4. Protectionism and Structural Adjustment

4.1 One of the most damaging consequences of the slowdown of economic growth in the North during the 1970s has been an inward-looking, defensive reaction epitomised by the 'new protectionism'. In the main this takes the form of quantitative restrictions, but it also includes countervailing and anti-dumping action, minimum prices for imports and government aids to ailing industries. Most of these are adopted outside the normal GATT rules and in a discriminatory manner.

The Spread of Protection

4.2 The new protectionism has been applied so far to a limited number of products. These include textiles and garments, footwear, consumer electronics, motor cars, steel and shipbuilding. But recent developments point dangerously to its widening and intensification, thus confirming its expansive and cumulative nature. Similarly, the proportion of international trade affected by the new protectionism so far is relatively small. But since it is directed largely against labour-intensive imports, some of the affected products make up a substantial proportion of the exports of developing countries. Textiles and garments, the most seriously affected category of manufactures, comprise more than a third of the exports of developing countries to the industrialised countries. A recent estimate for South Korea showed that in 1979 nearly 50 per cent of its exports to the industrialised countries suffered from restrictions of one kind or another. This was almost double the proportion affected in 1975.

4.3 Quantitative restraints are imposed under 'Orderly Marketing Arrangements' (OMAs) and 'Voluntary Export Restraints' (VERs). The former comprise formal agreements laying down targets for the growth rates of imports into the restricting country and of supplies from participating exporters. The latter involve informal agreements in which exporters agree to limit their exports to specified levels.

4.4 The Multi-Fibre Arrangement (MFA) is the most important example of an OMA. Though completely against the spirit of the GATT, it sets the dangerous precedent of being negotiated and administered within the framework of the GATT. It illustrates some of the pernicious effects of protectionism on development prospects. The MFA had its origin in the Long-Term Arrangement on Cotton Textiles established in 1962 and directed at controlling exports mainly from Japan. It was intended to be temporary, to deal with what was described as a unique situation requiring a unique solution. In no way was it to be seen as establishing a precedent. However, in its evolution the arrangement has become entrenched, more comprehensive and increasingly restrictive. Transformed into the Multi-Fibre Arrangement from 1974, it extended its coverage from items of cotton to items of wool and man-made fibres. In 1977 when the MFA was renegotiated, although its text remained unchanged, the GATT waiver under which it operated provided for "reasonable departures". This made it possible for some bilateral agreements to be negotiated which have been more restrictive than the 6 per cent growth of imports allowed under the MFA. The consequence is that the overall growth of exports of the restricted items of textile and clothing from developing countries to the industrialised countries has now fallen significantly. The present MFA comes to an end in 1981. Already there are demands from textile and clothing organisations in the EEC for a more restrictive agreement still. The MFA has also been seen as a possible model for other products such as steel. There is a forceful lobby who advocate the extension of OMAs. They see 'organised free trade' as a central part of international trade policy.

4.5 It cannot be too strongly emphasised that the whole process of economic development is being severely affected by restricted market access. Products such as textiles, clothing and footwear are first-stage manufacturing products for developing countries. When the early growth of exports of manufactured goods is inhibited in this way, economic change is made much more difficult for many developing countries.

Threat to North and South

4.6 The new protectionism is a threat to the structural changes in world production and trade which are necessary for continuing growth and development. While the proliferation of protective devices has had its most immediate damaging effects on the so-called Newly Industrialising Countries (NICs), it is important to all developing countries. It threatens the prospects of the next generation of industrialising countries -- and in the longer-run almost all of the smaller developing countries must seek foreign markets for their manufactures and some of the largest will find it advantageous to do so – but in addition, by slowing down the growth of income and structural change in the NICs, it adversely affects market prospects and development throughout the Third World.

4.7 In the most advanced NICs, such as Korea, Taiwan, Hong Kong and Singapore, rapidly rising real wages have been the fruit of success but also the impetus to further change in comparative advantage whereby these countries move on to the production, for export, of more capital- and technology-intensive products and vacate markets for labour-intensive products to the next generation. Moreover, the rate of growth of industrial production in current and prospective NICs will in considerable measure determine their demand for the primary products, raw materials and foodstuffs, which will remain the staple exports of much of the rest of the Third World. For these reasons, all the Third World shares, in varying degree, the concern of the NICs about the new protectionism and their interest in easier market access through trade liberalisation.

4.8 The paradoxical fact, widely recognised by economists but hard to get across to politicians and the general public, is that resurgent protectionism, while a conspicuous example of policies of the North which hurt the South, does quite as much harm to the economic health of the North itself. Beggar-my-neighbour policies – and much of the resort to higher protection by OECD countries in recent years has been against one another – are liable to spread recession. At the same time, restrictions on imports, whether through tariffs or quantitative controls or other measures to protect high-cost producers, by raising domestic prices add to the forces of cost-price inflation.

4.9 Protectionism has been exacerbated, and rationalised, by the belief that unemployment rates in developed countries are highly sensitive to competition from developing countries. Recent studies do not confirm this view. They have shown that labour displacement brought about by imports from developing countries has generally been negligible. Manufacturing trade between industrialised countries and developing countries has, on the contrary, tended to have a positive effect on employment in the industrialised countries. It is true that industries affected by competition from developing countries tend to be more labour-intensive than export industries, but the overall balance in manufacturing trade between the industrialised and the developing countries is so overwhelmingly in favour of the former that restraints on this two-way trade are likely on balance to have adverse, not beneficial, effects on employment in the industrial countries. Even in terms of gross labour displacement, the effect of competition of imports from developing countries is insignificant compared with other causes of labour displacement, such as technological change, import penetration from other developed countries and demand changes.

4.10 A recent study of this issue with reference to the West German economy has shown that, in the period between 1962 and 1975, 50 times more jobs were lost through growth in labour productivity than through the growth in imports from developing countries.[1] It is pertinent to note also that in the developed countries as a group, 5 million jobs were lost in 1975 through faltering demand. According to another study, relating to the UK economy,[2] the increase in imports of manufactures from 23 NICs during 1970-1975 is estimated to have displaced at most 2 per cent of the 1970 labour force; when account is taken of the effect of increased exports of manufactures to these countries, net displacement was probably zero. These estimates, moreover, make no allowance for positive gains that would have accrued from the higher level of skills in the jobs created than in the jobs lost.

4.11 A survey sponsored by US retail organisations in 1978 found that goods imported from Asia and Latin America were on average sold at retail in the United States for 16 per cent less than domestic products of the same quality. It has been estimated in a recent study that the effects of protectionist measures imposed by the United States between 1975 and 1977 resulted in extra costs to consumers of $660 million for sugar, $1,250 million for carbon steel, $400-$800 million for meat, $500 million for television sets and $1,200 million for footwear.

4.12 It is worth noting also the small extent of import penetration which has actually taken place. Exports of manufactures from developing countries were only 7 per cent of world exports in 1976 and were responsible for less than 2 per cent of the consumption of manufactures by industrialised countries. Even in clothing and textiles, where import penetration was highest, developing countries in 1975 supplied only 8.2 per cent and 3.2 per cent respectively of the consumption of the industrialised countries.

4.13 These facts pose an obvious question: why is there so much protectionism when it can be shown to have such boomerang effects? An important

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1. Frank Wolter: *Adjusting to Imports from Developing Countries: The Evidence from a Human Capital-Rich Resource-Poor Country*, in Herbert Giersch (editor): *Reshaping the World Economic Order, Symposium 1976* (Tubingen, 1977).

2. UK Foreign and Commonwealth Office: *The Newly Industrialising Countries and the Adjustment Problem, Report by a Working Group* (London, January 1979).

factor seems to be that while the benefits from foreign competition are diffused and not easy to identify immediately, the social costs are easily identifiable in actual jobs lost and firms which have to diversify to new products, to contract or to close down. This causes an asymmetry in political pressures. What is needed is more information and knowledge about the wider effects of protectionism. This is a task for governments and affected groups such as consumers. It must be carried out if governments are not to continue to be led to adopt irrational and inefficient policies.

4.14 Trade restricting policies not only hamper growth in obvious ways by limiting actual and potential productivity gains and probably have on balance adverse effects on employment but, more fundamentally, they also contribute to what has recently been described as the 'core of the malaise' in the North, 'lost dynamism'. "What make many of these systems now sound like muted versions of 1930s-style secular stagnation are sluggish innovation, dampened investment, lock-ins of resources to low-return uses, impaired reallocation, attenuated competition and fractured markets -- in short, weakened propensities for what OECD has taken to calling 'positive adjustment'."[1]

4.15 Such a diagnosis leads to the conclusion that the relation between faster growth and freer North-South trade is two-way. The correlative of "the standard observation of most diagnoses of protectionist pressures . . . that the best antidote will be accelerated growth and diminished unemployment in the developed countries" is that "by comparison with all realistic alternatives, the combined potency and feasibility of using competition of imports from the developing countries to agitate and stimulate supply-side adjustments in the OECD countries is formidable". "We have a chicken-and-egg phenomenon: trade needs growth but also . . . growth needs trade".[2]

Positive Adjustment Policies

4.16 We strongly support this emphasis on "the centrality of trade in a mutual interest agenda".[3] Primary responsibility here lies with the North, and the most general recipe for improvement is well defined by the notion of 'positive adjustment'. We cannot do better than quote a recent statement of its general policy implications:

(i) "Action should be temporary and should, wherever possible, be

1. OECD: *Development Cooperation, 1979 Review* (Paris), page 31.

2. Ibid., page 32.

3. Ibid., page 32.

reduced progressively according to a pre-arranged timetable.

(ii) Such action should be integrally linked to the implementation of plans to phase-out obsolete capacity and re-establish financially viable entities, without, however, seeking to raise prices above levels providing an adequate return to efficient producers.

(iii) The cost should be made as evident as possible to decision-makers and the public at large. Careful attention should be paid to the cost to consumers of action which raises prices, to the cost to taxpayers, and to the effects of subsidised competition on employment elsewhere.

(iv) Where public funds are being injected into the private sector, it is desirable that private risk capital should be involved.

(v) Assistance given on a company-by-company basis should be framed so as to provide an incentive for improved management practices, notably by ensuring sufficient domestic and international competition.

(vi) Where the primary objective is to support employment in particular regions or towns, consideration should be given to action that can benefit any eligible company in the area concerned, rather than only those in financial difficulty.

(vii) While recognising that governments must pay due regard to the interests of national security, care should be taken to see that arguments based on considerations of self-sufficiency should not be misused to justify measures for protection and support".[1]

In this spirit, and with the need for freer market access for the developing countries particularly in mind, we list some of the policy initiatives which in our view should have a major place in the North-South dialogue in the months and years to come.

Maintaining the Momentum of Trade Liberalisation

4.17 The first need is for the industrialised countries to persevere in the process of trade liberalisation through multilateral trade negotiations (MTNs) along the road travelled by the Kennedy and Tokyo Rounds, and for the developing countries to maintain their political pressure on the industrialised countries for freer access to their markets for Third World manufactures.

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1. OECD: *The Case for Positive Adjustment Policies* (Paris, June 1979) pages 4-5.

Beyond this, the developing countries should take the maximum advantage of the openings for liberalisation presented by the Tokyo Round. They can do so by signing the Tokyo agreements and thus securing the right to participate actively in the future management of the new codes and in the material benefits which can be achieved under the improved rules of the codes.

Safeguard Measures

4.18 One of the most serious obstacles to the liberalisation of trade is abuse by the industrialised countries of 'safeguard measures'. The case for such safeguards to obviate severe disruption of a local industry cannot be rejected entirely, yet once conceded it opens the way wide for restrictive policies. Failure to reach agreement on this issue was a major shortcoming of the Tokyo Round. Discipline in the application of safeguards would have provided some deterrent to protectionist policies. In the event, a GATT Committee of all MTN participants was established to continue negotiations beyond the conclusion of the Tokyo Round. Its aim is to elaborate supplementary rules and procedures regarding the application of Article XIX, so as to provide greater uniformity and certainty in the implementation of its provisions. The Committee was expected to submit a report to the Contracting Parties by 30 June 1980, but at this stage there is no indication of progress on outstanding issues. It is our hope that the negotiations will consider safeguard actions taken not only under Article XIX, but also under other GATT provisions, as well as VERs and OMAs negotiated outside the GATT.

4.19 What is needed is a safeguard system comprehensive in scope and sufficiently flexible in operation to encompass circumstances which, while not a feature of the trading world at the inception of the GATT, are today more the rule than the exception. We strongly support the recommendation of the Brandt Commission that safeguard action should be permitted only under limited and clearly defined conditions; it should be subject to automatic reductions over time and to multilateral control and surveillance, and be linked with the adoption of positive policies of industrial adjustment.

Barriers to Processing

4.20 The reduction of tariff escalation on processed products is of concern to many developing countries. Industrialised countries historically have tended to have an initial cost advantage in processing industries for a wide range of raw materials produced in developing countries and have continued to encourage and protect such industries when their cost advantage began to wane. They have done this chiefly by levying higher tariffs on the processed products than on the raw materials. Since such higher tariffs fall largely on the value-added, they provide very high levels of effective protection.

4.21 The Generalised System of Preferences (GSP) was intended to deal with the problem of tariff escalation but it has made little difference. The reduction of tariff escalation on a most favoured nation (mfn) basis thus remains of great importance to developing countries. Even after the Tokyo Round, the degree of tariff escalation for manufactures (CCCN 25-99) is still very marked, as shown by Table 4.1.

4.22 Local processing of raw materials is a form of industrialisation in which developing countries frequently have a comparative cost advantage or the least comparative disadvantage. Its discouragement by tariff escalation is therefore particularly damaging to many countries of the Third World, including the least developed. The rise in the cost of energy in the past decade has tended to shift comparative advantage in energy-intensive processing towards countries with adequate sources of energy, including many in the Third World. They should be helped, not hindered, in taking advantage of this opportunity.

4.23 How large the potential scope for industrial development based on processing can be is indicated by several recent studies. A World Bank study on minerals has shown that in 1970 developing countries obtained less than one-third of the gross value-added they could have generated had they refined their minerals up to the metal ingot stage before export. A more recent UNCTAD study has estimated that developing countries would have earned in 1975 $27 billion more from ten commodities had they undertaken production only up to the semi-processing stage. This amount would be one and a half times the level of export earnings from these commodities. Such figures do not, of course, prove that local processing would in each and every case be an economic use of resources. But they demonstrate that this is an area where trade liberalisation would make a particularly important contribution to development.

Agricultural Protectionism

4.24 Protectionism in agriculture has a long history. Unlike trade in manufactures, trade in most agricultural products benefited little if at all from the movement towards trade liberalisation by and among the industrialised countries during the 1950s and 1960s. Indeed, the European Economic Community remains the most conspicuous example of agricultural protectionism. One symptom of this asymmetry is the failure of GATT to apply to agricultural trade the principles it seeks to maintain for trade in manufactures. The feature of agricultural protectionism which permits, if it does not

TABLE 4.1

Tariff Rates on Processed and Unprocessed Imports into Industrialised Countries (percentages)

		Post-MTN tariff averages	
		Trade-weighted	Simple
Wood, pulp, paper and furniture	Raw materials	0.2	0.7
	Semi-manufactures	1.9	3.7
	Finished mfrs.	4.2	5.1
Textiles and clothing	Raw materials	0.8	2.9
	Semi-manufactures	11.5	9.6
	Finished mfrs.	16.7	11.8
Leather, rubber, footwear and travel goods	Raw materials	0.0	1.0
	Semi-manufactures	4.4	4.5
	Finished mfrs.	10.2	10.2
Base metals	Raw materials	0.0	0.2
	Semi-manufactures	3.2	4.6
	Finished mfrs.	5.9	6.1
Minerals, precious stones and metals	Raw materials	0.3	1.4
	Semi-manufactures	1.1	3.6
	Finished mfrs.	6.9	6.5

Source: GATT: *The Tokyo Round of Multilateral Trade Negotiations,* Volume II – Supplementary Report (Geneva, January 1980).

justify, this differential treatment is that it largely takes the form of domestic agricultural price support programmes, rather than tariffs or other overt trade restrictions. But the effect on trade is often much more severe, with tariff equivalents frequently well over 100 per cent. Another facet of agricultural protectionism that has made it so pervasive and obdurate is that it derives support from non-economic motives, such as self-sufficiency in food for reasons of national security or protection of the countryside on environmental grounds, which, sound or specious, are not easily brought into an economic calculus. As in the case of industrial protectionism, the benefits to well-organised producer interests are concentrated while the costs to domestic consumers and taxpayers are diffused, and the damage to more efficient foreign producers is discounted.

4.25 In the case of agricultural protectionism, much of this damage falls on the major non-European temperate-zone food producing OECD countries. But developing countries also suffer. Very little progress has so far been made in rationalising agriculture within the EEC. The Common Agricultural Policy is regressive in its effects, since poor consumers, who spend a higher proportion of their incomes on food, and poorer taxpayers provide income transfers to better-off farmers. It has served to discourage movement of people from the land, despite the fact that in the 1960s there were labour shortages in the industrial and service sectors. Internationally, it entails a misallocation of resources since it discourages production in other countries even though they may have a comparative advantage in the products concerned.

4.26 At present, products such as sugar, beef and rice from developing countries are allowed very restricted access to the EEC. This is the case even under the fairly liberal ACP/EEC Lome Convention. EEC sugar policy provides a good example of how inefficient domestic policies can distort world production and trade. Backed up by high internal prices, the EEC has been able to move over the last five years from self-sufficiency to surplus production of over 3 million tons of sugar. The surplus has been dumped on the world market at a cost to the EEC taxpayer of about £350 million in 1979. Meanwhile, the EEC has remained outside the International Sugar Agreement which in order to stabilise prices has over the last two years been restricting supply to the world market. EEC policy appears even more incongruous when account is taken of the fact that most of the increased consumption of sugar in the world is taking place in the developing countries.

4.27 Present GATT rules, for the reasons just mentioned, are tolerant of barriers to agricultural trade. Certain exemptions allow the imposition of import restrictions on agricultural or fisheries products where this is necessary in the enforcement of such governmental measures as domestic agricultural support programmes. In fact, measures adopted at borders, such as tariffs, quotas, variable levies and export subsidies, are usually geared to such programmes. Their relaxation, therefore, becomes closely tied up with domestic farm income and other policy objectives. One of the most perverse aspects of agricultural policies such as the Common Agricultural Policy of the EEC is that they tend to result in huge surpluses which are then often disposed of on world markets by means of overt or covert export subsidies, to the detriment of third-party exporters, whether in other developed or developing countries.

4.28 Although the position of agriculture in the GATT received greater attention in the Tokyo Round than in previous rounds of MTNs, the results were limited. Even after the Tokyo Round, about one-half of agricultural exports from developing countries to industrialised countries remain dutiable at either mfn or GSP rates. The impact of agricultural protection on the exports of developing countries has been assessed in various studies. The latest of such studies, undertaken for FAO in 1979, estimated that a 50 per cent reduction in the protection on food and feed commodities in OECD countries would bring a $3 billion annual increase in aggregate foreign exchange earnings on exports from 57 of the more populous developing countries. Two-thirds of the overall increase in exports would be accounted for by sugar, beef and wine; non-competing products (coffee, cocoa, tea and bananas) would account for 10 per cent.

4.29 A more determined effort is required to liberalise agricultural trade. Such liberalisation is of interest to many developed countries also, and developing countries should join forces with these countries in demanding freer agricultural trade. The EEC should contribute to more stable world markets by less frequent variation in its import levies and by lowering intervention prices. It should certainly phase-out export subsidies and should consider offering guaranteed shares in its market to low-cost producing countries which crucially depend on exports of particular commodities. In the longer-run, it should be persistent in promoting a smaller and more efficient farming sector though liberalisation and structural adjustment, in much the same way and for basically the same good economic reasons as its members rightly demand of countries with traditional policies of industrial protectionism.

4.30 There is no justification for the continuation of barriers of any description on exports from the developing countries of non-competing products. A commitment should therefore be sought for their complete removal as early as possible and in any case not later than the end of 1981. For other products, where free-access would present too great a disturbance to internal farm support or other policies, assistance to developing countries should be in the form of at least partial relaxation of measures, for example enlargement of quotas, duty-rebates, etc., and the scrupulous observance of developing country interests in implementation of the relevant codes on non-tariff measures that emerged from the Tokyo Round.

Trade with Centrally Planned Economies

4.31 Although trade between developing countries and the socialist countries of Eastern Europe has been expanding rapidly, it remains a very small proportion of world trade, with considerable scope for expansion. In 1977, only 3.7 per cent of the exports of developing countries went to the USSR and other East European countries. Although not significant producers themselves, the socialist countries constitute a large potential market for tropical products such as coffee, bananas and citrus fruits as the standards of living of these countries rise. Trade with centrally planned economies requires of course special trading and payments arrangements and these are at an early stage of development. While the payment problem should not be underestimated as a constraint, centralised decision-making in the socialist countries provides the opportunity for policy decisions which could quickly expand purchases of products of developing countries. The socialist countries could play a substantial role in expanding trade opportunities for developing countries and it is important for economic development that they should take these responsibilities seriously.

Trade Among Developing Countries

4.32 The expected lower growth rates of the industrialised countries in the foreseeable future, as well as the rise of protectionism, make it necessary for developing countries to pay special attention to the opportunities for trade expansion among themselves. In 1975 intra-developing country trade was responsible for 23 per cent of the exports of developing countries and 35 per cent of their exports of manufactured goods. Recent years have seen some improvement in the relative importance of intra-developing country trade, especially trade in manufactures. The rapid expansion of imports by OPEC has no doubt been a major factor. This points to the great potential for the future. Between 1973 and 1978, exports of manufactures by the non-OPEC developing countries increased at an average annual rate of 22 per cent to industrialised countries, of 35 per cent to OPEC, of 23 per cent to non-OPEC developing countries and of 10 per cent to the Eastern trading area.

4.33 A significant constraint on this trade is the undeveloped state of the infrastructure – shipping linkages, export credit financing and payments arrangements. These must be given priority attention. Trade policy must also be geared to facilitating such trade. There is scope for mutual trade preference schemes, both regional and inter-regional. Some such regional schemes are in existence. The path to greater trade and economic integration has not in all cases been smooth because of the complexities introduced by unequal levels of development and the unequal sharing of benefits and costs. Strains have also been caused by the serious balance of payments problems faced by some member countries in recent years. Such problems should be regarded as challenges, and the opportunities provided for economic development through trade creation from scale and infant industry considerations, especially for smaller countries, must continue to be grasped. Regional and other economic integration schemes among developing countries, however, must be sufficiently outward-looking that the greater trade opportunities with industrialised countries will not be neglected.

Need for New Initiatives

4.34 There are clear opportunities for new initiatives. As a consequence of the Tokyo Round, the 35th Session of the GATT Contracting Parties held in November 1979 gave permanent legal sanction to special and differential treatment for developing countries. This now makes possible, for the first time, special MTNs for the express purpose of trade liberalisation by developed countries in favour of developing countries. At such meetings any agreements would be subject to the traditional GATT binding (unlike the GSP). This advantage secured by developing countries should be fully utilised.

4.35 This development comes at the same time as the end of the first ten years of the EEC GSP which, after the modest Australian scheme, was the first to be implemented. The EEC is now giving consideration to the need for basic changes in its scheme. It coincides with the renegotiation of the MFA, which must take place before the end of 1981. The fact that the Tokyo Round did not deal with the relaxation of OMAs and VERs makes this a particularly important issue.

4.36 The time is ripe for a comprehensive examination of the whole problem and for negotiation of access of the exports of developing countries to the markets of the industrialised countries. The global round of North-South negotiations which is to start in 1981 provides an opportunity. Negotiations, and the framework for such trade negotiations, should be a priority subject for the UN Special Session on Development which is to take place in August-September 1980.

4.37 "The great challenge for the North", to quote the Brandt Commission's Report,

> "therefore is to cope with the difficulties of adjustment so that world trade can expand; to see its trade with the South not as a threat but as an opportunity; to see it not only as part of the problem but as part of the solution. In the end, failure of the mature industrial economies to adjust to the realities of international competitiveness may deprive them of their prosperity and impose far costlier and more disruptive adjustments than those which their current measures of protection attempt to postpone. The industrialised countries cannot expect their valuable exports to developing countries to continue (and the large loans by commercial banks to several of them to be repaid) if they do not permit them to earn their way by selling their manufactures in return. The challenge to the South is to develop the necessary expertise and trained manpower to ensure their own industrial development and to respond positively to the trade opportunities created by improved access to the markets of the North. Considerable mutual interests of North and South lie in the changes in the world economy implied by the South's industrialisation".[1]

1. Independent Commission on International Development Issues, op.cit., pages 70-71.