

Trade Policy Issues for the Developing Countries in the 1980s

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Prepared by: Isaiah Frank [Consultant]
Economic Analysis and Projections Department
Development Policy Staff

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The World Bank
1818 H Street, N.W.
Washington, D.C. 20433, U.S.A.

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THE POLITICAL STRUCTURE OF THE NEW PROTECTIONISM

A Background Study for World Development Report, 1981

This paper presents a political-economic analysis of what has been called "the new protectionism." Sections II and III trace the roots of this phenomenon to specific economic and political developments since the second World War. These developments caused trade policy first to be politicized as an international issue, and then to become a domestic political issue in the major industrial country traders.

Because the major trading countries have agreed in the General Agreement on Tariffs and Trade (GATT) not to increase the level of their protection except under agreed circumstances (dumping, subsidies, and "surges"), the bureaucratic mechanisms which police these exceptions have become an important marginal supplier of protection. Section IV examines the legal and administrative structure of this administered protection, and Section V examines its impact on economic theories of protection seeking and the market for protection. The major conclusion of this analysis is that, on the one hand, these bureaucratic mechanisms embody a protectionist bias (that is, they increase the level of protection beyond the level necessary to offset unfair trade practices), but that, on the other hand, because of the bureaucratic nature of the process, the increases in protection will tend to be more stable than if they were legislated directly.

Prepared by: Douglas R. Nelson, Consultant
World Development Report **Gore group**
Development Policy Staff

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The World Bank
1818 H Street, N.W.
Washington, D.C. 20433
USA

Acronyms and Abbreviations

ASP	American Selling Price System
EEC	European Economic Community
GATT	General Agreement on Tariffs and Trade
GPTA	GATT preferential trade agreement
GSP	General system of preferences
IATA	International Air Transport Association
ILO	International Labour Organisation
MFN	Most-favored-nation
MTN	Multilateral trade negotiations
OECD	Organisation for Economic Co-operation and Development
OMA	Orderly marketing agreement
QR	Quantitative restriction
UNCTAD	United Nations Conference on Trade and Development
VER	Voluntary export restraint

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I. Introduction

Aside from international commodity policy, the salient trade issues for the developing countries in the 1980s concern, in one way or another, access to markets. The ability of developing countries to sustain satisfactory growth levels while adjusting to higher debt service and oil import costs is critically dependent on their export capabilities. More fundamentally, it is hardly an exaggeration to say that those oil-importing developing countries that have realized the greatest economic progress over the last two decades have achieved their success through structural changes in their economies based largely on their ability to achieve a rapid expansion of exports of manufactures.

The potential exists in many relatively labor-intensive industrial sectors for continuing rapid shifts in comparative advantage from one group of countries to others lower on the development scale. Whether this potential, and the consequent vast opportunities for a new international division of production, will be realized depends primarily on domestic economic policies within individual countries, both developed and developing. But internal policies can be profoundly affected by the way in which the international economic system evolves. Although resource transfers may be critical for improving the prospects of low-income developing countries, improved access to world markets may be at least as important for middle-income developing countries. A crucial question for the 1980s, therefore, is how to maintain a reasonably open world trading system in the face of slow growth and mounting protectionist pressures in the industrial countries.

Implicit in this approach is a rejection of the hypothesis that trade can no longer stimulate growth in the developing countries because of the major discontinuity in the world economy caused by oil price increases,

inflation, and economic stagnation. According to the latter view, developing countries should face the reality of shrinking opportunities to expand exports to the industrial countries. They should, therefore, tilt toward the earlier, inward-looking growth strategy for import substitution and also seek more vigorously to expand trade among themselves. 1/

Import substitution may have played a useful role at one stage in the evolution of some of the larger developing countries, and the potential for expanded trade within the developing world may not yet be fully realized. Nevertheless, this paper is predicated on the notion that rapidly expanding opportunities will continue for developing countries to export both to each other and to their main markets in the industrial countries and that expanding developing country exports will not adversely affect overall growth in the developed world (since the developed countries will in turn enjoy greater export possibilities as the developing countries' capacity to import improves). The major proviso is that steps be taken to underpin and strengthen those international institutions and policies that are designed to foster an open world trading system. In short, whether outward-looking growth strategies for developing countries will continue to be valid in the 1980s greatly depends on what is consciously done to shape the international policy framework within which trade takes place rather than on an inexorable unfolding of adverse circumstances.

The subject of appropriate trade policy will be addressed in four parts. The next section briefly reviews the recently completed multilateral trade negotiations (MTN) and assesses the policy significance

1/ Arthur Lewis, "The Slowing Down of the Engine of Growth," American Economic Review (September 1980).

for the developing countries in the 1980s. The third section considers the major trade policy issue of safeguards (and the related question of informal trade barriers) on which agreement could not be reached in the MTN. The fourth section considers more briefly four other subjects that are expected to assume increasing importance in the coming decade and that warrant a fresh look: industrial policy and structural adjustment, fair labor standards, trade among the developing countries, and trade in services. Concluding remarks are made in the final section.

II. The Multilateral Trade Negotiations (MTN)

The most comprehensive set of trade negotiations ever conducted was concluded in 1979 under the aegis of the General Agreement on Tariffs and Trade (GATT). Three major sets of results were achieved: a substantial reduction in tariffs; a refinement and improvement of the international rules on non-tariff measures; and the adoption of a framework of procedural arrangements to encourage and facilitate adherence to the agreements on the part of signatory countries.

Tariffs

Despite the diminishing importance of tariffs compared with non-tariff barriers to trade, a great deal of attention was given to tariffs in the MTN. Average tariffs on industrial products were reduced by approximately one-third (38 percent calculated as a simple average, or 33 percent on an import-weighted basis). In addition, the negotiations succeeded in liberalizing tariffs by harmonizing the rates. Because the restrictiveness of a country's tariff structure is partly a function of the degree of dispersion of the rates around their average, liberalization was accomplished by application of a formula for harmonization under which the percentage reduction increased with the height of the tariff.

Under the most-favored-nation (MFN) rule, the duty reductions will be extended to all GATT members on a non-discriminatory basis. Nonetheless, the developing countries have expressed keen disappointment with the results on two grounds: first, that the reductions on products of special interest to developing countries fell short of the average cuts; second, that the MFN reductions implied an erosion of the margins of preferences enjoyed by the developing countries under the general system of preferences (GSP).

The evidence appears to bear out the claim that the tariff reductions on products of interest to developing countries are smaller than the average cuts -- 25 percent versus 33 percent on a weighted basis. If products of potential interest to developing countries are included, however, the picture that emerges is one of roughly comparable reductions. This more dynamic view may be the more relevant given the rapidly growing diversification of developing countries' exports. Moreover, the harmonization of tariffs achieved in the MTN would appear to mitigate the developing countries' long-standing concern about tariff escalation; i.e., that the gap between the tariffs on manufactured products and the lower tariffs on semi-processed and raw materials tends to solidify the traditional role of developing countries as suppliers of basic materials. 1/

As for the erosion of the margins of preference, the problem is to compare the loss to developing countries of the benefits of trade diversion in the preference-granting countries with the gains from trade creation in those countries that are a result of MFN tariff reductions on non-GSP

1/ An additional benefit of narrowing the escalation of nominal tariffs is that it reduces the extent to which the effective protection exceeds the nominal tariff on the higher stages of processing and fabrication.

products. The net result of this calculation, according to the United Nations Conference on Trade and Development (UNCTAD), is a substantial net loss for the developing countries. 1/ The methodology underlying the UNCTAD estimate, however, appears to be open to serious question. As Balassa 2/ has shown, the gains to developing countries from the MFN tariff reductions should, under reasonable assumptions, far exceed any trade losses from reductions in preference margins.

Additional gains by the developing countries will be made because the MFN reductions apply to products that have lost their GSP status in the United States and to products subject to GSP import limitations by tariff quotas applied in the European Economic Community (EEC) and Japan. Moreover, preferences can be -- and in fact have been -- unilaterally withdrawn, whereas the MFN reductions negotiated in the Tokyo Round are legally "bound." Although bindings can be suspended through safeguard action, they are nevertheless a more reliable basis for the long-term planning of investment and export strategies.

Codes on Non-Tariff Measures

What distinguishes the Tokyo Round from previous rounds of MTN is its accomplishments in the field of non-tariff measures. As the

1/ UNCTAD V, "Multilateral Trade Negotiations: Evaluation and Further Recommendations Arising Therefrom" (Manila, May 7, 1979).

2/ Bela Balassa, The Tokyo Round and the Developing Countries, World Bank Staff Working Paper no. 370, (Washington, D.C., February 1980), pp. 9-11.

level of tariffs has receded over the years, non-tariff distortions have become more significant. 1/ Moreover, they have often been applied in a manner that circumvents the basic GATT rules. The codes adopted in the Tokyo Round update the rules and provide more effective international discipline in their application.

Subsidies and countervailing duties

This code prohibits outright the subsidization of exports of industrial products and minerals. With respect to agricultural products, it reaffirms the GATT principle that export subsidies should not be used to gain more than an equitable share of world markets. In contrast to export subsidies, domestic subsidies are not barred. Indeed, their role in achieving legitimate domestic goals is acknowledged, but signatories are committed to avoid the use of domestic subsidies if these have harmful effects on the industry and trade of other countries.

A substantive change of great potential significance for developing countries is the acceptance by the United States of the material injury test for applying countervailing duties. Under a "grandfather" clause, the United States has not previously applied the GATT-mandated injury test and was in fact legally bound under its domestic law automatically to apply countervailing duties once foreign subsidization was established. The U.S. commitment to apply the injury test extends, however, only to signatories of the code.

1/ Actually, resort to non-tariff barriers is substantially less today than in the 1950s, when they were widely used by the industrial countries to defend the balance of payments. Such use of non-tariff barriers by the industrial countries has been rare in recent years, but these measures have become more important relative to tariffs as purely protective devices.

Specific recognition of developing country interests is reflected in the differential treatment accorded them. Acknowledging that subsidies are an integral element in economic development programs, the code exempts developing countries from the general prohibition of export subsidies in non-agricultural products. In addition, the use of countervailing duties against a developing country is subject to more stringent standards: the illustrative list of export subsidies cannot be invoked as a basis for a presumption of harmful effects, nor will the examples in the code of internal subsidies be regarded per se as subsidies. In return for this differential treatment, developing countries signatory to the code agree to "endeavor" to enter into a commitment to eliminate export subsidies when their use is inconsistent with the countries' competitive and development needs.

Finally, signatory developing countries may utilize the improved procedures of the code for protecting their own interests against developed country export subsidies, domestic subsidies prejudicial to developing country interests, or unilateral retaliatory measures.

Government procurement

This code breaks new ground in addressing an increasingly important sector of trade in which GATT has expressly permitted discrimination in favor of domestic suppliers. As the proportion of government expenditures in GNP has been steadily rising, this exception for government procurement has become a seriously limiting element in international trade.

The intent of the code is to provide national and MFN treatment for foreign suppliers of products purchased by government entities subject to the code in amounts above approximately US\$200,000 on individual transactions. To this end, the code provides for greater transparency of laws,

regulations, and practices and contains detailed rules on how tenders for contracts should be invited and awarded. As in the case of the code on subsidies and countervailing duties, explicit provisions are included for the multilateral adjudication of disputes.

Special measures for developing countries are provided in the code. Developed countries are called upon to include in their list of government entities those which purchase products of special interest to developing countries and to provide developing countries with technical assistance. Developing countries may negotiate mutually acceptable exclusions from the code, and suppliers in the poorest developing countries may benefit from the provisions of the code even if they are not parties to it.

The significance for developing countries of opening up this new sector to non-discriminatory trade was well stated in an UNCTAD report prepared for the 1979 Manila Conference: "In view of the substantial size of public procurement by developed countries and the capability of the developing countries to meet a good deal of these procurement needs, the developing countries attach great importance to efforts at the national and international levels to liberalize restrictive national and local-government procurement policies that now seal off potentially large markets from international competition." 1/

1/ UNCTAD, "The Industrial Policies of the Developed Market-Economy Countries and Their Effect on the Export of Manufactures and Semi-Manufactures from the Developing Countries," TD/230/Supp. 1/Rev. 1 (New York, 1979), p. 21.

Technical barriers to trade

Governments have increasingly been adopting technical regulations to ensure that products conform to standards relating to such matters as health and safety, environmental protection, and energy efficiency. Although such product standards generally serve legitimate social objectives, they can be used in various ways for protectionist purposes.

The intent of the code is to ensure that product standards "do not create unnecessary obstacles to international trade." In addition to providing for equality of treatment for domestic and imported products, the code calls upon signatories to cooperate in establishing international standards and to use them where they exist. In the absence of international standards and regulations, signatories should set national standards for performance rather than for design or descriptive characteristics that lend themselves more easily to protective use.

Developing countries receive various forms of special treatment under the code. In addition to providing for technical assistance, the code relieves them of the obligation to apply international regulations and standards when the latter are incompatible with the developing countries' desire to preserve "indigenous technology and production methods and processes compatible with their development needs." In addition, developing countries may receive specific exemptions from other provisions of the code for limited periods.

Customs valuation

The purpose of this code is to clarify the GATT provisions on valuation and to ensure that imports are assessed for duty purposes on commercially realistic terms, not on an arbitrary basis that is a disguised form of protection. The transaction value (i.e., the price actually paid or payable)

is established as the primary basis of customs valuation, with four subordinate methods specified in a stipulated order of precedence.

Under the new rules, the United States has agreed to eliminate the much-criticized American Selling Price system (ASP) under which certain goods have been valued not at the actual transaction price but at the higher price at which the products were sold in the U.S. market.

Special provisions for the developing countries include technical assistance in applying the code, a five-year postponement of its application, and a further delay of up to three years in applying the provisions of the code to trade between related parties (primarily transactions between transnational enterprises and their developing country subsidiaries). However, developing countries pressed in the negotiations for a longer postponement and greater latitude for their customs authorities in transactions between affiliated companies.

Import licensing

The purpose of this agreement is to ensure greater equity, transparency, and simplicity in the administration of import licensing systems and thereby to discourage their use for purposes other than those for which they are publicly intended. In allocating import licenses, special consideration is to be given to importers purchasing products from developing, and especially the least developed, countries.

The Framework Agreement

This agreement is a composite of decisions on three sets of issues of importance to developing countries.

Balance-of-payments and safeguard measures

The two declarations on these subjects grant greater flexibility for developing countries to adopt protective measures than provided under present GATT rules. In the case of balance-of-payments difficulties, developing countries may resort not only to quantitative restrictions but also to other forms of protection. With respect to safeguard actions for development, the agreement broadens the purposes for which such restrictive trade measures may be taken. They are no longer limited to the protection of particular infant industries but are also sanctioned for broader development purposes.

Administration of GATT and the codes

Refined principles and new rules can have a significant impact on the world trading system only if fair and effective procedures exist for applying them.

The framework agreement regularizes and strengthens the procedures for notification of trade measures, consultation among interested parties, and the conciliation and resolution of disputes. Detailed provisions apply to the establishment, composition, and functions of panels to examine complaints and to the follow-up and surveillance of actions of signatories in the light of panel findings and recommendations.

This strengthened framework of procedures is particularly important for developing countries, since it institutionalizes a mechanism for affording better protection for the interest of countries with weak bargaining power.

Enabling clause and graduation

For many years developing countries had pressed for the legal right to exceptions from the two basic GATT principles of non-discrimination and reciprocity. Until the Tokyo Round, exceptions from the non-discrimination

rules, whether in the form of preferences for developing countries under GSP or preferences among developing countries, could only be adopted by ad hoc waivers of the non-discrimination rule. The new agreement establishes for the first time a legal basis for both types of preferences.

An exception for developing countries from the principle of reciprocity in trade negotiations has already been included in Part IV, the "Trade and Development" section of GATT, adopted in 1965. The new "enabling clause" reaffirms and strengthens the commitment of developed countries not to seek concessions inconsistent with the needs of developing countries in trade negotiations.

Taken together, the provisions on preferences and non-reciprocity are regarded by developing countries as reflecting a more equitable trading relation between rich and poor countries because they remove the anomaly of "equal rights and obligations among unequals."

As a counterbalance to this legitimization of "special and differential treatment" for developing countries, the industrial countries insisted on inclusion of the principle of graduation. In response, therefore, to the changing "development, financial, and trade needs of developing countries," the special dispensations granted to them in both the codes and the framework agreement would be gradually withdrawn. In addition, the developing countries would be expected ultimately to graduate by participating "more fully in the framework of rights and obligations of GATT" as warranted by their economic progress. No specific provisions were spelled out, however, for implementing the graduation principle.

Overall Implication for Developing Countries

The MTN results were greeted with keen disappointment by the developing countries. Although a number of developing countries have signed individual codes (e.g., Argentina, Brazil, India), none has formally subscribed to the full results of the MTN (as of December 12, 1980).

Fundamentally, the objections of the developing countries have been of two kinds. First, it was felt that issues of vital interest to the developing countries were not resolved in the MTN. No liberalization of existing quantitative restrictions (QRs) was achieved nor were any limitations placed on such increasingly common measures as voluntary export restraints (VERs) and orderly marketing agreements that have effects similar to those of QRs. Closely related to these deficiencies was the failure of efforts to negotiate a "safeguard code" that would define with greater precision the conditions and procedures for restrictive "escape clause" action in the case of market disruption.

Although it is true that progress was not achieved in these two areas, this failure reflects a limitation in the scope of the MTN agreements rather than a deficiency in the results on subjects on which agreement was in fact achieved. At the same time that the positive results of the MTN are consolidated, an international effort must be mounted to liberalize QRs in their various forms and to develop an acceptable safeguard code.

The second objection of the developing countries is that the special and differential treatment, which is an essential feature of the "new international economic order" in trade policy, has been compromised in all three aspects of the MTN. With respect to tariffs, it is claimed that the gains from lower MFN duties on non-GSP products are more than offset by the loss of margins of preference under GSP. With respect to the codes, it is argued that