NOTES ON RISING PROTECTIONISM IN DEVELOPED COUNTRIES AND ITS IMPLICATIONS FOR DEVELOPING COUNTRIES

By

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In recent years there has been a growing perception that growth
world trade has decelerated. The perception manifests itself in t
negotiations for trading agreements wherein countries either h
into existing restrictive arrangements or substitute new but equa
restrictive guidelines for the dismantling of others at the same ti
announcing a commitment to free trade. Partly resulting from serio
economic crises that have troubled most of the world, the mo
specific perception is the increasing protectionist move amo
developed and industrialized countries and the reactions taken
others that have been, if any, retaliatory.

This paper is intended to lay out some of the issues around rece
world economic events and to understand the notion of rising prot
tionism in developed countries and its implications for the develo
ing countries. In the four sections of this paper an attempt is made
(a) trace some factors that have led to rising protectionism, (
elaborate on some of the manifestations of protectionism, (c) poi
out a range of implications for the developing countries, and (
indicate directions and options for the trading nations.

I

The post-war growth of world trade has been significantly hi
relative to the previous post-depression era. This was characteri
by satisfactory economic performance among most world tradi
nations and problems were more of searching for acceptable mea

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[1] See the World Bank, *World Development Report, 1978* (Washington D
The World Bank, 1978), p. 13.

of liquidity, of transferring real resources and of helping emerging nations into sustained growth paths than of opposing barriers to trade.

But the succeeding disturbances, internally or internationally during the late sixties and early seventies led to an emerging order with a character wherein countries, especially developed ones, began to pay more attention to domestic interests and applied inward-looking policies. Some of the mutually reinforcing dimensions precipitating this changing order were the prominent inflation and employment issues, the oil crisis and raw materials question, the slow recovery from various shocks, and the increasing competition posed by developing countries in the international trading arena.

The wide application of post-Keynesian synthesis in economic policies in the United States and Western industrialized countries to prime growth at targeted rates carried with its inflationary and unemployment tendencies, the long term trade-offs of which not many appreciated nor anticipated. With the increasing difficulties of solving unemployment and inflation dilemma, more and more clamor was heard for policies to direct domestic economic activities.

A creeping inflation, interspersed with undesirable employment effects, became more prominent with the oil crisis in 1973. The shock was doubly dramatic since not only was a four-fold price increase in oil unexpected but that the possibility of supply cartels was indeed real. This singular disturbance also revealed the dependency structure, at least for some countries such as Japan, in the international trading system. The resulting domestic focus came in the form of adjustment measures to ease affected industries and an accelerated search for energy substitutes.

The twin factors of domestic economic management and coping with the oil crisis implied a slow and difficult recovery. If comparison can be made on the performance of industrialized countries before and during the onset of the set of dimension that demanded inward and protectionist stance, it is clearly shown that only about half of the growth rate was recovered in the ensuing years. For example, the average annual growth of the gross domestic product in North America was about 4 per cent in the decade of 1960-70 while the average in 1970-75 was 2.4 per cent. Japan achieved 9.4 per cent prior to the crisis and struggled to 5.0 per cent in 1970-75.

In the more germane scene of international trade, the changing and emerging comparative advantage structure signalled the competitiveness of developing countries' exports of light manufactures such as clothing, leather, and electronics. Partly because of constant technology in these types of industries and partly due to slow labor productivity growth unit costs in the light and semi manufacture industries implied declines in comparative advantage relative to some developing countries. The reactions to this changing pace of comparative advantage have been both emotional and rational. Within the affected industries and firms, the demand has been for support of distressed sectors. Within some developed countries, the alternative had been to devise ways and schemes for a compromise — preserving or easing adjustment processes while at the same time finding ways to accommodate industrial growth and competitiveness of developing countries. All in all however the skill and technological diffusion that occurred quite fast among developing countries paved the way for a new emerging trade pattern that has immediate threatening effects on a small range of developed countries' traded products.

II

When the several dimensions briefly noted in the previous section are seen *en toto,* it is clear that the pattern of policy, trade and economic behavior of developed countries has been toward increasing attention to domestic interest and renewed protectionism. While most of (non-oil producing) developing countries were equally exposed to the post-1970 world economic disturbances, the openness of these economies perhaps relieved some of the external shocks. At the same time, it must be admitted that more degrees of freedom were available to developed countries in terms of incremental protectionist measures whereas some self-limits are already existent in developing countries.

Both traditional trade and non-trade barriers were increasingly erected especially after the 1974 general recession. Although simultaneous negotiations were being carried out to promote free trade, it is apparent from the foregoing discussion that indeed the eventual effects were far from the avowed intentions of free trade and commerce.

Perhaps the single victim of increased protectionism would be trade of semi and light manufactures from the developing countries

As pointed out previously, this seems to be where the growing comparative advantage of low labor cost countries' lie. While it is true that trade in primary products still dominates a developing country's commerce, rates of growth of manufacturing exports are of greater significance.[2] Conversely, it is also in the area of manufacturing that developed countries' potential lies.[3] Obviously this is where both conflict and agreement will occur. Exports that go through multi-stage processing or accrue high value added such as those in the field of manufactures undoubtedly contribute to developing countries' aim of industrial growth and sustained economic development. It is thus important to achieve accelerated trade in these items of comparative advantage. In the same vein, therefore, policies which hinder the free exchange and trade among them constraint any country's growth potential.

Neither can one expect diffused and sustained long run development from primary export trade. Low income elasticities of demand, availability of adequate substitute, and the specter of fixed supplies would contribute to trade instability among them.

The attention in the area of manufacturing is intended to provide focus in the assessment of various protectionist policies adopted by developed countries.

First, the imposition of tariffs provides the initial vehicle in putting trade barriers. The tariff structure of developed countries is biased against semi-finished and finished manufactures. Although progress has been made in the five rounds of the General Agreement on Tariffs and Trade (GATT), in the Kennedy Round between 1967 and 1972 and in the current Tokyo Round in terms of reducing the absolute *ad valorem* duties of traded products across different stages of processing, the *relatives.*[4] Structure basically remains the same

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[2]In the period 1960-1975, a dramatic shift in the composition of developing countries' exports accrued showing manufactures increase by three times in share from 5 to 17 per cent of merchandise exports.

[3]The developed countries on the other hand experienced during the same period of growth in share of manufactured exports of only around 40 per cent from 52 to 76 per cent of its merchandise exports.

[4]See G.F. Erb, "Negotiations on Two Fronts: Manufactures and Commodities," Overseas Development Council, *Development Paper 25* (March 1978).

and the existing biases against processing continue. The average nominal tariff levels in 1973 in the European Economic Community (EEC), the United States (U.S.), Japan, Australia, Sweden, and New Zealand among others was 2 per cent on all items of raw materials, [illegible] per cent on semi-finished manufactures, and 9.8 per cent on finished manufactures.[5] The multiple escalation of nominal tariffs is particularly deterring increases in value added in the developing countries. For example, the trade weighted average tariffs of eleven developed countries in zero for raw hides and skins, 9.6 per cent for Bovine cattle and equine leather, 5.6 per cent for sheep and lamb skin leather, 14.3 per cent for travel goods, 13.1 per cent for leather clothing and accessories, 16.4 imposes 6.1 per cent nominal tariffs for raw cotton, 8.3 per cent for cotton yarn and 15.6 per cent for cotton fabrics.[7]

Now when the tariff structure is reckoned in terms of its effective rates, the protective wall would obviously be higher. The mean tariff rates from some calculations show effective rates from twice to as much as three times the nominal rates such as the U.S. (8.6 per cent and 18 per cent), Japan (16.5 per cent and 45.4 per cent), and EEC (12.2 per cent and 33.1 per cent).[8] As long as tariff cuts are couched in nominal terms the room for protection is still large and in fact preserved. Comparing Pre-Kennedy and Post-Kennedy Round tariff rates on industrial countries' imports of manufactures from the developing countries, the average nominal rate decreased from 17.[illegible] per cent to 11.8 per cent, yet in effective terms it dropped from 33.[illegible] per cent to 22.6 per cent.

Second, with the acceptance of the need to reduce protectionist stance along tariff cuts and multi-lateral trade negotiations (MTN) the adoption of most-favored-nation (MFN) clauses, and just the sheer commitment to free trade must come short-term measures

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[5] Derived from the World Bank, "Trade Liberalization and Export Promotion," (Mimeographed, 1977).

[6] *Ibid.*

[7] A.J. Yeats, "Effective Tariff Protection in the United States, the European Community and Japan," *Quarterly Review of Economics and Business* (Summer 1974).

[8] *Ibid.*

intended to cushion the impact of developing country accessibility to developed country markets. Various forms of non-tariff barriers (NTB) are being imposed either to artificially encourage exports or curtail imports.

What is particularly noticeable in this context is that more countries have applied a wider range of NTB's to a greater proportion of their imports in 1976 than at any time since the 1974 recession or the prior crises year. The manifestations of such NTB's are varied — from institutional schemes such as customs classifications and procedures, weights and measures, trade and marketing agreements, health requirements to technical schemes such as safety requirements, various taxes, quotas, and countervailing duties — a count can be made up to 47 different schemes.

The message of NTB's is that it can more than adequately provide the protection that nominal tariffs do in international trade, either multilaterally or through bilateral arrangements. Standards of safety are equivalent to MFN tariff structures since they are applicable to all countries. The few research studies of NTB's show a positive association between (unweighted) tariff averages and NTB-incidence rates such that if success is made with regard to MTN tariff reductions, the NTB's are likely to absorb the protective mechanism.

At the bilateral negotiations level, NTB's are equal tools of protectionism. The creation of Orderly Marketing Agreements (OMA) in the U.S. is effectively a quota system designed to protect domestic industries from developing country competition. The same can be said of "voluntary export restraints" arrangements between importing and exporting nations. It must be admitted however that in some cases, such applications are warranted (e.g. balance of payments problems) although one can argue that NTB's may not be the appropriate solution. The issue is not the application but rather the extent to which they curtail the efficient structural change in the international trading system.

Third, and along the same line as NTB's, the concern for environmental factors in developed countries has critical implications for pricing a competitiveness of developing country exports. For one, the stringent standards set by importing countries demand additional processes which could have been achieved. For another, the detailed environmental matters developed countries seek in particular products are not usually symmetric in developing countries. Through transmission, such protectionist measures shift pricing structures even in the domestic sectors of the developing countries.

Finally, there is also apparent distortion in the process of physically moving manufactured exports from developing to developed countries. It appears that shipping rates, perhaps administered, escalate with the processing stages of the products being exported. Furthermore, the shipping freight rates do not appear either to be determined by the associated (derived) demand for the products being stripped.

The enumeration of the various tariffs and non-tariff barriers or mechanisms that reflect protectionist atmosphere in developed countries implies that the exhaustion of traditional barriers to trade does not guarantee a freer world trading system.[9] What must be appreciated is that the institution of protectionist measures to limit or prohibit trade has consequences for both trading countries in the short and in the long run. It is only by understanding these can discussions of trading arrangements be seen in a proper perspective. The implications of the growing protectionist sentiments among developed countries need to be clarified in the context of the exporting and importing nations.

III

Given the variety of protectionist tools the developed countries evolved, one need not invoke nor technically explain neoclassical international economics in order to point out their associated theoretical and empirical difficulties.

On the part of the developing countries, rising protectionism among developed countries does not guarantee sustained and accelerated economic growth. Restrictions imposed and barriers erected prevent smooth structural adjustments according to factor endowments and comparative costs to occur not only in one country but among developing countries. For example, as Japan adjusts to an increasing comparative advantage in heavy industries she must be

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[9] I. Walter, "Barriers to International Competition: The Application and Liberalization of Non-tariff Distortions," Chapter 5 in R.G. Hawkins and I. Walter (editors), *The United States and International Markets* (Lexington, Massachusetts: Lexington Books, 1972).

able to break into new markets as she moves from labor-intensive light manufactures. Similarly, emerging developing countries must be able to get access to developed country markets for light manufactures in order to gain comparative advantage at the same time displacing Japan. But none of these adjustments will occur if trade rigidities are present. Therefore, while restrictions may be product or country specific, their implications are far more general and encompassing.

Lower export earnings may mean inability to get development assistance through loans, unfulfilled growth plans and downward adjustments for balance of payments purposes.

Skewed nominal and effective protection rates tend to prevent manufacturing processes that would otherwise be optimally pursued in a policy of freer trade. Since trading prices include in them distorted resource costs, resource misallocations are the general tendencies in both developing and developed economies.

On the part of developed countries, the rationale includes preventing mass unemployment in import-competing industries, avoiding inflationary pushes that disturb the general economy, and easing adjustment processes in cases of clear comparative advantage.

The issues of unemployment as a result of imports from a developing country is not clear to be of net benefit to developed countries. The evidence that surrounds this is quite ambiguous but indicative. For example, it is probably true that employment is affected more by the economy in general than imports in particular. Where imports are concerned it is known that employment lost through imports are fully offset by employment in the export industries. Of course adjustments may have to be made in particular firms or affected industries. But then the need may be for incentives to resource mobility rather than adjustment relief.

The stark implication of these behavior is that developed and developing countries are affected by the volume and direction of trade with each other. Yet the developed countries are affected more by this kind of protectionist stance. Around 21 per cent of the merchandise exports of developed countries went to developing countries while around 72 per cent of developing country exports went to the developed countries. In absolute size however, what's important is the volume and value. The World Bank reports[10] some US$ 123 billion exports from developed countries (1975) whereas developing countries in turn exported around US$ 26 billion. The interaction between the two kinds of countries through trade has been quantified to show that a 3.1 per cent increase in the growth rate of non-OPEC developing countries lead to a 1 per cent growth rate in the growth of OECD.[11]

With respect to the perceived surge of developing country products into industrialized nations, developing country exports of manufactured products are on the average an insignificant (but increasing) fractions of total supply — less than 10 per cent. The implication argued of displacing import competing industries is not true though some painful adjustment may be necessary to arrive at an equilibrium mix of numbers in the industry structure.

In the short run, it is quite obvious that protectionist policies provide latent relief to affected industries, reduce imports, and improve payments situation (assuming this is a concern). On the other hand, supplying countries experience plant under-capacities, reduced export earnings, and worsened payments position. To the extent however that restrictive practices are not followed the short run also creates uncertainties for developing countries and opens industry sentiments in developed countries to be translated into protectionist policies.

The kinds of protectionist tools outlined in this section means that the long run trade patterns may be inefficient and not reflective of comparative costs and resource endowments. To continue applying protectionism in the short run delays smooth structural readjustments vis-a-vis cost and demand changes and it only creates rigidities that ultimately will have to face. In this context, the developing countries would be at the shorter end in terms of foregone production and growth. But the fact remains that developed countries will also suffer.

Considering the apparent net disadvantages of the growing protectionism for both developed and developing countries,

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[10] The World Bank, *op. cit.*, p. 16.

[11] G.F. Erb, *op. cit.*

wonders whether such policies are pursued for non-economic reasons. Needless to say, the MTN provides a partly sober forum to assess various alternatives and directions for the developing countries.

IV

Assuming developing country potentials are in manufactured exports, various options are worthwhile to consider in trade negotiations. Given the past few years' track record, it would seem that the long-run opportunities are mostly in manufactures for many emerging and developing countries, including the Philippines.

Philippine trade patterns follow the character of a developing country — a spurt of manufactured export growth in recent years, devolution of traditional exports into processed forms and increased trading of new nontraditional products. With a recent yearly growth of 30 per cent, manufactured exports are expected to take the brunt of trade in the coming decade reaching a 50 per cent share (from its present 34 per cent in 1988).[12] Such new exports as textile yarn, fabrics and made-up articles, clothing, paper and paper products, handbags and others hold promise. The conditions and environment under which it will thrive appear sensitive in view of the strong protectionist sentiments earlier explained. The negotiations that will have to be followed are therefore critical for shaping an international order and comparative advantage for most developing countries.

Not only is a gradual dismantling of existing tariffs desirable but what must be vigorously pursued is a shift in any remaining tariff structure away from increases in rates as processing increases, and at the extreme towards uniform duties across the board.

It is essential therefore to work for tariff reductions. Despite the results of some studies[13] showing that a uniform liberalization might initially create second generation problems (e.g. ten countries reaping majority of additional gains from tariff cuts), in view of necessary adjustment processes.[14] This is a trade off that must be accepted (though its costs perhaps minimized) as part of a long-term vision.

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[12]*The Philippine Five-Year Development Plan, 1978-1982* (Manila: September 1977), Chapter 7.

[13]W. Cline, N. Kawanabe, and T.G.M. Kronsjo, and T. Williams, *Trade Negotiations in the Tokyo Round* (Washington D.C.: Brookings Institution, 1978).

[14]Refer to III above.

A second task is to negotiate removal or reduction in the present and proposed set of quotas and other forms of non-tariff barriers. With regard to NTB's, it is not so much as their arbitrariness but their subject to wide discretion in the hands of the administrative authorities. The recent reports about opposing classification of Philippine exports to the U.S. attest to this grey area of discretion in order to avoid falling under agreed-upon quotas or of classifying goods under them.

What seems to be most attractive within these two tasks is to work in the direction of discussing both tariff and non-tariff questions simultaneously. The suggestion of some developed countries not (e.g. Canada) to look at MTN sectorally but as a package appears a fruitful avenue assuming developing countries accept a commitment to free trade. To negotiate trading arrangements by looking at mechanisms in isolation from one another invites schemes to promote protectionism in developed countries. Indeed once agreement is reached for MFN or tariff reductions, it is likely that some domestic demand NTB's can be imposed since the disposal of one retains non-tariff substitutes for possible imposition. For as long as this option of simultaneous approach is feasible, it is less likely to create new trade barriers.

A final task (and issue as well) that appears to be partly dragging the protectionist behavior is the demand of developed countries for reciprocity. True enough, the developing countries demand for the principle of non-reciprocity might have warranted some strong validity in the search for trading arrangements prior to the 1974 recession since it was quite clear that developed countries' performances were impressive. But the recent trends, the buoyant strides of the developing countries despite numerous disturbances and their growing competitive ability indicate less hope of adhering to non-reciprocity. The option is perhaps to slowly and eclectically accept reciprocity. In terms of a long-run comparative advantage structure, this obviously can be turned to a developing country's advantage. For one, the varied nominal and effective protection engendered by developing countries may be useful for some "infant industries" but it really needs closer examination and market testing to objectively gauge an international market setting. For another, reciprocity carries with it the notion of allowing developed countries some information about their own set of new comparative advantages. Finally, reciprocity tempered with appreciation of some other mitigating conditions (e.g. balance of payments) can rationalize a broad based development process.

In short, the rising protectionism (in developed countries, an internal and external reaction), poses a potent threat to freer and larger trade between developed and developing nations. And since the protectionist stance is a reaction, there are still wide possibilities for averting the consequences of a new form of "neo-nationalism".

Indeed the alternative might be to foster intra-developing country trade and intra-developed country trade. Though both types of trade have expanded equally, it must be accepted that such an alternative is closer and more limited in terms of technical change, consumer preferences, and production structure. One must come to this only when lines are already drawn. And that does not appear in sight as yet.