

## APPENDIX 1<sup>1</sup>

Import substitution industrialization (ISI) is a trade and economic policy based on the premise that a country should attempt to substitute products which it imports (mostly finished goods) with locally produced substitutes. Even though ISI is a development theory with links to dependency theory, and not naturally a trade theory, its political implementation and theoretical rationale are rooted in trade theory.

ISI policies are theoretically grounded on the Singer-Prebisch thesis and practically on the infant industry argument. From these postulates it derives a body of practices, which are common: an active industrial policy to subsidize and orchestrate production of strategic substitutes, protective barriers to trade (e.g. tariffs), an overvalued currency to help manufacturers import capital goods (heavy machinery), and discouragement of foreign direct investment.

Conceptually, ISI could be outward-looking in that it promotes exports (like in Asia, especially South Korea) or inward-looking without significant links to world markets (like in Latin America). In both cases, however, external competitions by imports in the markets of the targeted industries are discouraged by tariffs. Hence, policies to pursue ISI have a strong protectionist component and are not favored by advocates of absolute free trade.

Import substitution policies were adopted by most nations in Latin America in the 1930s and 1940s because of the Great Depression of the 1930s. In the 1950s the

---

<sup>1</sup> *Wikipedia Encyclopedia Online*, s.v. "Import Substitution Industrialization," [http://en.wikipedia.org/wiki/Import\\_substitution\\_industrialization](http://en.wikipedia.org/wiki/Import_substitution_industrialization).

Argentine economist and UNECLAC head Raúl Prebisch was a visible proponent of the idea. Prebisch believed that developing countries needed to create forward linkages domestically, and could only succeed by creating the industries that used the primary products already being produced by these countries. The tariffs were designed to allow domestic infant industries to prosper.

ISI was most successful in countries with large populations or high living standards, having already a more solid economic basis upon which to function. Latin American countries such as Argentina, Brazil, Mexico, and, to a lesser extent, Chile, Uruguay and Venezuela had the most success with ISI. Smaller and poorer countries such as Ecuador, Honduras, and Dominican Republic were not very successful in implementing ISI policies. In Latin American countries where ISI was most successful, it was accompanied by structural changes to the government. Old neocolonial governments were replaced by more or less democratic governments. Banks and utilities and certain foreign-owned companies were nationalized or transferred ownership to local business people.

Many economists contend that ISI failed in Latin America, being one of many factors leading to the so-called Lost Decade of Latin American economics. Other economists contend that ISI led to the "Mexican Miracle", the period that lasted from 1940 to 1975 with economic growth of 6 percent or more.