

Pfaller, Alfred

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The New Protectionism and the Limits of Structural Adjustment

by Alfred Pfaller, Bonn*

However sharp the clash between the industrial countries' notions of a world economic order and those of the developing countries, one point is gaining increasing importance for both camps: the fight against spreading protectionism. Rising import barriers in the North restrict the developing countries' opportunities to increase their foreign currency earnings, to come to grips with their debt problems and to push ahead with industrial development. Those concerned with economic policy in the North fear an escalation of trade discrimination that would gradually neutralise the allocative function of the market, hamper recovery from the present recession, encourage inflation and lead to the inefficient organisation of production throughout the world. Why is protectionism so difficult to halt in spite of the unanimous condemnation of it?

In the words of a recent study, "The history of declared 'standstills' on trade barriers has not been a very impressive one".¹ Doubts about whether the cause of open world trade is safe in the hands of its political advocates are becoming difficult to suppress. At any event, up to now they have discovered no formula for exercising adequate control over interested parties that call for protection.

Even the most resolute defenders of free trade, such as the British Prime Minister, the President of the United States and the Minister of Economic Affairs of the Federal Republic of Germany, have not been able to avoid making significant concessions to protectionists in their own countries.

In this situation one can regretfully point out that in economically difficult times the political dice are weighted against free trade and that even determined free-traders eventually have to bow to the superior strength of protectionism.² Nor is it difficult to show that the skilful use of tactical but limited concessions to protectionism can quite often parry much more far-

reaching demands for trade restrictions.³ Nevertheless, the question remains why alternatives to protectionism carry so little political conviction as soon as the adjustment to increased imports poses problems.

Dimensions of Protectionist Motivation

What does adjustment imply in this context? What are the difficulties that protection seeks to avoid? There are three; the fact that they coincide in the present international economic situation accounts for the particularly problematic nature of the new protectionism.

Import restrictions are an expression of keener competition for markets that are contracting overall. Seen in this light, they constitute an attempt to deflect the costs of the worldwide recession and its sectoral impact from the producers in one's own country and to place them on others – beggar-thy-neighbour policies in the classical sense. Such attempts are doomed to failure sooner or later because of the contraction of export markets they cause and the protectionist counter-measures of "neighbours". Trading partners are drawn into a negative-sum game in which all the players come off worse. The same principle applies to

* Research Institute of the Friedrich Ebert Foundation.—This article summarises some of the central points of a recently published study on the new protectionism by Heinrich Müller-Godeffroy, Alfred Pfaller, Reinhard Rode, Helena Rytönen: *Der neue Protektionismus. Zur politischen Ökonomie von Handelsbeschränkungen gegenüber Fertigwarexporten aus Entwicklungsländern*, Bonn 1983.

¹ Cf. Carlos F. Díaz-Alejandro, Gerald K. Helleiner: *Handmaidens in Distress. World Trade in the 1980s*, Overseas Development Council, Washington 1982.

The paradigm of a division of labour among countries on the basis of comparative cost differences is unsuitable as a way of adequately expressing the changes in the structure of production throughout the

world. It views individual economies as units organising production internally in accordance with the opportunities available for exchanges with other units of the same kind. This notion then forms the basis for considerations as to:

- ☐ the reaction of national production structures to different price patterns, and
- ☐ the optimum shape of these production structures.

However conclusive these considerations may be per se, they divert attention away from the fact not only that resources are scarce and have to be employed optimally but also that individual suppliers of factors are competing against one another for limited production opportunities.⁸

Individuals' real incomes are higher, the better the price they can obtain for their own productive services

⁷ This argument is reflected in the attitude of American trade unions towards cheap imports and foreign investment. In economic literature it is explicitly formulated by Wolfgang Hager (The Strains on the International System, in: Christopher Saunders (ed.): The Political Economy of New and Old Industrial Countries, London 1981; Protectionism in the 80s: the Managed Coexistence of Different Industrial Cultures, in: Michael Noeike, Robert Taylor: EEC Protectionism: Present Practice and Future Trends, European Research Associates, Vol. I, Brussels 1981; Protectionism and Autonomy. How to Preserve Free Trade in Europe, in: International Affairs, 58, 3, 1982); he does not, however, deduce it strictly from circular flow theory (as in the present article) and therefore leaves it very vulnerable to attack (cf. Hindley's critique of Hager 1982 and Hager's reply in International Affairs 1983, pp. 335 ff). This argument is also treated by Folker Fröbel, Jürgen Heinrichs, Otto Kreye (Die neue internationale Arbeitsteilung. Strukturelle Arbeitslosigkeit in den Industrieländern und die Industrialisierung der Entwicklungsländer, Reinbek 1977) and by Werner Oile (Neue Weltarbeitsteilung und Auslandsbeschäftigung der westdeutschen Industrie. Zur Diskussion der Studie "Die neue internationale Arbeitsteilung" (Fröbel, Heinrichs, Kreye), in: Kritik 24, March 1980; Externalisierung von Beschäftigungswachstum. Zur quantitativen Bedeutung der deutschen Direktinvestitionen im Ausland, in: WSI-Mitteilungen, Nov. 1982) who set it in the wider context of changed conditions for capital utilisation. The remarks here do not examine this line of argument, but in certain respects can be seen as complementing it.

⁸ Cf. in this connection Alfons Lempert: Handel in einer dynamischen Weltwirtschaft. Ansatzpunkte für eine Neuorientierung der Außenhandelstheorie, Munich 1974.

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The events in Afghanistan gave the authors the occasion of taking a closer look at the activities of the Soviet Union in this country and some of its neighbouring states. The countries additionally selected for the investigation – India, Pakistan, Iran and Turkey – are all characterised by an above-average commitment of the Soviet Union as compared to other regions of the Third World. Nevertheless, none of these countries has become nearly as dependent on the Soviet Union as has Afghanistan. The present study offers information on a field of external economic activities which has so far been neglected in the literature. (In German.)

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and the less they have to pay for those of others. Seen in these terms, increased competition reduces the individual's own market opportunities – either he sells his services more cheaply or he is forced out of the market. The former entails a partial loss of income, the latter a total loss. New market opportunities and hence income prospects occur directly for those squeezed out in this way only if the appearance of additional competition is accompanied by an increase in demand. Such an increase in demand could come about if the new competitors have themselves withdrawn as suppliers on other markets or be the result of income growth stemming from economic expansion. However, the arrival of new suppliers of production factors in existing markets does not in itself stimulate demand. It may make the factor services cheaper and thus release additional purchasing power on the part of the market partners, but this increase only offsets the decline in the demand exerted by the providers of the factor services that have become cheaper. If the new competitors drive previous suppliers out of the factor market they also take over their position as trading partners in other markets, for they are now receiving their predecessors' income, perhaps less the amount of the reduction in price. The former suppliers, however, can find no markets for their services if the above-mentioned conditions do not obtain. All they can do is to attempt in turn to drive other suppliers out of their "traditional" markets, but initially the changes entail one group of individuals entering the existing circular flow of economic activity and another group leaving it.

A geographic dimension can now be introduced into this approach. Say the established producers of product group X are located in region A and the new competitors in the market are in another region B. As the latter take over the position of the former, the interregional trade relations shift. The markets in A and B are supplied with product X increasingly from B and income from the production and marketing of product X that was previously generated solely in A accrues increasingly to B. As a result, the markets in other goods and services also move to some extent from A to B. In B the demand for, say, products in group Y increases, but in A it declines. As far as the suppliers of product Y are concerned it is as though their customers had moved from A to B. If these suppliers are in A, they record increasing exports but simultaneously falling sales within their own region. The only course open to the displaced producers of X in A is to re-enter the market with a more competitive product (reduction in price or improvement in quality), for the shift in production has neither created nor released additional demand for

productive services, apart from the effect of a fall in price described above. In sectoral terms the trade structure has remained the same; only the geographic pattern has changed.

Displacement of High-wage Labour

How is it that established producers are driven out of the market by new competitors? How does such an oversupply of factor services come about? The explanation lies in the processes within the labour market. There are regions in which labour is relatively cheap because demand is low and others where it is relatively expensive because demand is high. These differences in the demand for labour are attributable to regional differences in the production density, measured relative to the population, which is manifested in different levels of labour productivity. The different production densities are in turn the result of different natural and socio-cultural conditions. As a rule they are accompanied by differences in the regions' physical, institutional and human infrastructure. In conjunction with naturally occurring factors, this has the effect that in relatively backward regions production is not cheaper, despite lower wages. However, the coexistence of regional labour markets with different wage levels is jeopardised if labour migrates from low-wage to high-wage regions or if production conditions are improved in low-wage regions. The latter may be the result of development efforts (improved physical infrastructure, better training of the workforce, the granting of investment incentives) or it may stem from

⁹ In foreign trade theory the transferability of a particular production process is conceived in different ways. The product cycle theory (see Raymond Vernon: *International Investment and International Trade in the Product Cycle*, in: *Quarterly Journal of Economics*, 80, 1966) places the transposition of a product to a later cycle phase in the forefront. Others attribute a decisive role to the technology-intensity of production (e.g. Mark Posner: *International Trade and Technical Change*, in: *Oxford Economic Papers*, 13, 1961; G.C. Hufbauer: *Synthetic Materials and the Theory of International Trade*, London 1966; Seev Hirsch: *Capital or Technology? Confronting the Neo-Factor Proportions and Neo-Technology Accounts of International Trade*, in: *Weltwirtschaftliches Archiv* 110, 4, 1974; Seev Hirsch: *Rich Man's, Poor Man's and Every Man's Goods. Aspects of Industrialization*, Tübingen 1977). The latter also proceeds to classify goods according to their locational suitability, a classification that was previously presented in similar form by Detlef Lorenz: *Dynamische Theorie der internationalen Arbeitsteilung*, Berlin 1967. (In this connection see also Alfred Pfaller: *Industrieexporte aus Entwicklungsländern im weltwirtschaftlichen Interessenkonflikt*; *Forschungsbericht des Landes Nordrhein-Westfalen* 3082, Opladen 1981, p. 106). The suitability of different locations for the production of particular goods is dealt with by Lorenz in the concept of "comparative development advantages" (Detlef Lorenz, op. cit.). This makes it possible to perceive increasing transferability as the erosion of such development advantages. This erosion may be due to growing imitation potential in the relatively backward regions or, with reference to regional economic categories, a reduction in agglomeration advantages or a change in trade barriers (see Reinhard Sohns: *Theorie der internationalen Arbeitsteilung. Gegenwärtiger Stand und Problematik*, Stuttgart 1976, pp. 498 ff.).

technological change (easier communications, ability to split off and relocate parts of the production process). In any event, even if national borders prevent migration, low-wage labour becomes available for production processes that previously had to use high-wage labour.⁹

This is precisely what has been happening in the world economy for some time. In one production field after another the relatively highly-paid labour force of the industrial countries is coming into competition with the cheap labour of the Third World, which is ultimately driving it out of these industries. It is immaterial for the state of affairs described here whether this occurs through the relocation of production by transnational enterprises or through the displacement of established firms by competitors from the Third World.

Increased Demand for High-wage Goods

There is absolutely no guarantee that the demand for high-wage labour will increase at a rate to match that at which it is displaced by low-wage labour. This would require a corresponding increase in demand for those goods that can still be produced more cheaply in industrial countries on account of technological factors and continuing differences in the level of development.

Where is this demand to come from? It has been demonstrated above that to rely on increasing exports to the newly industrialising low-wage countries would be to wrongly assess the circumstances, for initially these additional exports only replace the domestic demand previously generated by the displaced producers. The trade flows between labour-cost-sensitive and knowhow-intensive sectors increasingly extend beyond national borders, but they do not yet increase in volume. In other words, the production sectors remaining in the industrial countries increase their exports to the Third World but their overall production volume stagnates.

The increase in the demand for high-wage goods that is to compensate the industrial countries for the increasing shift of production to low-wage countries must therefore spring from processes other than the shift itself. It may be generated as a result of economic growth originating in the industrial countries and causing incomes to increase there. Such growth would be the prerequisite for making it possible to offset the shift in production. At the same time, the latter would ensure that sufficient labour was available to expand production in knowhow-intensive sectors, just as the influx of foreign workers made possible the steady increase in production in western Europe in the sixties. In an interdependent world economy the growth stimuli emanating from production sectors in the industrial

countries will naturally also be transmitted to developing countries via rising incomes and from there can have an impact on the demand for high-wage products.

Increased demand for high-wage products can also stem from growth originating in the developing countries themselves. This, so to speak, autonomous rise in demand must be distinguished from the demand that shifts from industrial to developing countries along with production and which means no increase when the system is viewed as a whole. The developing countries' own contribution to overall growth, which does not arise merely as a multiplier effect, springs from an expansion in production for the home market or for a market limited in some way to the region and which leads to an increase in income there (expansion of a more or less autonomous economic system). To the extent that this new income is spent on products from the industrial countries, industry there receives a demand boost and the suppliers of production factors also see their income rise. This can only continue over the long term, however, if the developing countries also increase their sales in industrial countries and thus earn the foreign exchange with which to buy products from the industrial countries. Depending on the resources the country possesses and the world market situation, this may require increased exports of finished products to markets that were previously supplied by producers in industrial countries. The resultant fall in production and income in the industrial countries is countered, however, by the original increase in exports derived from rising demand on the part of the developing countries, which acts as a compensating quantity.

Cut-throat Competition v. Heightened Division of Labour

We therefore have two different scenarios for the future course of trade relations between high-wage and low-wage countries. In the first, high-wage labour in the North is increasingly replaced by low-wage labour in the South, and manufacturers in the South take over the trading position previously held by their equivalents in the North, though on less advantageous terms. According to this scenario, production in the South expands at the cost of production in the North. The narrowing of the North's development lead or of its locational advantage tends towards an equalisation of the production density and hence towards erosion of the North's income privileges associated with a high

¹⁰ This train of thought therefore links notions of the dynamic foreign trade theory and of the newer regional economic theory on the determinants of North-South trade with considerations on global supply and demand volumes (particularly in the labour market).

production density.¹⁰ The beneficiaries are the producers from the South who were previously not present in the market and those producers in the North whose terms of trade have improved (cheap imports instead of expensive domestic products). Such a development is compatible with the employment and economic welfare interests of the industrial countries – as regional interest groups – only if they themselves record sufficiently rapid growth to be able to surrender part of their production activities to others in the sense of an increased international division of labour.

In the other scenario the surrender of certain lines of production is the precondition for the North to share in the autonomous growth of the South. This growth offers the North the opportunity to increase its specialisation and thus to upgrade its production structures without there being a net decline in production (as in the first scenario) that has to be offset by indigenous growth.¹¹ If the North denies the South export markets, it forgoes this opportunity and at the same time jeopardises the growth of the South insofar as this depends on an expansion in import capacity (raw materials, capital goods).

In assessing the interests of an industrial country with regard to imports of finished goods from developing countries, it is important to establish clearly which of the two scenarios is more relevant to the situation. There would be good reason to allow market access for cheap imports from countries with a strong growth momentum of their own. Where other imports are concerned, however, a defensive trade policy may seem appropriate, depending on the circumstances.

The Dilemma of the Industrial Countries

In practice, however, such a distinction is of little value as a guideline for the import policy of an individual industrial country. For example, if French textile workers have to surrender their jobs to competitors in the Far East, there is no guarantee that the French high-technology industry will consequently be able to increase its exports to Korea, Taiwan or Malaysia and will thus be able to offer new employment opportunities. It is just as possible, and perhaps even more likely, that Japanese and German exports will benefit from the expanding markets, regardless whether Japan or Germany import more textiles. The exchange rate mechanism cannot be relied upon ultimately to equalise the trade balances, especially if international

competitiveness depends less on price than on other factors, as in the case of high technology. Even “pure” transferee countries which contribute nothing to overall world demand but merely take over production from industrial countries, can offer additional market openings to the most competitive among the industrial countries.

Take a simple, hypothetical example: dismissed workers and firms forced out of business in the Swedish clothing industry are replaced by their successful competitors producing in, say, North Africa as purchasers of high technology goods and goods not traded internationally. However, the new purchasers no longer buy from Sweden but from Germany and France (and in North Africa itself) and thus provide welcome relief for the labour markets in these countries. In Sweden, on the other hand, not only the wage-sensitive clothing industry contracts but also the turnover of the rest of industry.

The internationalisation of production can therefore lead to a marked redistribution of market opportunities by destroying established producer-buyer relationships. As a result the production density, i.e. the degree of industrialisation, can increase in certain geographical regions (to the benefit of the national labour forces involved) and fall in other regions (to the detriment of the workers engaged there).

In a context of weak growth worldwide and general underemployment there is therefore a strong incentive for every high-wage country to defend itself against low-wage imports and at the same time to exploit the new market opportunities that result from the internationalisation of production. It does not pay any country (except perhaps a few that are highly competitive) to pursue a liberal import policy as a contribution towards an expansion in the world market in high-technology products unless the others do the same. The predominance of this reaction not only prevents the possible inclusion of developing countries in a wider division of industrial labour and an easing of the international debt problem, but undermines the world trade order, thus weakening the normative barrier to further protectionism.

If the forces urging import controls in industrial countries are to be halted effectively, a politically convincing alternative must be put forward. The formula “free trade + positive adjustment policy” is less and less able to perform this function in the present world economic context, for what is actually at stake are increasingly the privileges that were linked with the almost “exclusive right” of high-wage labour in the North

¹¹ The difficulties in matching factors of production to new productive uses (the target problem of “positive adjustment policy”) naturally remain, as does the problem of the “rationalisation effect” of increased specialisation (cf. in this regard Alfred Pfaller, *op. cit.*, pp. 101 ff.).

to industrial jobs. This still applies even though it can be shown that the actual scale of displacement has been relatively small so far.¹²

The prescription "structural adjustment in place of protection" passes over the problem of the substitution of high-wage labour by low-wage labour that is becoming available on a massive scale. It is geared towards the notion of a changing international division of labour that only partly corresponds to economic reality. In political reality the concept of structural adjustment or modernisation conceals a strong dose of nationalistic (or "mercantilistic") economic thinking. The aim is to strengthen the competitiveness of domestic industry and secure the largest possible share in the world market in high-technology products. Viewed from this angle, modernisation is a formula for doing well in the world economy's zero-sum game (i.e. in the battle for scarce markets) at the cost of weaker players but not for instituting a positive-sum game (i.e. an expansion of the markets). The outcome is that the more successfully some countries can adjust and hence keep their markets open, the further the others are driven to protectionism.

Global Adjustment Potential

Protectionism against finished products from low-wage countries can only be stemmed to the extent that individual high-wage countries see the possibility of making good the loss of wage-sensitive production by exploiting new market opportunities in other areas. As we have seen, this is not always possible (indeed, not even in principle) but depends on specific world economic patterns, so that for purposes of trade policy a distinction would have to be made between those imports that could be compensated for and those that could not. The area in which free trade is possible for all industrial countries without any lasting disadvantage would have to be isolated from the problem area in which protection cannot be avoided. Protection that barred the net transfer of production to low-wage

locations would have to be distinguished from the refusal to make adjustments that were feasible but entailed temporary sacrifices.

The GATT rules recognise only temporary problem areas, since in accordance with its theoretical premises only the transitory adjustment process can become a problem but not the result of adjustment. The erosion of the GATT principles in the realities of trade policy, however, is due partly to the fact that in the face of increasing low-wage competition at a time of general economic stagnation confidence in an acceptable adjustment *outcome* has been lost – quite rightly so in view of the diversity of the world labour market that is tending ever more strongly towards parity.¹³

It therefore appears that the first step towards an agreement on industrial North-South trade that is binding and proof against protectionist erosion would have to be a new consensus among the industrial countries on their common adjustment potential. This would be determined by economic growth in the industrial countries themselves and the linkage of export expansion and growth momentum in the low-wage countries as set out above. It is probably impossible to ascertain the global adjustment potential exactly; it would have to be set politically. In other words, the industrial countries would have to set binding global import growth volumes (instead of sectoral ones, as in the Multi-Fibre Arrangement) geared towards their common intersectoral adjustment potential. Such an agreement, which would require periodic renewal, would offer three advantages over the present trade policy situation:

1. It takes changing world economic conditions as point of reference and is not based on a timeless norm whose unconditional validity has become questionable. As a matter of principle it therefore becomes more acceptable.
2. It makes the scale of import concessions to be granted subject to consensus, and is thus more acceptable politically.
3. It explicitly gives the various countries shared responsibility for realising the global adjustment potential and for enlarging the world markets in high-technology goods. It therefore ensures greater economic efficiency than unilateral and bilateral measures, which tend to lack a sense of responsibility in global terms.¹⁴

¹² Cf. for example Centre Interuniversitaire de Recherches en Sciences Humaines (C.I.R.S.H.): Effet sur l'emploi dans la Communauté Économique Européenne de l'évolution de la division internationale du travail entre la C.E.E. et les pays en voie de développement, EC (V/218/78-FR), Brussels 1978; Deutsches Institut für Wirtschaftsforschung (DIW): Handel der Europäischen Gemeinschaft mit Entwicklungsländern. Beschäftigungseffekte nicht überschätzen, in: DIW-Wochenbericht, 17, 1981; Henryk Kierzkowski: Displacement of Labour by Imports of Manufactures, in: World Development 8, 10, 1980; Anne Krueger: Restructuring for Import Competition from Developing Countries, I: Labor Displacement and Economic Redeployment in the United States, in: Journal of Policy Modeling 2, 2, 1980; United Nations Industrial Development Organization (UNIDO): The Impact of Trade with Developing Countries on Employment in Developed Countries. Empirical Evidence from Recent Research, UNIDO Working Paper on Structural Change, 3, UNIDO/ICIS.85, Vienna 1978. But see also the contrasting empirical position of Werner Otle, op. cit.

¹³ Cf. Eckard Minx: Von der Liberalisierungs- zur Wettbewerbspolitik. Internationale Wirtschaftspolitik zwischen Industrieländern nach dem Zweiten Weltkrieg, Berlin 1980, Ch. III.

¹⁴ Cf. the much more detailed discussion in Heinrich Müller-Godeffroy et al., op. cit., pp. 169 ff.