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Neo-Protectionism and Economic Growth

by Franz Peter Lang, Bochum*

The world economy is threatening to find itself in a vicious circle of escalating protectionism. Franz Peter Lang explains the dangers and consequences of this. Gary Banks argues that the “new protectionism” is not so much a temporary by-product of the recession as the external manifestation of internal domestic struggles between vested interests and the public interest, and pleads for the establishment of a “transparency institution”.

After the Second World War free international trade became a generally acknowledged principle among western nations. During the post-war period the world economy as a whole has experienced unprecedented economic growth, based in the main on a steadily growing interdependence of national economies. On a global scale real exports outpaced industrial production, and the international division of labour allowed more and more of that production to be channelled into exports.¹ Whilst the share of industrial production in the national products thus remained relatively constant, the share of exports in the total output of goods and services grew accordingly.²

The practice of free trade finds its theoretical roots in the theorem of comparative advantage developed 200 years ago.³ Interpreted on a global basis it states that each country should specialise in those goods which it is able to produce more cheaply than other countries. The part of production which, as a result of this specialisation, exceeds domestic demand can subsequently be exchanged on the international market for those goods which could only have been produced domestically at a relative cost disadvantage and which can be produced more cheaply abroad. In comparison with a situation of autarky, this international division-of-labour pattern is able to raise productivity and provide greater opportunities for worldwide production and consumption. In addition, international competition fosters technical progress and encourages innovation.

This classical concept of international trade presupposes the existence of free trade and unimpeded foreign exchange and capital transactions. For the

international division of labour can only allocate the scarce factors of production to their various possible uses in an optimum manner if the mechanism of free-market pricing functions smoothly and keen efficiency-based competition is guaranteed. If these conditions are not met, misallocations of resources are bound to occur.

The Need for Structural Adjustment

Free trade means that individual national economies are involved in a form of competition extending beyond national borders. By specialising in certain fields the nations participating in a free trade system are able to contribute towards each other's growth and welfare. However, the competition to discover new and better products and production techniques can only function properly if the countries in question are prepared to accept considerable structural adjustments. Industries which are no longer internationally competitive must be replaced by industries which stand a good chance of finding international markets.

Free trade also involves strong competition between national economies in the field of employment. This makes the implementation of changes difficult in times of poor economic growth, when structural changes are needed most. Delayed or inadequate structural adjustment leads to sectoral underemployment. The greater the pressure to adjust, however, the stronger the tendency to avoid such adjustment by restricting free

¹ Cf. United Nations: Monthly Bulletin of Statistics, Vol. 33-37, New York.

² Cf. UNCTAD: Handbook of International Trade and Development Statistics, Supp. 1977-1982, New York.

³ Cf. D. Ricardo: On the Principles of Political Economy and Taxation, London 1817.

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trade. Structural adjustment problems become particularly serious if the specialisation – based on the international division of labour – of any one country has led to a pattern of production marked by relatively poor opportunities for expansion.⁴ The trade pattern between highly developed industrialised countries and developing countries underlines the point.

Trade Problems Facing Developing Countries

During colonial times, this area of the world economy witnessed the evolution of a complementary specialisation pattern⁵, a pattern which still exists in many countries up to this very day. The ASEAN countries, Taiwan, Hong Kong, South Korea and a number of Latin American newly industrialising countries are probably the only exceptions in this respect. The majority of developing countries still concentrate on the production of primary commodities, such as agricultural products and raw materials. The industrialised countries, on the other hand, specialise more and more in the manufacture of research and capital intensive industrial goods. There are, of course, cases of developing countries producing capital intensive industrial products (e.g. steel). However, the quality categories involved are generally no longer

profitable for production by industrialised countries. The manufacturing of such products is left to the developing countries, an aspect of international specialisation which the product cycle theory sets out to explain.

Not all parties in this international division of labour reap the same rewards. The exchange of primary commodities with limited opportunities for expansion for industrial goods with much greater value added and larger growth potential has brought about a situation in which developing countries have been able to participate to only varying degrees in the general economic upturn of the post-war period. The share of total world exports attributable to those developing countries which do not produce oil continued to fall well into the 1970s. Only recently have a number of newly industrialising countries managed to improve their position on international markets and bring the developing countries' share in the total world exports figure back to the level reached in 1965.⁶

⁴ Cf. A. Pfaller: The New Protectionism and the Limits of Structural Adjustment, in: INTERECONOMICS, No. 5, Sept./Oct. 1983, pp. 219ff.

⁵ Cf. H. R. Hemmer: Wirtschaftsprobleme der Entwicklungsländer, in: Vahlens Handbücher der Wirtschafts- und Sozialwissenschaften, Munich 1978.

⁶ Cf. UNCTAD, op. cit.

PUBLICATIONS BY THE CENTRE FOR RESEARCH ON REGIONAL DEVELOPMENT AT THE JUSTUS LIEBIG UNIVERSITY, GIESSEN, VOL. 25

Hartmut Krietemeyer

DER ERKLÄRUNGSGEHALT DER EXPORTBASISTHEORIE (The Export Basis Theory and its Explanatory Content)

There are a number of theories which seek to explain regional economic growth, but few have been found as worthy of notice as the export basis theory. This book examines empirically the theory's hypotheses. The result of this examination makes it possible, among other things, to state whether support for investment along the lines of the law on the "... improvement of the regional structure of the economy" and of the law on investment allowances is meaningful or not. (In German.)

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VERLAG WELTARCHIV GMBH – HAMBURG

The percentage share of manufactured goods in the exports of developing countries is still comparatively low. If oil is excluded, manufactured goods only account for approx. 29 % of exports from Latin American countries and for 22 % of exports from African developing countries. In the case of up-and-coming industrialising countries in South East Asia, such as Taiwan, Hong Kong and South Korea, on the other hand, almost 70 % of total exports are manufactured goods. Only a few developing countries, therefore, have been able to overcome their dependence on this historically evolved complementary structure of world trade via their own industrialisation efforts.

In addition, insufficient use has been made of the opportunities available to developing countries to expand trade among themselves. Industrialised countries and eastern bloc countries are still preferred as export markets. In 1981 over 70 % of total exports by Third World countries went to these countries.⁷

Obstacles to Structural Adjustment

On the whole, developing countries have pinned too many hopes on dirigistically oriented commodity agreements.⁸ In the final analysis, these agreements have only gone to reinforce the dependence of developing countries on the complementary international division of labour without at the same time achieving the hoped-for stabilisation of raw materials markets.

It was, not least, this experience which favoured the stepping-up of industrialisation concepts which were in many cases over-ambitious and which have led the majority of developing countries into high external indebtedness. What is more, the economic policies pursued by many developing countries have often set out to increase domestic consumption and promote import substitution, neglecting an adequate diversification of their range of exports.

This multiple dependence of the developing countries on the industrialised countries – as sellers of low-value products, as buyers of high-value industrial goods, and as borrowers – became an even greater disadvantage when the industrialised countries began to hinder Third World access to their markets. These protectionist efforts have not only reduced the chances of developing countries to make good their shortage of foreign exchange via export earnings, but also their ability to

push through investments aimed at readjusting the structure of production in favour of more labour and research intensive manufactured goods, in which they have cost advantages.

Renunciation of Free Trade

The structural problems outlined underline the consequences of economic policies in which priority is given to national interests rather than to the demands of a free trade system. Such a system can only endure, however, if certain limitations are accepted to decision-making autonomy in the field of economic policies. Foreign trade relations create an international economic cohesion which necessitates a harmonization of national economic policies. At present, however, there is a growing trend towards protecting the domestic economy to the detriment of foreign economies, contravening the basic principles of free trade and payment transactions. This is particularly true of many western market economies, which were once among the most ardent advocates of unimpaired international trade. The current controversy between the European Community and the USA on measures to regulate steel trading, and the accompanying import restrictions, is just one alarming symptom of the pathological state of world trade.

However, the measures which are being put into practice in the form of “neo-protectionism”, whose methods are based on GATT’s safeguard clauses or on new variants of protectionism not covered by GATT regulations present much greater risks in this respect. “Undesired imports”, for example, are being blocked by import quotas or “voluntary” marketing agreements. Currencies are being devalued or necessary revaluations delayed so as to make national exports cheaper and imports more expensive. Other non-tariff trade barriers are being erected by subjecting imports to stiff rules and regulations as well as to tough specification standards or complicated clearance procedures.

Despite international agreements, the use of protective tariffs is becoming more and more common. The GATT safeguard clauses are often referred to in an effort to justify such moves, even though they are explicitly set aside for use in “special” emergency situations.⁹ In response to such restrictive measures, exporting countries see themselves forced to either directly subsidise their export sectors or to grant them preferential tax treatment. Indemnity bonds and cheaper export credits are becoming a frequent way of

⁷ Cf. UNCTAD, *op. cit.*

⁸ Cf. S. Baron, H. H. Gliessmann, B. Stecher: *Internationale Rohstoffpolitik – Ziele, Mittel, Kosten*, Kieler Studien No. 150, Tübingen 1977.

⁹ Cf. J. B. Hindley: *Current Issues in Commercial Policy and Diplomacy*, London 1980, pp. 52ff.

subsidising exports, and in many cases central banks quite openly resort to massive restrictions of free foreign exchange and payment transactions.¹⁰

Consequences of Protectionism

All this occurs regardless of the generally accepted fact that protectionism of any kind is no way of solving national economic and social problems. Protectionism only leads to a poorer supply situation for domestic consumers and to rising prices on the "protected" markets. If nominal wages follow suit, underemployment cannot be ruled out as a result of "job-killing" protectionism. What is more, the costs of imported intermediate products also increase. Both developments weaken the competitiveness of domestic industry to the detriment of overall employment objectives.

If import restrictions indirectly lead to an increased exchange rate, export prospects also deteriorate. Dirigistic currency devaluations designed to promote exports or hinder imports run the risk of importing inflation. Subsidies for threatened sectors of the economy discriminate against non-subsidised branches and tie up resources which are then unavailable for allocation elsewhere. Such steps are frequently justified by claiming that they serve the interests of restructuring the domestic economy and make it easier to regain international competitiveness. In the long term, however, the protection of inefficient industries raises the level of costs for the economy as a whole and opens the way to the misallocation of labour and capital. The international competitive strength of the economy is thus in fact undermined.

The consequences of neo-protectionism also have other adverse effects: they reduce growth and

employment opportunities abroad and also provoke economic policy countermeasures by other countries. The world economy is in danger of being caught up in the vicious circle of escalating protectionism. Whether this takes the form of a subsidy race or of import restrictions countered by export promotion measures is irrelevant in terms of the fatal consequences for the development of world trade and the welfare of the international community as a whole. During the Depression years of the 1930s industrialised nations attempted to resolve their national employment and balance-of-payments problems at the expense of their trading partners. However, escalating import restrictions everywhere only meant that on balance individual economies lost more in the form of reduced exports than they gained by protecting their – in comparison to a free world market – small domestic markets. A disintegration of international economic relations and a marked drop in the volume of world trade and aggregate global national product, accompanied by market interventionism and currency controls were the result.

Up to now there has not been a repetition of such developments, for the effect of protectionist measures on the volume of world trade has been offset by corresponding countermeasures: import barriers by export subsidies, preferential tax treatment or direct subsidising of export products by import restrictions.¹¹ World trade has thus managed to keep pace with worldwide industrial production, although both exhibit growth rates which are relatively low compared with previous decades. Economic growth today takes place less within the framework of specialisation based on division of labour outlined in the theory of comparative advantage but, rather, on a global scale those branches of production marked by comparative disadvantages

¹⁰ The currency restrictions for international tourism in France are one spectacular example of such action.

¹¹ Cf. D. Greenway: International Trade Policy, London 1983, pp. 2ff.

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(Poland's Crisis and its Foreign Trade and Payments)

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are being protected against the competition of foreign imports or kept competitive on world markets by special subsidies. This ties up financial resources which could have been allocated more efficiently in the development of new technologies. In many cases the overall social costs of protectionist measures have risen to such an extent that they outweigh the income gained by exporting protected or subsidised goods. This misallocation of scarce resources leads to growth losses and the loss of jobs. The chances of successfully eliminating structural faults in the economies of both industrialised and developing countries are thus reduced, and, to an equal degree, the chances of re-establishing the conditions of free trade.

The primary objective of international trade policies must therefore be to align each country's general economic policies to the requirements of a system of free international trade. This demands that national economic policies gradually refrain from protecting branches which are no longer internationally competitive and that more determined efforts are made to bring about structural adjustment in a framework of specialisation based on division of labour principles. At the same time, intensive efficiency-oriented competition must be guaranteed. The removal of trade restrictions and, in particular, the renunciation of "neo-protectionist" measures are essential prerequisites for success in this endeavour.

PROTECTIONISM

Vested Interests, Domestic Transparency and International Trade Policy

by Gary Banks, Geneva*

It is ironic that the very success of the GATT as a forum for international trade liberalization throughout the post-war period has brought it criticism now that liberal trade is unravelling. People accustomed to looking to Geneva for progress in trade policy see the mounting abuses of the system as somehow originating there too. As illegal measures multiply, the existing trade rules are called into question, a position logically equivalent to blaming the Criminal Law for not preventing a rise in the crime rate.

The truth is that international trade policy, while ostensibly emerging from negotiations between countries on an international stage, is essentially domestic in origin. Trade disputes, such as those we have been witnessing lately between the United States, the European Community and Japan, are the external manifestation of an internal struggle within each country: a struggle between vested interests and the public interest. The rise in protectionism is simply a sign that special-interest pressure groups have been increasingly successful in their quest for public support;

in other words, that governments have found it increasingly difficult to resist.

Some governments have in effect admitted this, by explaining away the rise in protectionism as a temporary by-product of the recession – something to be regretted economically, but inevitable politically. It is implicit in this view that protectionism oscillates, almost as a matter of course, with the business cycle: when aggregate activity falls protectionism rises, and when growth resumes protectionism recedes.

There are a number of difficulties with this proposition. First, while protectionism in industrial countries has undoubtedly escalated with the recession, its roots can be found in the late 1960s, especially in such industries as shipbuilding, and textiles and clothing (not to mention agriculture). No simple correlation with macroeconomic activity seems possible. Second, it is not clear why an upswing in the economy should cancel out the protection imposed during the downswing. Even if the *increments* to protection diminish, the previous rise in the *stock* of protection will presumably remain, unless some positive action is taken.

In considering what action is possible or appropriate, we have to understand that protectionism is

* The author is an economist in the Economic Research and Analysis Unit of the GATT Secretariat. This article is solely the author's own responsibility and in no respect implicates the organization with which he is affiliated.