4. The Costs of Protection to Developing Countries

> "Liberal access to OECD markets for the manufactured exports of developing countries is a fundamental condition for the successful evolution of the new patterns in the world economy".
>
> *Emile van Lennep, 1982*

4.1 The emphasis in this chapter is on the effects on developing countries of barriers to their exports. Particular attention is given to the impact of different forms of protection, for even if levels of protection remain unaltered, there may be substantial benefits for exporters if the forms were to be changed. We concentrate on the barriers of the developed market-economy countries; less attention is given to the barriers erected by the developing countries themselves, even though they are on average higher than those of the developed countries. This relative neglect arises because the costs of such barriers tend to be borne by the countries imposing them. Many of these barriers may be unwise and may, in the longer run, have serious impact on the growth of the international economy. But there is little doubt that it is the barriers of the developed countries which most restrict international commerce and the growth of exports from the developing countries. In the following chapter attention is given to the costs of the barriers erected by developed countries to the countries which erect them.

4.2 The growth process varies among countries according to endowments of factors of production and national policies. For those countries with plentiful supplies of natural resources — mineral, forest, ocean or agricultural — the early stages of growth will tend to be concentrated in these areas. If the supplies of these resources are particularly abundant relative to population, and if export markets are available, high levels of income may be supported by industries dependent upon them — as, for example, in New Zealand and Australia. In other countries, less well endowed with such resources, the growth process will tend at an early stage to move into products and techniques of production well suited to low-cost labour, later shifting towards products and processes which use more capital and skilled labour. As growth proceeds the patterns and volumes of both imports and exports will alter. The erection by trading partners of barriers to either the exports or the imports of a country will restrict growth and lower real income below the levels that could otherwise have been achieved.

Exports and Growth

4.3 In the last thirty years, a number of developing countries have had considerable success by pursuing export-oriented policies. Japan, though no longer classified as 'developing', is a prime example. More frequently cited are the 'newly industrialising countries' or 'fast-growing exporters of manufactures' — particularly Taiwan, Hong Kong, Singapore and Rep. of Korea. Per capita annual growth rates of GDP of 7 per cent or more were achieved by Singapore, Rep. of Korea and Hong Kong over the sixties and seventies, rates that would have been quite impossible for such relatively small states in the absence of export markets.

4.4 For many countries in the nineteenth century, exports of primary products provided an 'engine of growth'. This growth was seen, contemporaneously and subsequently, to be greater than that attributable simply to the gains from producing according to static comparative advantage. In more recent years, labour-intensive manufactures appear to have served the same function for those newly industrialising countries which have followed export-oriented policies.

4.5 High and rising trade barriers inflict major harm on those countries which attempt to develop exports as the leading growth sector. Investments in export-oriented industries have their yields depleted and may collapse. As a consequence, difficulties are experienced in servicing debts incurred to finance development, including, sometimes, debts due to countries which have imposed the barriers. Development will be forced away from industries appropriate to the economy.

4.6 But it is not only the export-oriented 'engine of growth' products that may be stalled by the erection or threat of trade barriers (or by the stagnation of world trade). Many governments may choose a more inward-looking development strategy, even if it implies a lower growth of GDP. These more inward-looking and import-replacement development strategies also can be frustrated by the erection of trade barriers. Countries pursuing the import-replacement path typically restrain imports by a variety of tariff and non-tariff barriers and frequently maintain an overvalued rate of exchange. Those imports which are permitted are generally of the high-priority 'essential for development' nature and exports are the means by which these essential imports are financed. While the closing of export markets is not the only reason why countries pursuing import-replacement strategies have found it difficult to export — for the strategy itself implies internal discrimination against exports — the closure of markets can wreak havoc with development plans. The nature of the import-replacement strategy makes it difficult to switch from one export product to another, for the strategy is typically implemented within a system of controls which are inflexible except in the longer term. Thus export shortfalls have implied an inability to obtain essential inputs for key development projects which, in turn, has frustrated the growth of industries dependent upon these projects. Import-substitution strategies can, paradoxically, result in very high dependence on trade.[1]

4.7 In view of the variety of ways in which exports may contribute to growth, and the problems of identifying some of the channels, the task of calculating a total cost to the developing countries of the trade barriers in place is extremely difficult. Several economists have studied empirically the relation between the growth of exports and of real GNP. Covering a large number of developing countries and various periods from 1950 to 1975,[2] the studies found a strong link between export growth and overall growth rates, particularly for the more advanced countries. While some economists may have doubts regarding the direction of causation, few would doubt that restricting exports would inhibit growth. One estimate suggests that the increase in the GNP of Rep. of Korea and Taiwan would have been 37 and 25 per cent smaller, respectively, in 1973 if the rate of growth of their exports from 1966 to 1973 had been at the average level achieved by the ten developing countries in the sample, this despite the suggestion that the empirical technique tended to underestimate the relationship. On the other hand, the increase in the GNP of Chile, India and Mexico, respectively, would have been 14, 12 and 8 per cent greater if these countries had experienced export growth rates equal to the average in the sample.[3]

4.8 In this chapter, further calculations of this nature are not attempted. Rather, calculations that have been made of the trade restraining impact of existing barriers are reported. Consideration is then given to the differential impact of alternative forms of protection designed to achieve the same objectives. Particular attention is directed to identifying those aspects of the current barriers which, without adding significantly to the achievement of the objectives of the countries imposing them, have a specially deleterious effect on exporting countries.

The Impact of Protection on Exports

1. Manufactured Goods

4.9 While there have been some estimates of the impact on exports of trade restrictions on manufactures, these are rather dated and generally do not include the effects of the crucially important non-tariff measures. One study concludes that exports of manufactures by developing countries in 1974 could have been 16 per cent greater if tariffs had been reduced by 60 per cent (and textile import quotas relaxed sufficiently to allow these additional exports).[4] But as even the documentation of non-tariff measures affecting imports of manufactures is far from complete — and, by their very nature, it is doubtful whether the documentation will ever be exhaustive — it is not surprising that comprehensive calculations of the restraining effects of these barriers are not available. Calculations which do not include them must be treated as substantial underestimates of the total effects of protection.

4.10 One way of attempting to show the impact of the 'new protectionism' is to examine the extent to which the penetration of developed country markets by developing countries has been arrested. The developing countries' annual growth in market penetration of 14 major OECD countries (as measured by their share in the apparent consumption of manufactures in these countries) was about 13 per cent for the years 1970-74 but thereafter fell sharply, so that for the decade as a whole it averaged only 8 per cent per annum.[5] While this average growth for the 1970s was higher than the 5 per cent per annum of market penetration by all imports, the sharp fall in the second half of the decade reflects the protectionist bias against the developing countries, and this has not abated.

4.11 Textiles and clothing still constitute one of the largest components of developing countries' exports of manufactures, although their share is declining. The deterioration in the position for developing countries in these products can be illustrated, as in Table 4.1, by comparing the growth of developed countries' imports from other developed countries and from developing countries during the three periods 1963-73, 1973-76 and 1976-79. The change was particularly marked in the case of clothing, where growth in developed countries' imports from developing countries had been approaching double that from other developed countries in the first period. In the years 1973-76 the rate of growth of imports from developing countries held up rather well while imports from developed countries fell. In the last three years of the 1970s, however, the rate of growth of imports from developing countries was substantially below that from developed countries. Finally, in 1980 developed countries' exports of textiles and clothing each rose more quickly than did their imports (including intra-trade in each case), and their net deficit with developing countries diminished.

TABLE 4.1
Real Growth Rates of Imports of Clothing and Textiles by Western Europe and North America[a]
(average annual percentage increases)

Imports from	Clothing			Textiles		
	1963-73	1973-76	1976-79	1963-73	1973-76	1976-79
Developing countries	21.1	14.4	4.6	6.9	-0.4	4.6
Southern Europe	28.8	6.4	8.4	13.8	-0.8	9.2
Developed countries	11.7	-0.4	7.3	7.8	-4.5	5.0
All countries *b*	15.3	5.6	6.5	8.0	-3.6	5.3

a Comprising imports by the EEC, European Free Trade Association (excluding Portugal), United States and Canada. Imports are deflated by the United Nations value index for developed country manufactured exports to developing countries.

b Including centrally-planned economies.

Source: G.Curzon *et al., MFA Forever?* Trade Policy Research Centre, October 1981.

4.12 It is significant that in both 1963-73 and 1976-79 the rate of growth of imports of textiles from Southern Europe was double that from the developing countries. Clothing imports from Southern Europe also grew more rapidly than from the developing countries.

4.13 A rough guide to the impact of recent events and actions on the exports of developing countries can be obtained by observing changes in the relation between the income of the developed countries and their imports from the developing countries. One estimate[6] is that clothing imports from the developing countries would have been around 90 per cent (some $10 billion) greater in 1980 than they were, if the income elasticity of demand in developed countries for imports of manufactures from developing countries had remained the same as between 1968 and 1976; the increase for textiles would have been around a quarter (about $1 ¼ billion). To some extent this loss in potential earnings was countered by increased exports of other manufactures, but it occurred, of course, in products in which the developing countries — and particularly the poorer countries — have a marked comparative advantage.

2. Primary Products

4.14 Studies of primary products are more common and complete, although there is a wide range of results. One estimate was made of the increased value of exports of 99 food products and their derivatives that would accrue to 56 developing countries if 18 major OECD countries reduced tariffs and non-tariff barriers by 50 per cent.[7] Overall it was estimated that these exports would increase by $3 billion per annum (in 1977 dollars, based on 1975-77 exports), which is 11 per cent of actual agricultural exports by these developing countries in the base years.[8]

4.15 Over four-fifths of these gains were estimated to accrue to developing countries in the middle-income bracket, though agricultural exports of low-income countries showed an increase of 8½ per cent. The largest increases in gross revenues would be registered by Brazil, Argentina, India, Philippines, Thailand and Colombia. Latin America would receive 60 per cent of the increase and Asia 23 per cent. On a net basis, the increase for India and for most other low-income countries would be much less, and in some cases (e.g. Bangladesh) could be negative (owing to higher world prices). It was also estimated that the real income gain for the 56 developing countries, taking into account the effects of the hypothetical OECD agricultural trade liberalisation on both imports and exports and the cost of producing the additional exports, would be about $500 million per annum (in 1977 dollars). Excluding wheat from the liberalisation programme would increase this real income gain significantly, as the developing countries are substantial net importers of this grain. However, for a number of reasons these results may underestimate the increases in the value of exports and in real income which would occur. For example, the full effect of tariff escalation in discriminating against processed products is probably not captured.

4.16 With regard to processed products it has been estimated that removing tariffs on imports of the processed forms of eight agricultural products, in which developing countries already have a significant share of world exports, would have increased the value added in developing country processing activities by 20 per cent or more and would have boosted export revenues by more than the GSP has done.[9]

4.17 Another study has attempted to capture some longer-term effects of agricultural protection by examining the changing composition of exports of primary food products to EEC countries between 1962 and 1979.[10] Thus, for example, whereas New Zealand provided 21 per cent of the EEC countries' imports of cheese and curd in 1962, that percentage had shrunk to zero in 1979. As a result of losses in market shares (mainly caused by the Community's Common Agricultural Policy (CAP) and reflected in increased intra-EEC trade), it is estimated that developing countries had lost exports to the EEC of $2.9 billion in 1979. (Other large losses were: Australia, $1.1 billion; New Zealand, $1.8 billion, and the United States, $0.7 billion.) This is a rough and ready calculation.[11] But again it is suggestive of an order of magnitude.

Forms of Protection

4.18 From the point of view of exporters, it would be most desirable if importers ceased protection. Many objectives of governments of importing countries may be better achieved by policies of assistance that are not linked to the continued production of particular goods.[12]

4.19 If assistance is tied to the production of particular goods, payment of production subsidies (bounties) is a means by which the harmful effects on exporters may be contained. Imports will be curtailed to the extent that production is sustained. On the other hand, as the prices paid by consumers are not raised by such a policy, demand is not restrained. With regard to stability of world prices, if prices for the protected producers are kept constant by production subsidies while world prices are oscillating, some instability is exported onto world markets, but not to the extent that occurs with some other protective devices.

4.20 It has been suggested[13] that in practice many such subsidies have been increased to an extent that would not have been possible with other forms of protection — due to lack of international scrutiny and to the ability of bureaucrats to 'tailor-make' regulations to satisfy various pressure groups. The supposed restrictiveness of budgetary considerations on such subsidies does not always apply, it is argued, particularly when the subsidies are given by tax exemptions rather than by direct payments. Nevertheless, while there may be particular exceptions the direct subsidy method generally has advantages over most other forms of protection.[14]

4.21 Calculations can be made of the expansion of trade which could occur if production subsidies replaced other forms of protection though in a way in which the actual level of protection is unchanged. In Table 4.2, such estimates are shown for Japan, Germany (F.R.), France and the United Kingdom, for several agricultural commodities. Beef is the commodity in which the most dramatic impact on trade could be expected to occur, particularly in Japan, with net imports for the four countries increasing eighteen-fold. Net imports of sugar, wheat and barley could be expected to increase about 70 per cent, while the relatively smaller increase in maize imports is in excess of a million tonnes. While much of the benefit of such increased imports would flow to developed country exporters, much would also be available to developing country exporters, particularly in South America and, for sugar, in some Commonwealth countries. Two points should be noted about these calculations: first, they assume no change in the level of protection for producers in the four countries, only in its form; and secondly, they are for 1976, and the disparity between world and internal prices in the EEC has increased significantly since then, implying that the proportionate increase in imports of EEC countries would now be much larger.

TABLE 4.2
Effect on Consumption and Trade of Replacing Existing Forms of Protection by Production Subsidies[a]
1976

	France	Germany (F.R.)	U.K.	Japan	Total of four countries: Increased consumption ('000 tonnes)	Total of four countries: Increased net imports (%)
	Increased consumption ('000 tonnes)					
Wheat	321	476	219	147	1,163	69
Maize	424	548	325	-35	1,262	16
Barley	316	538	16	174	1,044	71
Sugar	122	180	143	72	517	70
Beef	254	297	120	932	1,603	1,781

a Bale and Lutz provide high and low estimates for elasticities; the figures shown here derive from simple averages of these two.

Source: Calculated from data in Malcolm D. Bale and Ernest Lutz, "Price Distortions in Agriculture and their Effects: An International Comparison", *American Journal of Agricultural Economics,* February, 1981, Tables 1 and 2.

4.22 Tariffs raise prices facing consumers as well as the prices received by producers, and both these impacts tend to reduce imports and depress world prices. As long as duties are at fixed rates, existing and potential exporters who reduce their export prices will be able to gain additional access. But this access does not exist when the trade barriers take the form of variable import levies which allow the maintenance of fixed internal prices that do not alter with world market conditions. Similarly, import quotas and so called 'voluntary export restraints' (VERs) give little opportunity for competitive entry by existing or potential exporters — they cartelise the trading system. This cartelisation may not be too harmful for some existing exporters, for they may be able to share in the gains from such restriction. This applies particularly in the cases of VERs and bilateral (rather than global) quotas. However, new entrants tend to be excluded. Exports can hardly be an engine of growth under such arrangements. Thus, the Multifibre Arrangement, by almost freezing quota allocations, has all but denied countries as varied as Sri Lanka, Bangladesh, Mauritius or Indonesia the chance of seriously fostering export-oriented manufacturing in this, the archetypal activity for a less industrially advanced developing country. At the same time, it has taken away from more industrially advanced developing countries, such as the Philippines, Pakistan or Colombia, the incentive to make the necessary policy adjustments to their textile and clothing industries.

4.23 Variable import levies and other trade barriers which allow constant internal prices to be maintained insulate the internal economy from world price variations. By refusing to share the effects of world instability, countries imposing such measures aggravate instability in the rest of the world. In this regard variable import levies, as under the EEC's CAP,are similar to the state trading policies of centrally planned economies and to other import controls under which the level of imports is determined by the aim of domestic stability. Such protective devices tend to aggravate instability in exporting countries (as well as in other importers) and from this point of view, as well as in their depressing effects on world prices, they are generally regarded as having harmful effects on exporters.

4.24 Instability has been of most importance in primary product markets and the EEC's CAP, together with the increasing insulation of the East European and Japanese markets, has been a major force in exporting instability. It has been argued that the increased insulation of major importers from world market conditions caused world grain prices to fluctuate more widely in the early 1970s than a decade earlier, even though the disturbance — in terms of a shortfall in world grain production below trend — was substantially smaller.[15] It might be noted, however, that it is not only the developed countries which attempt to insulate their food markets from instability. Developing countries do also, though typically for the benefit of consumers rather than producers.

4.25 As described in Chapter 3, the EEC's CAP is now even encouraging the building up of huge exportable surpluses of some products, which further disturb export markets of other countries, including developing countries. These surpluses do not appear to be the conscious aim of policy but rather are the by-product of the pursuit of the domestic objectives of income support and stability. The surpluses indicate clearly the inappropriate policies being used to achieve these objectives. Failing a substantial change in the form of policy weapon, acreage or production limitations would at least contain some of the most deleterious effects on traditional exporters.

4.26 Production subsidies, tariffs, import quotas and even variable import levies are generally imposed and implemented in a manner that is visible to existing and potential exporters. However, health, sanitary and 'standards' regulations, often applied in an arbitrary manner not intended by the legislature, increase uncertainty among existing exporters, are concealed from consumers and legislators, and leave hopeful potential exporters frustrated and often ignorant of the real source of their frustration. Lack of information creates uncertainty and requires the use of scarce resources to overcome it. Again, where market access can only be obtained as a result of extensive negotition, skilled officials are needed for the negotiations, and they are in short supply. These are real costs for exporters and are part of the protective barriers.

Centrally Planned Economies

4.27 So far in this chapter, attention has been directed at the effects on developing countries' exports of protective measures taken by developed countries with market economies. Since the majority of developing country exports are destined for these countries, their policies are of prime importance. But although exports to developed centrally planned economies constitute only a small proportion of the total (4 per cent in 1980 and 6 per cent of those from 'non-oil' developing countries), the effects of import restrictions by these countries are by no means insignificant. Several East European countries levy tariffs in much the same way as the developed market economies, but much more important are their policies of state procurement and bilateral balancing of trade which have effects similar to the more harmful forms of trade restraint imposed by the market economies. The relatively slow growth of developing countries' exports to the centrally planned countries is indicative of the degree of protection encountered. Although imports of food have been relatively buoyant since 1973, and those of steel, chemicals and machinery have risen quite swiftly (albeit from a very low base), growth in the important textiles and clothing sector has been sluggish even in terms of current values, and in volume the total was almost certainly lower in 1980 than it had been in 1973. Losses in potential export earnings in that sector at least must therefore have been very considerable if unquantified. It is important that markets in the centrally planned economies should be made more open to trade with the developing countries.

Developing Countries

4.28 To complete the picture, reference should also be made to the losses to individual developing countries' potential exports caused by protection in other developing countries. No aggregate estimates are available of these losses, but an indication of their size may be gained by reference to two statistics: first, intra-trade among developing countries in 1980 was 26 per cent of their total trade (22 per cent if trade with the major oil exporters is excluded); and secondly, the average tariff levied by those developing countries for which that information is available was 46 per cent, ranging from 11 per cent for metallic ores to 91 per cent for beverages, tobacco and clothing.[16] Whilst it could no more be expected that all developing countries would abolish their protective barriers to imports than that all developed countries would do so, it would seem not unreasonable to expect the newly industrialising and other economically more advanced developing countries to reduce barriers considerably in the near future.

The boost to trade from such a move could be substantial, particularly in capital goods and equipment and semi-manufactures among the newly industrialising countries.

Overall Effects

4.29 It is of particular concern that countries are increasingly introducing forms of protection which have especially damaging effects. Having achieved significant reductions in tariffs — a relatively less costly form of protection — it is ironic that less transparent and more obnoxious forms are now developing. We recommend that particular attention be given to the aims of those imposing trade barriers and to the way in which these aims can be achieved with the least cost, particularly in so far as exporting countries are concerned.

4.30 Any country maintaining protective barriers or imposing new barriers that are inconsistent with its obligations under agreed international rules and procedures should have to justify its action in an open multilateral forum. Countries wishing to impose such protective barriers should be required to specify the economic aims of such barriers not only in terms of a trade objective but also in terms of underlying considerations such as maintenance of employment. The specification of such objectives would allow an opportunity for discussion of alternative ways of achieving the objectives, at less cost to exporters.

4.31 The really insidious damage done by protectionism is the long-term effects it has on government policies aimed at efficient economic development and on the attitudes of productive enterprises which would have to put such policies into operation. As the World Bank has stated, "the worst result of the increased protectionism may be a greater unwillingness on the part of many developing countries to risk more outward-looking trade policies, even where these are urgently needed. They could, therefore, suffer the consequences of inflexibility and low import capacity usually associated with inward-looking trade regimes — costs that are likely to be particularly high in an uncertain and protectionist international environment, where flexibility is at a premium. . . . the adverse effects of heightened protection may be felt more by the poorer and less successful developing countries than by the most successful and visible targets".[17] And, as noted above, even inward-looking trade regimes are also severely harmed by this protectionism.

References

1. A.O. Krueger, *Trade and Employment in Developing Countries,* forthcoming, Vol.3, "Synthesis and Conclusions", Ch.3.

2. See A.O. Krueger, *op.cit.,* for a summary of several of the studies.

3. B. Balassa, "Exports and Economic Growth: Further Evidence", *Journal of Development Economics,* Vol.5, 1978, pp.186-8. The other five countries were Argentina, Brazil, Colombia, Israel and Yugoslavia.

4. T.B. Birnberg, "Trade Reform Options: Economic Effects on Developing and Developed Countries", in W.R. Cline (ed.), *Policy Alternatives for a New International Economic Order: An Economic Analysis,* 1979.

5. H. Hughes and J. Waelbroeck, "Can Developing Country Exports Keep Growing?", *The World Economy,* 1981, pp.127-147.

6. UNCTAD Secretariat (unpulished), 1982.

7. A. Valdes and J. Zietz, *Agricultural Protection in OECD: its Costs to Less-developed Countries,* International Food Policy Research Institute, Dec. 1980.

8. The largest increases would accrue to sugar ($1.1 billion or a 29 per cent increase), vegetable oils, seeds and cake ($378 million or 7 per cent), meat (almost entirely beef — $336 million or 44 per cent), and coffee ($277 million or 4 per cent). Making allowance for exports from Cuba and from those developing countries whose 1975 populations were under 4 million, which were excluded from the developing countries selected, would raise the total increase considerably, probably to more than $4 billion.

9. World Bank, *World Development Report 1981,* p.23.

10. A.J. Yeats, "Contemporary Agricultural Protectionism: an analysis of international economic effects and options for institutional reform", 1982, mimeo.

11. It ignores gains that these exporters may have made from exports to third markets as a result of increased exporting from one EEC member to another; on the other hand it ignores the reduced imports of each EEC member arising from increased protection for its own farmers.

12. See also paras 3.23 and 5.4.

13. H. Hughes and J. Waelbroeck, *op. cit.*

14. It is, however, more difficult to incorporate preferential schemes into this system of protection than into some other forms.

15. D. Gale Johnson, "World Agriculture, Commodity Policy and Price Variability", *American Journal of Agricultural Economics,* 1975, p.826.

16. UNCTAD, *Protectionism and Structural Adjustment in the World Economy* (TD/B/888), 15 Jan. 1982.

17. World Bank, *World Development Report 1979,* p.22.