitative studies confirm the usefulness of Import Substitution to economic development. Question arises, would it be expedient for the Government to promote Import Substitution indiscriminately in all spheres of production? It is difficult to answer.

Production system gets distorted often as a result of import controls. When new industries are set up under the cover of protection, the factors of production are redistributed in the country there are wide disparities in the distribution of income in India and power is under the control of affluent class. When the import of luxury goods is prohibited their domestic production gets encouraged. Consequent upon the policy of Import Substitution, industries producing conspicuous consumption and luxury goods sprang up rapidly in the country. Of course, in an underdeveloped country like India there is ample scope of the establishment of these industries. According to Dr. Manmohan Singh, "Along with the control on the import of non-essential goods, their domestic production should also be encouraged." In the words of Prof. Padma Desai, "As an instrument of development of an underdevelopment economy, policy of Import Substitution seems to be unable to generate any fundamental change in the economy." Government has not always exercised caution in this respect.

According to Prof. M.P. Todaro, the following are the main defeats of policy of Import Substitution:

1. First, the main beneficiaries of the Import Substitution process have been the foreign firms who, well placed behind tariff walls, could take advantage of tax and investment incentives. After deducting interest, profit, royalty and management fees, mostly which are remitted abroad, the little that may be left over usually accrues to the wealthy local industrialist with whom foreign manufacturers cooperate and who provide their political and economic cover.
2. Second most Import Substitution has been made possible by the heavy and often government subsidized importation of capital goods and companies.
3. A third detrimental effect of many of the Import Substitution strategies was its import in traditional primary product exports.
4. Fourth and finally Import Substitution in practice inhibited the industrialization. It reduces the competitive power of industries, and increase the cost of production of the industries.

It is on account of these achievement that the complexion/composition of our imports has tended to show a perceptible change over time. We are gradually shifting from the import of low-tech consumer durables to the import of hi-

tech producer durables. Even when our import bills are spiking, the compositional change in import bill underscores our success in slashing non-development imports.

Conclusion

In conclusion, we can say that we must support the domestic production, Many consumer goods which were earlier imported are not a part of domestic production. Examples are: TVs, refrigerators and a large variety of automobiles. We have expanded our industrial base (particularly, in the area of information technology) which has given us a competitive edge in the international market. We have gradually increased our focus on the growth of heavy industry and infrastructural assets on account of which our dependence on rest of the world is expected to taper off. Import Substitution should be in respect of the production of those goods which are incidental to industrialization, such as, machine tools, steel, chemical fertilizers, petroleum, news print, etc. Allocation of investment for Import Substitution should be in favour of primary industries. Public and Private sectors should co-operate with each other for the success of Import Substitution. Assistance of foreign capital should be sought to establish Import Substitution industries.

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