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The New Protectionism and the Third World

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Although there is general agreement on the fact that the new protectionism of the industrialised countries is damaging to developing countries, the majority of the latter show hardly any interest in a return to the classical GATT system. Prof. Körner provides an explanation for this apparently paradoxical attitude on which be bases his case for a reform of the existing system of international trade.

The increase observed over the past decade of non-tariff trade restrictions unilaterally imposed by the industrialised countries, as well as the growing number, over the past few years, of bilateral or multilateral market regulations often appreciably narrows down the markets of the developing countries, especially for manufactures. This results in a diminution not only of their export earnings but also of the trade-related development potential provided by an export-oriented industrialisation. Bhagwati[1] even inclines to the view that a repetition of the "success story" of export-oriented growth in South Korea, Taiwan, Brazil, Singapore and Hong Kong would nowadays be impossible in view of the increasing supply pressure from the Third World and the simultaneous increase in market barriers to entry in the industrialised countries.

Against this background it seems paradoxical that the majority of developing countries, while generally opposing quantitative restrictions unilaterally imposed by the industrialised countries, nevertheless show hardly any interest in a return to the classical trade system of GATT, a system fundamentally based on the rules of most-favoured-nation treatment and reciprocity. It is significant in this context that in the course of the Tokyo Round of GATT, concluded in the spring of 1979, the developing countries did not merely insist stubbornly on the principle of non-reciprocity in their own favour. They also expressly voiced (and still voice) misgivings about any lowering of most-favoured-nation tariffs for certain manufactures because they feared that this might result in an "erosion" of the unilateral tariff preferences granted by the industrialised countries within the framework of the Generalized Systems of Preferences (GSP). Clearly therefore, there is not only a "villain" in the tragedy of the new protectionism in the person of the "ugly man from the industrialised countries"; actors – albeit in secondary roles – are also provided by the Third World. This state of affairs is often justified by the following arguments:

□ Developing countries frequently feel economically dependent on the industrialised countries. Moreover, they regard GATT as a "rich man's club", where their interests have few champions. For that reason they withdraw towards other, in terms of power supposedly more balanced, UN organisations and to the Generalized Systems of Preferences negotiated there with the industrialised countries.

□ Developing countries have long developed a structural preference for the administrative regulation of the market, a preference based on the belief that economic activities are only a means towards a political end. That is why they endeavour to maintain the trade barriers erected on their side (mostly in connection with an import substitution policy), which, moreover, have for the most part the character of non-tariff restrictions.

□ Developing countries are all the more inclined to accept non-tariff trade barriers unilaterally imposed by the industrialised countries and to cooperate in their formulation and administration within the framework of the GSP or of self-restriction agreements, because they believe this will assure them of a share of the market in the industrialised countries. The distribution of the welfare effects arising from non-tariff trade restrictions is not as a rule obvious from the outset to those affected. In this connection the developing countries have a particular interest in trade restrictions which imply export restrictions on their part, because the hoped-for supplier rents accrue, as a matter of definition, to the

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[1] J. N. Bhagwati: Anatomy and Consequences of Exchange Control Regimes, New York 1978, p. 216.

exporting country and are available there for distribution. Even if there is widespread uncertainty as to the exact amount to which such rents accrue, or on the question of which social group they benefit in the final account, the mere hope of such advantages frequently induces the developing countries to participate in the trade-restricting systems of the industrialised countries.

Each one of these above-listed arguments, viewed separately, sounds plausible. Nevertheless, the considerable affinity shown by certain developing countries towards non-tariff restrictions must be traced to deeper roots.

Political Economy of Market Restriction

In analogy with the "Political Economy of Protection", which has lately been employed in the analysis of the motive forces behind the industrialised countries' protectionism[2], a "Political Economy of Market Restriction" in economically poor societies may be developed by the following arguments:

(a) Domestic or foreign market restrictions – compared with an unrestricted state of affairs – give rise to rents. In economically poor societies, which are characterised by a lack of viable markets and hence of economically exploitable market opportunities, the attainment of such rents – as shown by Krueger in her description of the "rent-seeking society" – can move into the centre of entrepreneurial activity which, as a rule, aims at the gaining of rapid and safe monetary income[3].

(b)The extent to which the attainment of rent replaces or supplements the attainment of market revenue in entrepreneurial activities depends on the alternative costs of rent attainment in the form of foregone net market revenue. These costs are usually slight, at least in the short term, under the socio-economic conditions of the developing countries: monetary expenses for the establishment of new production and an appropriate opening of markets, as well as the associated risks, are as a rule high in relation to any short-term yield. By contrast, expenses in the form of material and non-material support for a rent-yielding institution are relatively slight in relation to an assured short-term rent revenue. In consequence, if often pays entrepreneurs in a developing country to acquire income through a rent-creating "marketing" of policital and social influence.

(c)The suppliers of such sources of income are (in all countries) the State authorities which control the instruments of market regulation and hence of rent production.

The extent to which sources of rents are opened up can again be explained by the alternative costs of rent production. Production of producer rents frequently competes with other economic policy measures designed to improve the welfare of consumers. Consumers are poorly organised in all countries; in most developing countries indeed their influence is virtually nil, since the majority of them live in the (to all intents and purposes politically non-existent) countryside. Engagement in costly development projects therefore holds little attraction for governments, as scarcely any gains in the form of political acclaim are to be expected.

The cost-effectiveness of rent production, on the other hand, is assessed differently: at a slight administrative expense for market restriction the acclaim to be gained from the favoured urban groups, especially the entrepreneurs, is considerable and assured. Since the governments of many Third World countries are – in the absense of other institutional means of enforcing their will – largely dependent on the acclaim of the traditionally powerful groups, which also include the entrepreneurs (Myrdal's "soft state"[4]), they frequently resort to the means of buying political approval by rent production.

(d)The actual functioning of this "market for politically motivated rents", described here in outline, depends chiefly on general communication costs as well as risks being low. At least the first of these conditions is met in most of the countries of the Third World, as their modern economic activities as well as their political machinery are usually concentrated in a few urban centres. Likewise, the existence of risks is unlikely greatly to impede the functioning of the market in which political acclaim is traded for politically motivated sources of income, because the close collusion between politicians and entrepreneurs, given the reciprocal dependence resulting from it, diminishes any possible economic or political risks.

Risks of Foreign Trade

A specific partial market of the "market for politically motivated rents" is foreign trade protection. This is especially attractive and also capable of considerable expansion because the revenue advantages available for share-out are usually at the expense of foreign consumers: unlike the other "rent markets", where a

[2] Cf. e.g. H. H. Glismann, F. D. Weiss: On the Political Economy of Protection in Germany, World Bank Staff Working Paper, No. 427, Washington D.C. 1980.

[3] A. O. Krueger: The Political Economy of the Rent-Seeking Society, in: The American Economic Review, Vol. 64 (1974), p. 291 ff.

[4] G. Myrdal: Asian Drama. An Inquiry into the Poverty of Nations, Vol. II, New York 1968, p. 849 ff.

"zero sum game" is often played between the ruling groups, in the case of foreign-trade controls "the kitty" is usually held by third parties, so that possible losses of loyalty at home play hardly any part in the calculation of the cost and revenue of rent production.

Foreign trade restrictions are so attractive to entrepreneurs in the developing countries also because they enable them to cover the additional market risks arising specifically from foreign trade.

These risks arise, on the one hand, from competition with other suppliers in domestic and foreign markets, a competition which many entrepreneurs are reluctant to take on because of a lack of developed marketing channels and market information facilities. A further risk factor is the uncertainty as to form, intensity and effective date of market regulations operated by the industrialised countries; this is a risk especially for exporters (though in the case of project-linked development aid also for importers). That is why the entrepreneurs in the developing country endeavour to get the State to adopt a policy of "socialisation" of such risks by means of fiscal intervention, or also to achieve a reduction of risks through international arrangements on market channelling, market partition and "orderly behaviour". As the governments of the developing countries can, on their part, only apply appropriate subsidies for the correction of the political risks arising from trade barriers by the industrialised countries when there is certainty as to the future trade policy of the industrialised countries, they, too, have a direct incentive to engage in market arrangements and to cooperate with the purchaser countries on an administrative and information level.

The developing countries therefore have a systematically motivated general interest in non-tariff trade barriers and a specific interest in the shaping and administration of such restrictions within the framework of cooperation agreements with the industrialised countries.

Such cooperation, first of all, gives greater security to suppliers from the Third World countries, since national quotas with increment regulations, whether negotiated or dictated, provide the suppliers with a – narrow but assessable – framework for their own export dispositions. Secondly, there is the point that even the definition of categories of goods – together with the magnitude of the threat to the markets from competing producers in the importing country – provides indications to the exporting country as to which lines of production can be developed without the risk of market disruptions. Finally, the establishment of institutionalised contacts on the administrative level opens up a flow of information on market conditions and on trade policy actions planned by the governments of the industrialised countries.

The price which the developing countries have to pay for this is slight in view of the one-sided functioning of the GSP. Since the exporting countries, for their part, are able to maintain all import-discriminating restrictions, the rent potential of the domestic "market for protection" remains undiminished. In all those instances of trade policy cooperation in which national quotas are arrived at through the self-restriction of exporting developing countries, an additional profit arises for the governments of the exporting countries in the shape of those rents which arise from national export quotas. Whatever the actual magnitude of such rents within the given market conditions, the position of the government will undoubtedly be strengthened by the expectation of an increase in rent potential.

Differential Growth of Exports

Even though the effects of the Generalized Systems of Preferences upon the export structure of the developing countries should not be overrated, one gains the general impression that the developing countries as a whole have not done too badly by participating in the system of the new protectionism: between 1965 and 1977 imports of manufactures by the OECD countries from the developing countries, adjusted for structure and growth, rose more rapidly than those from the rest of the world. Moreover, calculations by Helleiner[5] show that the exports of the developing countries under the various Generalized Systems of Preferences of the industrialised countries, when compared with possible additional exports given a general lowering of most-favoured-nation tariffs by 40 % within the framework of GATT, achieve substantially higher figures. Since the customs reductions negotiated in the Tokyo Round at an average of 34 % are, in fact, lower, the trade profit resulting from the multilateral lowering of most-favoured-nation tariffs, especially for exports of manufactures from the developing countries, will probably be even less, compared with the export increment stemming from preferential trade.

A global examination, however, conceals what are often major differences in the growth of exports of manufactures by the developing countries between different groups of commodities and also – since not all

[5] G. K. Helleiner: The new industrial protectionism and the developing countries, in: Trade and Development, An UNCTAD-Review, No. 1, Spring 1979, p. 34; see also B. Balassa: The Tokyo Round and the Developing Countries, World Bank Staff Working Paper, Nr. 370, Washington D.C. 1980, p. 8 ff.

developing countries offer the same assortment of goods – between countries or groups of countries.

This emerges clearly from the differential annual growth rate of imports by the industrialised countries during 1972-77 in the categories of machines and vehicles on the one hand, and of footwear, leather goods and clothing on the other. Imports of machinery by the OECD countries from developing countries during that period increased nearly twice as fast (33 % p.a.) as imports of machinery from the world as a whole (18 % p.a.). Particularly high are the partial growth rates within the framework of Japan's Generalized Preferences at 39 % p.a. (world 12.5 % p.a.). This is due mainly to the rapid expansion of deliveries of electrical machinery, more especially of electronic components from the Third World to Japan and to the EC-countries. The growth rate for imports to the OECD countries in the category of "various finished articles", primarily for leather goods and textiles, from developing countries, on the other hand, amounted to 30 % p.a., i.e. less than that recorded by imports of machinery from the Third World[6].

The Generalized Systems of Preferences thus evidently discriminate against those groups of commodities which represent the traditional export spectrum of those developing countries which are in the first phase of industrialisation, while more demanding – from the point of view of production technology and the necessary factor mix – so-called non-traditional goods find access more easily to the markets of the industrialised countries.

That this commodity pattern effect is not just a passing phenomenon is shown by projections of the commodity pattern of exports from developing countries to industrialised countries, as compiled for the eighties by Balassa[7]: according to these calculations, total imports of manufactures by the industrialised countries from the Third World will show an annual growth rate of 12.5 % in the period to 1990. A below-average trend is assumed for semi-finished goods at 11 % p.a. and for textiles and clothing at 6-7 % p.a., while an above-average trend is forecast for machinery and transport equipment at 17 % p.a., for iron and steel at 15 % p.a., and for chemicals at 14 % p.a. Considering that during 1973-78 the growth of total imports amounted to a good 10 % p.a., while the growth of imports of textiles and clothing amounted to 18-20 % p.a., the emerging structural change is certainly not insignificant.

The discrimination, inherent in the Generalized Systems of Preferences, against the simple product categories in the developing countries' range of exports implies a discrimination against certain groups of developing countries. Obviously, developing countries in the initial stage of industrialisation cannot be competitive with regard to technically exacting goods such as machines, transport equipment, iron and steel products or chemicals, and – according to the theory of the changing pattern of comparative advantage in the process of economic development[8] – such goods cannot successfully be offered for sale on the world markets until these countries' domestic structure exhibits a sufficient differentiation and flexibility.

Such country pattern effects are confirmed by an evaluation of the results to date of the EC System of Preferences. In addressing the question as to which countries have done especially well with their exports to the Community, different studies regularly come up with a similarly patterned success table. Invariably the Asian countries of Hong Kong, South Korea, and Singapore head the list, followed by India, Malaysia and Pakistan. Latin America has two peak performers in Mexico and Brazil. The most important supplier country in South Eastern Europe is Yugoslavia[9].

Newly Industrialising Countries Favoured

Thus it is chiefly the newly industrialising countries of the Third World, the ones with a strong supply position, which are favoured by the GSP, while young supplier countries with traditional, simple types of goods are, if anything, disadvantaged. The latter experience difficulties with regard to all those characteristics which are a premise for successful utilisation of export opportunities within the framework of the preferential systems. Lack of ability to supply as well as competitive disadvantages are the main explanation of the fact that in 1976 a large portion of the ceilings and customs quotas granted by the European Community were not fully taken up.

The fact is that the young supplier countries possess neither the structural prerequisites for differentiating their range of goods for sale, necessary in order to be able to take advantage of the preferential quotas made available, nor the institutional basis for effective export promotion and market penetration. Furthermore, they are able only to a limited extent to participate in the

[6] A. Weston, V. Cable, A. Hewitt: The EEC's Generalised System of Preferences, London 1980, p. 139 ff.

[7] B. Balassa: Prospects for Trade in Manufactured Goods between Industrial and Developing Countries, 1978-1990, in: Journal of Policy Modeling, Vol. 2 (1980), p. 437 ff., esp. p. 443 ff.

[8] Cf. B. Balassa: A "Stages Approach" to Comparative Advantage, in: J. Adelman (ed.): Economic Growth and Resources, Vol. 4: National and International Issues, London 1979, p. 121 ff.

[9] A. Weston, V. Cable, A. Hewitt, op. cit., p. 140 ff.

bureaucratic procedures of the preference systems (such as certificates of origin).

The theory that the pattern of comparative advantage in the foreign trade of the developing countries changes in the process of economic development tends to regard the obvious "distortion" of the commodity and country pattern in favour of "atypical", more sophisticated industrial manufactures and of the newly industrialising countries producing such goods, as a passing phenomenon. The theory assumes that the suppliers of "typical" industrial manufactures, though at present at a particular disadvantage from the trade restrictions of the industrialised countries, will in the course of time acquire all those capabilities necessary for the competitive production of sophisticated manufactures for the industrialised countries' markets, which are capable of further expansion. After a certain phase of learning all developing countries would thus find themselves in the better position of the present-day newly industrialising countries, while the latter might meanwhile have "graduated" as "new" industrialised countries.

However, there are many indications that such a "righting" of the structure of the supplying countries following a certain period of adaptation and learning will not take place. For one thing, the present lack of competitiveness on the part of young supplier countries favours a "relapse" by them into simple patterns of specialisation, such as semi-finished goods or simple manufactures. The industrialised countries' markets are not heavily protected against these goods. Moreover, the marketing channels are already in existence and the markets are transparent since they are largely organised by the purchasers in the industrialised countries. It seems, therefore, that the relevant thesis here is that suppliers whose competitive position is weak tend to counter the uncertainty of foreign markets by specialisation rather than by diversification.

Conflict Pre-programmed

However, a retreat from the risky production of industrial manufactures implies welfare losses which in turn may reduce domestic development potential – above all the ability to mobilise and regroup factors of production – so seriously that a transition to more demanding industrial production may no longer be possible, even with the best of intentions. The young supplier countries can thus be "nailed down" to their inferior specialisation position.

Participation in the industrialised countries' systems of preferences will therefore tend to deepen the structural gulf between the young supplier countries and those already established as newly industrialising countries. And this means nothing less than that the North-South conflict is transposed into the Third World itself.

The conflicts are thus pre-programmed: the non-privileged developing countries will try to offset their lack of economically founded competitiveness by intensifying their export promotion measures (in the shelter of the GSP). If the newly industrialising countries duly respond and – following the example of the industrialised countries – close their domestic markets even more firmly to the competition of the other developing countries, the merry-go-round of the new protectionism will make another turn. This means a growing danger of trade policy anarchy in the Third World, implying also political instability.

If it is correct that international trade represents an important force of development for the poor countries of the Third World – and, in the light of experience, there can hardly be any doubt about that –, then what is needed especially in the interest of these countries is a rejection of the past toleration of the industrialised countries' trade restrictions which have become established, mainly under the cover of the Generalized Systems of Preferences.

Admittedly, a return to the classical order of international trade based on the principles of reciprocity of non-discrimination and of most-favoured-nation treatment, as still embodied in GATT, appears to be out of the question in a world in which national states cannot be compelled to waive their right to an autonomous growth and employment policy. Besides, the political and economic starting-point of many developing countries vis-à-vis the industrialised countries is so bad that, even in the view of the participants in the Tokyo Round of GATT, compensating arrangements involving the suspension of the strict system of reciprocity seem indispensable.

What matters now is that the existing international trading system should be altered in such a way that justified exceptions from the fundamental principles of free trade could be permitted but should be subject to strict general rules of procedure. Such rules should include the definition of operational criteria for the application of balance-of-payments-determined import restrictions, export restrictions and export promotion measures, as well as other instruments for regulating the market, and should stipulate the manner, scope and time-span of the admissible use of these instruments. Stipulations that the burden of proof rests on the instigator, and regarding the supervision of interventions, are likewise of cardinal importance. The effectiveness of these rules should be ensured by a universal duty to consult prior to the realisation of any trade-restricting intervention planned by an individual country.

The reforms of trade policy achieved so far within the framework of the Tokyo Round – the code governing subsidies and countervailing duties, the code governing the practice of state procurement, the definition of assessment standards for customs valuation and the simplification of the procedure on import licensing – should not, of course, be underestimated. Nevertheless, they do not yet ensure the necessary breakthrough to a universal codification of the application of national protective measures against market disruptions, especially those introduced outside GATT.

Farther-reaching reforms are therefore urgently necessary. At the same time – according to Bergsten[10] – there is no need for the creation of entirely new institutions provided the well-tested consultation provisions of the International Monetary Fund can successfully be combined with the technical competence of GATT. It would then be the responsibility of the IMF to judge the necessity of trade-restricting interventions ex ante, as a matter of general principle, while the GATT Secretariat would be responsible for the definition of the modalities of the specific restrictions and for their supervision.

In whatever shape the reform is effected, it is important that the industrialised countries above all, from whom the most painful trade restrictions have originated, take the decisive first steps. For it will ultimately be up to them whether they exploit the inclination towards trade restrictions present in many developing countries in order to justify their own protectionism or whether they restrain such inclinations by their own example.

[10] C. F. Bergsten: Reforming the GATT: The Use of Trade Measures for Balance-of-Payments Purposes, in: Journal of International Economics, Vol. 7 (1977), p. 1 ff., esp. p. 10 ff.

LATIN AMERICA

Friedman versus Keynes in Latin America

by Jürgen Westphalen, Hamburg*

In a number of Latin American countries, the influence of John Maynard Keynes and his Latin American proponent Raúl Prebisch, was forced during the seventies to give way to the liberal-monetarist principles of Milton Friedman. What advantages and disadvantages have ensued from this change of course? Do Friedman's theories point a way out of Latin America's present economic and social problems?

The influence of John Maynard Keynes – a German journalist[1] wrote – came "to an end even before a quarter-century had elapsed since his death. For the legacy of the great Englishman, the doctrine that boom and growth can be induced by controlling State demand, is increasingly dissolving into nothingness". This "process of disintegration" had been triggered off by the American economist Milton Friedman, "who was the first to provide empirical evidence that the development of the national product depends . . . on the amount of money in circulation".

Latin America is generally regarded as an interesting and successful field of experiment for Milton Friedman's economic theories and policy recommendations. Certainly a clear change of course in economic policy is taking place in a number of Latin American countries. It is a change from Keynes to Friedman or – to label the old economic policy with the name of a Latin American economist – a change from Prebisch to Friedman. Throughout several decades, development policy, foreign trade policy and trade cycle policy in Latin America had largely been shaped by the UN Economic Commission for Latin America (CEPAL – Comision Economica para America Latina) set up in Santiago in 1948 and, in particular, by its former Executive Secretary Raúl Prebisch.

Prebisch repeatedly refers to Keynes; but such references are really unnecessary for the kinship between the principles of these two economists to emerge clearly. For example, a few observations may be quoted from Keynes's *General Theory*[2] and from the paper *Transformación y Desarrollo*[3], presented by

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[1] P. C. Martin in his introduction to the German edition of M. Friedman: Capitalism and Freedom (Kapitalismus und Freiheit, Munich 1976).

[2] J. M. Keynes: General Theory of Employment, Interest and Money, London 1936.