

# INTERNATIONAL TRADE AND GLOBAL DEVELOPMENT

ESSAYS IN HONOUR OF  
Jagdish Bhagwati

edited by

Ad Koekkoek & L B M Mennes



# **International trade and global development**

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**and**

**L.B.M. Mennes**



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# Preface

On 8 November 1988 a solemn ceremony took place in the great hall of the Erasmus University Rotterdam where the University's seventy-fifth *dies natalis* was celebrated. The second co-editor of the present volume had the great honour to address Professor Jagdish Bhagwati of Columbia University with the following words:

By virtue of the powers invested in us by statute and in accordance with the decision of the College of Deans, I hereby confer upon you, Jagdish Bhagwati, the title of *Doctor honoris causa*, together with all the rights which statute and custom attach to this degree.

As token and proof thereof, I present you with the corresponding charter, duly signed and sealed, and clothe you with the cappa.

The many reasons why it was thought very appropriate to confer an honorary degree upon Jagdish Bhagwati were summarized in the usual 'laudatio':

For more than twenty-five years Professor Jagdish Bhagwati has made major contributions in international economic theory and in development economics. This has resulted in more than twenty-five books, authored or edited by him, and in more than 200 papers published in all major economic journals. Professor Bhagwati's contributions are masterly combinations of economic theory, empirical validation and policy debate. They relate to four major areas: commercial policy, international factor mobility, domestic development problems and international problems.

In the theory of commercial policy Jagdish Bhagwati has formulated the generalized theory of distortions and welfare, where a considerable body of literature on the welfare economics of trade was unified in seven major propositions. Other major contributions in this area relate to the theory of immiserizing growth and its application; the

equivalence of tariffs and quotas; the theory of the optimum subsidy; project evaluation, effective protection and domestic resource costs; and directly unproductive profit-seeking activities.

The second area is that of international factor mobility with important and innovative contributions to subjects such as international migration, the welfare-theoretical aspects of the brain drain, trade and welfare in the presence of foreign factors of production, foreign investment, and international trade and comparative advantage.

The third area is that of national development problems. In this respect it must be emphasized that for Jagdish Bhagwati the objective of development always was the elimination of poverty. Growth was seen by him as an instrumental variable. Also in this area Professor Bhagwati has made valuable studies on topics such as regularities and explanations of a country's economic structure, technological development and employment, and in particular the theory of transfers and welfare, where the well-known 1929 debate between Keynes and Ohlin on reparation payments by Germany was taken as a point of departure, leading to a brilliant analysis of the so-called transfer problem.

The fourth and last area is that of international problems. Here Professor Bhagwati's contributions relate to, among others, the tying of aid, the substitution between foreign capital and domestic savings, and the relation between food aid, agricultural production and welfare.

One of Professor Bhagwati's major achievements is precisely in this field of international economic problems. Professor Bhagwati is the principal intellectual advocate of liberalization in the modern industrial and trade sectors of an economy. His highly scholarly and influential contributions in this respect are on the relative merits of import-substituting and export-promoting development strategies, demonstrating the great net benefits of non-distorting neutral export-promoting policies.

In his research activities Professor Bhagwati has co-operated with a number of other economists. In honouring Professor Bhagwati, we also honour his colleagues. I would like to mention three of them: T.N. Srinivasan, the late Harry Johnson and Professor Mrs Padma Desai, his wife, who is with us today.

Ladies and gentlemen, I will try to summarize the relevance of Jagdish Bhagwati's numerous contributions to economic science by referring to his last book. It is a small book, called *Protectionism*.

We are now in the middle of the Uruguay Round of the Multilateral Trade Negotiations. These negotiations concern the developing countries deeply. The threat of protectionism has resurfaced; it will

continue to do so, also or precisely, when the European Common Market will be completed in 1992. This tide of protectionist sentiments and legislation has to be stemmed, in order to give hundreds of millions of poor people a small opportunity for a somewhat better life.

Fortunately, there are major new interests and forces, but in particular new ideas in the theory of commercial policy that strengthen the ideological power of anti-protectionism. For this purpose we have to reform and strengthen the institutional framework, national and international, to harness these pro-trade interests and contain the forces of protectionism more effectively. This calls for continuous information by economic science.

Already for many years Professor Jagdish Bhagwati has provided such information, characterized by theoretical brilliance and thorough empirical analysis. In this way he has served economic science and, by fighting protectionism, mankind. For these reasons, the Erasmus University Rotterdam honours him today.

On the occasion of the awarding of the honorary doctorate to Jagdish Bhagwati the Department of International Economics of the Erasmus University organized a symposium with the title *International Trade and Global Development*, where some of the papers in this volume were first presented. To do full justice to the breadth of Professor Bhagwati's interests we tried to cover a wide spectrum of topics in international economics, namely trade policy in general, trade policy and development strategies, trade policy and direct foreign investment and international economic co-operation. We were very happy with the instant willingness to contribute of Giorgio Basevi, Jim Riedel, Onno Ruding, Leo Sleuwaegen together with Hideki Yamawaki, and Alan Winters. Their papers are included in this volume, except for Giorgio Basevi's, whose paper on international monetary co-operation, unfortunately, was already committed for publication elsewhere.

Of course, four papers do not make a book. So we tried to increase the number of papers in line with our aim of covering a wide area of international economics. We are very grateful therefore that so many distinguished authors were willing to join our enterprise. It is a reflection, we think, of the high esteem in which Jagdish Bhagwati is held by the community of international economists. Altogether the authors represent a group of admirers of Jagdish, who were, or would like to have been, also his students.

We have subdivided the volume into four parts of rather different size. The introduction comprises two papers; the main part on trade, protection and political economy consists of no less than five papers;

the third part on foreign direct investment has three papers and the fourth part on international economic co-ordination contains just one paper. This somewhat uneven distribution is mostly because of the differences in attention given to the various subjects during the symposium. Trade policy was indeed the main subject, followed by foreign investment and international co-ordination. For the last subject two contributions were planned; unfortunately, one did not materialize.

We shall now briefly present the various contributions: Onno Ruding, who was at the time Minister of Finance of the Netherlands and Chairman of the International Monetary Fund (IMF) Interim Committee, deals with the international economic environment from a practical policy point of view. In his contribution, the Minister supports further attempts to achieve substantial trade liberalization during the present Uruguay Round of the General Agreement on tariffs and Trade (GATT). Dr Ruding also discusses the present way of co-ordinating macro-economic policies. In fact he criticizes the decision-making in the G5/G7 framework, which he characterizes as 'too much politics and too little economics'. Instead he proposes to strengthen the position of the IMF.

We are glad we were allowed to reprint Professor Bhagwati's article, in which he extensively reviews the case for free trade in the light of the many recent developments in the theory of commercial policy, especially in view of the so-called strategic trade policy considerations which have been advanced over the last couple of years. He argues that, whereas the incorporation of imperfect competition into the theory of international trade augments the case for departures from free trade, the incorporation of political processes weakens the case. He thinks the latter are more interesting and compelling, whereas the former are subject to many difficulties on their way from theory to real-world application.

Alan Winters considers the question whether current protectionism, given its specific nature, is amenable to GATT-based processes. In his analysis he distinguishes high-track and low-track protectionism. The former is the visible one, often leading to bilateral solutions. The latter refers to the biased use of formally impartial procedures. Professor Winters is more optimistic about the chances of reducing high-track protectionism than low-track protectionism, because of the risk of 'rationalizing' existing codes, i.e. in his words: 'to fit GATT around the facts'.

Jim Riedel discusses the 'victory' of outward-oriented over inward-oriented development strategies. In particular, he pays attention to two aspects of the debate about these strategies: the infant-industry argument, for which he finds little support, and export pessimism, with regard to which he stresses that, traditionally, import demand elasticities are

underestimated, because in the estimation process export supply from developing countries is assumed to be infinitely elastic. Any doubts Jim Ridel may have about the relevance of outward orientation are reserved for the case of Africa.

Martin Wolf describes, in his inimitable way, the history of voluntary export restraints (VERs), starting in the 1930s. Points of departure for his discourse are on the one hand Jan Tumlirs' rather negative assessment of VERs and on the other hand Jagdish Bhagwati's more optimistic interpretation of VERs in terms of the porousness of protection. His own position can best be summed up by quoting two of the propositions he makes: 'A VER here and a VER there and pretty soon you will have real protection' and 'The road to hell is paved with good intentions'.

Robert Feenstra compares tariff-rate quotas and quota auctions in relation to adjustment assistance. Quota auctions imply the reversal of the transfer of rents from the importer to the exporter, in which case trade partners cannot be expected to remain passive. The advantage of tariff-rate quotas would then be to preserve part of the original rent transfer and to use the revenue collected for adjustment assistance.

Brian Hindley discusses whether national policy regarding international trade in services should be subject to the discipline of the GATT, in particular from the point of view of developing countries. He argues that services trade liberalization, even unilateral, would be to the developing countries' advantage. Of course, he adds, it would be in their interest if they could exact a price from the developed countries in the Uruguay Round negotiations for opening up their markets in services.

Leo Sleuwaegen and Hideki Yamawaki discuss intra-firm trade decisions of Japanese multinationals. In their theoretical framework they explicitly look at the role market imperfections, such as protectionism, play here. They find, *inter alia*, that Japanese parent-firms, compared with US firms, import relatively less from their foreign affiliates and strongly direct their intra-firm exports to their foreign distribution subsidiaries. There is evidence, though, that this kind of intra-firm trade will reduce in magnitude and be substituted by local manufacturing.

Elias Dinopoulos and Kar-yiu Wong deal with direct foreign investment, not as a means of circumventing protection, but rather as a way of defusing the threat of protectionist action. Professor Bhagwati called this sort of investment *quid pro quo* direct foreign investment. They carefully analyse various policies, for both the importing country and the exporting countries, in the context of protectionist threats and *quid pro quo* direct foreign investment, which can improve the national welfare of both the importing and the exporting country.

V.N. Balasubramanyam and M.A. Salisu focus on Bhagwati's thesis that countries pursuing an export promotion strategy are, *ceteris paribus*, likely to attract more foreign investment than countries following an import substitution strategy. They do indeed find substantial empirical support for this proposition on the basis of a cross-section regression over thirty-eight developing countries for the period 1970-80.

Jeffrey Frankel takes up the second point made by Minister Ruding: the G7 co-ordination mechanism. He explains that the present mechanism is vulnerable to serious obstacles of three sorts: compliance, inflation-fighting credibility and uncertainty. Professor Frankel argues that co-ordination should involve an explicitly agreed and publicly announced intermediate target and that this should be a nominal variable. He concludes that the nominal intermediate target to which countries should best commit is one that does not even appear on the current G7 list at all: nominal gross national product.

To round off this volume, Professor Bhagwati, at our request, has agreed to present some comments on the various papers.

Ad Koekkoek  
L.B.M. Mennes

# Contents

List of tables	vii
About the contributors	ix
Acknowledgements	xiv
Preface	xv
<i>Ad Koekkoek and L.B.M. Mennes</i>	

## Part I Introduction

1	Improvement of the international trade environment in order to stimulate economic growth in developing countries	3
	<i>H. Onno Ruding</i>	
2	Is free trade passé after all?	10
	<i>Jagdish Bhagwati</i>	

## Part II Trade, protection and political economy

3	Perspectives on trade and trade policy	43
	<i>L. Alan Winters</i>	
4	Strategy wars: the state of debate on trade and industrialization in developing countries	62
	<i>James Riedel</i>	
5	Why voluntary export restraints? A historical analysis	83
	<i>Martin Wolf</i>	
6	Quota auctions and adjustment assistance: an international perspective	105
	<i>Robert C. Feenstra</i>	
7	International transactions in services and developing countries	119
	<i>Brian Hindley</i>	

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## Contents

### Part III Foreign investment

- |    |  |     |
|----|--|-----|
| 8  | Foreign direct investment and intra-firm trade: evidence from Japan<br><i>Leo Sleuwaegen and Hideki Yamawaki</i>                               | 143 |
| 9  | <i>Quid pro quo</i> foreign investment and policy intervention<br><i>Elias Dinopoulos and Kar-yiu Wong</i>                                     | 162 |
| 10 | Export promotion, import substitution and direct foreign investment in less developed countries<br><i>V.N. Balasubramanyam and M.A. Salisu</i> | 191 |

### Part IV International economic co-ordination

- |    |   |     |
|----|---|-----|
| 11 | The obstacles to macro-economic policy co-ordination in the 1990s and an analysis of international nominal targeting<br><i>Jeffrey A. Frankel</i> | 211 |
| 12 | Threats to the world trading regime: protectionism, unfair trade <i>et al</i><br><i>Jagdish Bhagwati</i>  | 237 |
|    | Index   | 245 |