FOREIGN TRADE REFORMS AND DEVELOPMENT STRATEGY

Edited by
JEAN MARC FONTAINE

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Foreign trade reforms and development strategy

In recent years developing countries have come under increasing international pressure to liberalize their trade regimes. In particular, many aid and adjustment programmes recommend that import controls should be relaxed. This advice is normally based on theoretical considerations of 'optimal' specialization and insertion in international trade or on empirical studies demonstrating the counter-productive effects of policies aimed at protecting domestic industry or promoting import-substitution.

Foreign Trade Reforms and Development Strategy argues that trade liberalization is in fact inappropriate for many developing countries. The theoretical framework on which it is predicated takes no account of the instability of the international financial problems. Nor is the empirical evidence for liberalization all that robust. In other words, we know very little about the consequences of one of the major reforms advocated by Structural Adjustment Programmes.

The object of this book is to clarify the objectives, constraints, and dangers of foreign trade reforms, and to contribute to the articulation of a positive case for flexible, targeted and reversible import controls. Its aim is to reintroduce long-term strategic considerations into a debate dominated by the management of short-term constraints.

Both theoretical and empirical issues are addressed. Questions such as the place of foreign trade reforms in SAPs, the impact of trade liberalization upon industrial efficiency, the evolution of protectionist tendencies in the industrialized countries and conflicts between policy objectives are examined, and bases for alternative policies are outlined. Analytical case studies illustrate the main theoretical findings.

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Introduction

Jean-Marc Fontaine

If dissemination is the mark of success, then liberal notions have won a victory in the battle of ideas. This victory seems so complete that one sometimes feels as if only one paradigm in development economics is left: the liberal version of neo-classical analysis (Fischer 1990).

However, this victory is somewhat ambiguous. We are not sure whether it was won in a battle fought from beginning to end, or granted by default, following the withdrawal of one competitor.

After the 1970s, when primary commodity booms succeeded one another, when growth fed on debt, and new manufactured goods exporters emerged, the 1980s opened under depressing omens. The world economy slowed down, financial problems rose to insoluble proportions, and economic instability settled in. This gloomy atmosphere witnessed the breakdown of development models premised on the dynamic exploitation of sectoral disequilibria, investment fetishism, and direct state intervention (Singer 1989), either because new economic conditions exterminated them, or simply because they revealed their intrinsic inadequacy.

Strategies based on state intervention were discredited and replaced in the realm of accepted ideas by the notion that production should be extricated from the underbrush of regulations and interventions that choked down their latent economic potential.

BACKGROUND TO THE DEBATE: THE STRENGTH OF THE LIBERAL PLEA

The first and obvious explanation for the liberal victory is default. Acceptance and implementation of IMF and World Bank-designed programmes more often followed constraint than conviction and carried less enthusiasm than disenchantment.[1] From this point of view, the agreement concluded between the IMF and Tanzania in October 1985 marked a turning-point. On that day, the death certificate of the Arusha Declaration was signed and the burial of 'African Socialism' celebrated (Fontaine 1988; Biermann and Campbell 1990). However, defeat of a model – and in the case in point, of a lighthouse model – does not in itself justify the doctrine that emerges from its ruins. Development models of the sixties largely collapsed under their own weight, and the liberal option filled in a vacuum.

Still, the liberal option has many things to recommend it. First is obvious commonsense. The outdating of previous models begot such aberrations that any solution trimming down the costly relationships established between the public sector and overprotected, over-importing and over-privileged industries and public enterprises was welcome. In that respect, liberalization proposals raise an urgent alarm – perhaps with some overstatement and rhetorical emphasis.[2]

They also rely on a tradition going back more than a hundred years, which sees efficiency as resulting from simple rules, such as allocating resources in line with relative-price movements, rather than from behest, based on projects or dreams of the state.

As an instrument of critique, liberal analyses have great potential. They stress blatant inconsistencies, for instance in price-systems, and the adverse effects of monopoly positions acquired in the process of industrialization.

But, again, does this potential for critique mature into positive recommendation? This, of course, is the crucial question, and it receives no direct or simple answer.

A few indeterminate points

First, if the superiority of liberal solutions is a clear case in the classroom, empirical verification is quite another matter. Recent evaluations of structural adjustment programmes stumble over a few stones. To start with, results are ambiguous. At best, they do not contradict the optimistic view that adjustment improves performances. But often, blurred by methodological confusions, they do not indicate much,[3] or they turn out to be frankly negative (Taylor 1988). Furthermore, when we can presume success, causality is so difficult to establish[4] that we remain unsure whether it follows reforms, or some other external factor such as increased funding, for instance.

The other source of ambiguity is of a theoretical nature and arises from a confusion regarding the proper content of neo-classical teachings. Although often presented as an integrated block, they really have two facets.

One, which is the stone of the fruit, is an abstract theoretical construct of the optimal (or efficient) allocation of resources. The other is a practical recommendation in favour of resource allocation through the market. What the theoretical nucleus does establish is the superiority of one allocation scheme over others.[5] But what it does not establish is the essential superiority of one institutional arrangement (the market) over all others.[6] The market is a good arrangement only in so far as it approximates to the abstract allocation of resources singled out by theory.[7] But the approximation holds under certain conditions, such as the absence of externalities, which are subject to a host of exceptions: decreasing cost industries, indivisibilities, infant industries, non-monetary exchanges and so on. The market is also an institution (Buchanan and Tullock 1967) that may not exist everywhere, in which case it has to be created, which is an important task (Polanyi 1947) and requires a strong involvement of the state, increasing with the degree of backwardness (Gerschenkron 1966).

Yet, exceptions tend to be more frequent than rules in many developing countries where non-monetary transactions, non-market links and externalities abound, where industries are still in search of adequate markets, and large parts of populations survive on subsistence and informal activities.

The fact that markets in developing countries do not, by a long shot, approximate to the efficient resource allocating mechanism postulated by theory does not, a priori, support any particular conclusion.

We could argue that liberalization is pointless, since markets, in so far as they exist, are imperfect: institutions, habits, exchange networks oppose 'spontaneous' optimization, and corrective intervention is what is needed. Alternatively, we could argue (see World Bank 1987) that market imperfections are precisely the reason why the economy should be reformed along liberal lines. By removing imperfections, we would lift obstacles to spontaneous optimization, and the economy would move closer to efficiency. If markets were amendable, this last argument would carry much weight, although we would first have to know how they can be amended, in what time-span, and in which order various imperfections should be removed.

None of these questions receives a general answer. Identifying the source of the market distortion can prove a delicate matter, and we might easily confuse the visible imperfection with the cause of the distortion. Many situations exhibit the natural monopoly paradox: a