

Spinanger, Dean; Zietz, Joachim

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The MFA: Its Costs and Consequences

by Dean Spinanger and Joachim Zietz, Kiel*

The present Multi-Fibre Arrangement expires on July 31st. What are the arguments voiced by the proponents of a further extension? What would be the effects of a reduction in protectionism on the textile and clothing industries?

It is not the expressed purpose of the Multi-Fibre Arrangement (MFA) to protect the clothing and textile industries in industrialized countries (ICs) at the expense of the same industries in developing countries (DCs). Rather, the MFA is meant to ensure that the advantages to be gained from a more efficient allocation of resources are not jeopardized by ruinous international competition followed by an ensuing wave of protectionist measures closing off export markets for future as well as for existing producers. Based primarily on this line of reasoning the MFA and its predecessors have managed to survive or rather thrive for nigh on a quarter of a century. But more importantly they have served all too well as a classic example of how to organize trade in a manner which achieves the opposite of the basic aims laid down in the GATT charter without legally running counter to them. It is this latter aspect which has proved so damaging over the course of time. First of all the often promised short-term nature of protectionist measures inevitably slips into medium to long-term constellations often even without being questioned. Secondly, the propensity with which such measures are copied has turned out to be inversely correlated with the benefits engendered for the countries involved as well as the world itself. All this has meant that massive welfare losses have been generated in both ICs as well as DCs.

It is the purpose of this paper to succinctly but briefly present evidence on key issues covering the justification for MFA as well as the direction and magnitude of its impact. The paper begins with a short introduction to the origin of MFA. Following the verbal confrontation with the evidence the article concludes by offering some thoughts on what should become of MFA and how similar pitfalls can be avoided in the future.

* Institute of World Economics.

After World War II developments in the textile and clothing industry deviated at an early stage from the general trend towards a more liberal international order. With Hong Kong and Japan already being affected by trade restrictions in the 50's it was only a matter of time before an attempt was made to place trade in textile and clothing products under a more general agreement. However, with the ratification of the STA¹ in 1961 and then its conversion into the LTA² in 1962 a definite break was made with the basic GATT principle of non-discrimination in international trade. These agreements, which came into being under the umbrella of GATT,³ were extended twice in the 60's before the MFA was born in 1974.⁴ As mentioned above, these agreements had been justified not with protectionistic arguments, but rather with pleasantly sounding terms describing the benefits to be gained from allowing trade to expand in an "orderly" fashion. Under such conditions the necessary structural adjustments could be easily effected in ICs so the DCs would be able to expand trade in a predictable manner. As sensible as this sounded, reality soon looked quite different. Today, almost 25 years later, the system has become so complicated that its management requires a large bureaucracy to guard against the exporting countries exceeding agreed-upon limits or rates of expansion. In the EC alone there are over 3000 distinct quotas, not counting the many items which are under constant surveillance.

¹ STA = Short Term Arrangement Regarding International Trade in Cotton Textiles.

² LTA = Long Term Arrangement Regarding International Trade in Cotton Textiles.

³ GATT itself was (ironically enough) born out of the recognition of the need to ensure full employment and a steadily increasing volume of real income (see GATT Preamble).

⁴ The MFA was extended twice: 1978 (MFA II) and 1982 (MFA III).

Table 1
Pre-Tokyo Round and Post-Tokyo Round Nominal Tariffs in Three Major Western Economies

Category	EC		United States		Japan	
	Pre	Post	Pre	Post	Pre	Post
Textiles and Clothing						
Weighted Average	15	11.5	23.5	19	14	11.5
Simple Average	14	10.5	19	10.5	14	10.5
Manufactures						
Weighted Average	8.5	6	7	5	10	5.5
Simple Average	9.5	6.5	11.5	6.5	11	6.5

Note: Textiles exclude fibres, manufactures exclude petroleum.
Source: GATT: Textiles and Clothing in the World Economy, Geneva, July 1984, p. 68.

Table 2
Nominal and Effective Protection Rates, Germany, 1958-82

	1958	1964	1970	1972	1982
Textiles					
nominal	11.1	12.7	11.0	10.3	11.8
effective	20.3	24.0	21.2	20.8	17.7
Clothing					
nominal	13.8	16.5	14.7	14.0	12.4
effective	17.7	22.3	21.5	20.7	27.5
Total Manufacturing					
nominal	9.0	11.0	8.8	7.3	7.3
effective	11.8	14.8	11.9	10.0	—

Sources: For the years 1958 to 1972, the figures are from J. B. Donges, G. Fels, A. Neu et al.: *Protektion und Branchenstruktur der westdeutschen Wirtschaft*, Kieler Studien, No. 123, Tübingen 1973, p. 198. The figures for 1982 are from F. D. Weiss: *Importrestriktionen der Bundesrepublik Deutschland*, in: *Die Weltwirtschaft*, No. 1, 1984, pp. 88-100. The effective protection rates for 1982 that are quoted above have been recalculated since Weiss's paper appeared — they are roughly comparable with the earlier figures.

The Extent of Protectionism

For one of the products most easily exported by developing countries — i.e. textiles and clothing — average tariff levels are (depending on the indicator used) up to almost 4 times higher than for manufactures on the whole. This is clearly evidenced in Table 1 for the three major markets in the western world and in Table 2 for the specific case of Germany. In particular, Table 2 shows that effective rates of tariff protection⁵ exceed those of nominal protection in textiles and clothing much more so than in total manufacturing.⁶

The high effective rates of protection in both textiles and clothing imply that, to be competitive on the German market, countries outside the EC have to offer their products at a price at least twenty percent below that of their German competitors. This level of protection is substantially above that enjoyed by total industry.

By no means, however, is the total protection afforded to textiles and manufacturing fully captured by the effective rates of protection given above. Two important components of total protection are still left unmentioned, that is non-tariff barriers to trade and subsidies. Non-tariff barriers, in particular, push the level of total protection far above the levels of effective protection. As one can see from Table 3, their frequency is again particularly high in textiles and clothing compared to all of industry. In the EC, for example, the percentage of imports affected by NTBs even exceeds that of agriculture and equals that of iron and steel. The frequency of non-tariff barriers is also a good indicator of the severity of the restrictions applied in practice. For example, Witteler⁷ has recently calculated total rates of protection for Germany for the eight so-called sensitive product groups under the MFA and found values far in excess of the effective rates quoted above. For clothing, in particular, they imply ad valorem tariff equivalents of more than 100 percent. Another interesting result is that the total rates jumped upward noticeably when the various MFA agreements took effect. These observations are supported by a recent study by these authors⁸ carried out at the 5 digit Nimex classification. For imports of shirts for men and boys into Germany, the ad valorem equivalent of the MFA related quotas and voluntary export restraints that were put in place in 1978 as part of the first extension of the MFA was found to be in excess of 50 percent. In other words this amount can be interpreted as the effect of MFA II on top of the existing protection from MFA I (1974 to 1977).

Not dealt with so far in this paper, and often neglected in general discussions about the total level of protection, is the impact of subsidies. Contrary to what is often claimed by the proponents of continued or even intensified protection in textiles and clothing (i.e. many of those interested in an extension of MFA), subsidies in these industries are as much a part of economic life in industrialized countries as in exporting developing countries. In the case of Germany, for instance, one can

⁵ The term effective tariff protection applies to nominal levels corrected for the impact of trade barriers on imported inputs. Total effective protection goes further and includes subsidies as well.

⁶ Tariffs for cotton products at different stages of production are cascaded, i.e. raw cotton has zero tariffs whereas outerwear is subjected to 17 %. Specific products, however, are given tariffs reaching 40 % or 50 % — a level otherwise rarely observed outside of agriculture. Tariff data from: Official Journal of the European Community, L 335, Vol. 21, December 1, 1978.

⁷ D. Witteler: *Quantifizierung nichttarifärer Handelshemmnisse. Theoretische Grundlagen und empirische Analyse für die Sektoren Textilien und Bekleidung der Bundesrepublik Deutschland*, Dissertation, Münster 1985.

⁸ D. Spinanger and J. Zietz: *Managing Trade but Mangling the Consumer: Reflections on the EEC's and West Germany's Experience with the MFA*, in: *Außenwirtschaft*, No. 3, 1986.

Table 3
Percentage of Imports Subject to Non-tariff Barriers, by Country, 1983

	Agri- culture	Manufac- turing	Textiles	Footwear	Iron, Steel	Vehicles	Electr. Machinery	Other Manuf.
EEC	36.4	18.7	52.0	9.5	52.6	45.3	13.4	10.3
West Germany	22.3	18.5	57.0	9.7	53.5	52.0	6.8	6.6
France	37.8	27.4	48.4	6.6	73.9	42.9	41.7	19.4
Italy	39.9	9.3	37.2	0.2	48.6	10.2	7.1	2.6
UK	34.9	14.8	59.6	12.2	42.1	44.3	12.7	6.7
Japan	42.9	7.7	11.8	34.1	0.0	0.0	0.0	7.7
USA	24.2	17.1	57.0	11.5	37.7	34.2	5.2	6.1

Note: Textiles refers to Textiles and Clothing.

Source: J. L. Nogues, A. Olechowski and L. A. Winters: The Extent of Non-Tariff Barriers to Industrial Countries' Imports, Development Research Department Discussion Paper No. 115, World Bank, January 1985, p. 43.

observe that, despite decreasing tariff protection, subsidies have shown an increasing trend not only vis-à-vis value added shares, but in particular in terms of real DM per employee, whereby clothing rose relatively more than the whole group of non-durable consumer goods (Table 4).⁹ In comparison, it is difficult to argue that the major newly industrialized countries (NICs) are either subsidizing their textile and clothing industries at a greater rate or for that matter increasing the rate over time. Hong Kong, for example, the major clothing producer among the NICs, does not have any subsidies, a fact by no means hidden in a study conducted for the German textile producer association, an organization not known for its unconditional support of free trade in textiles and clothing.¹⁰

The Case for Import Restrictions

Commonly the case made in favor of import restrictions in textiles and clothing rests on one familiar argument: imports from low price countries, in particular the NICs, destroy jobs in the textile and clothing industry of the importing industrialized countries. As the familiar argument goes, imports either directly replace domestic production because of their "unfairly" low prices or because they force domestic producers to increase productivity beyond what would normally exist without such intense import competition.

As concerns the argument that cheap imports of textiles and clothing are inundating the domestic market, a glance at the import penetration ratios in these two industries as compared to those of total manufacturing is quite enlightening. Given the evidence in Table 5, it can be seen that for textile imports (as a percentage of total domestic consumption) the shares do not differ significantly from those in total manufacturing. This conclusion also holds independent of the exporting countries or regions examined. In 1980, less than a quarter of all imports originated in non-

OECD countries, less than five percent in the NICs. Import penetration in clothing and leather products is, on the other hand, significantly above that in total manufacturing. This is particularly true for 1980. Also, non-OECD countries have a share of close to 45 percent of total imports compared to barely 17 percent in all of manufacturing. More than half of those imports come from NICs. Taking a closer look at import flows over time it becomes apparent that, for clothing, most of the threefold increase in the import shares of non-OECD countries and NICs was realized up through 1976/77, when the restrictions of the MFA I were finally applied, thereby putting a sudden end to the import surge. It would thus be logical that only in the case of the leather and clothing industries (but not for textiles) could it be possibly argued that they are subject to a "special" burden.

But even in the case of clothing, arguments for overall protection become much weaker if a more disaggregated level of analysis is applied. In a study by Krueger¹¹ it is shown for the US clothing industry, for example, that in the period 1970-76, the relative magnitude of labor displacement "attributable" to imports varies considerably among four digit industries: it is rather low for men's and boys' pants or women's and children's underwear but very high for children's clothing (a particularly labor intensive product group) as well as for leather and sheepskin clothing.¹²

⁹ Further evidence on the extent of subsidies in Germany (as well as in other industrialized countries) is collected in a recent ILO study: International Labour Organisation: The Employment Effects in the Clothing Industry of Changes in International Trade, Programme of Industrial Activities, Second Tripartite Technical Meeting for the Clothing Industry, Geneva 1980.

¹⁰ K. Neundörfer and E.-H. Stahr (eds.): Wettbewerbsverhältnisse und Wettbewerbsverzerrungen im Welttextilhandel, Schriften zur Textilpolitik, Heft 2, Frankfurt/Main 1985. It might be added, however, that the conclusions drawn for Hong Kong contained a veiled implicit contention that the low tax rates represent a definite distortion.

¹¹ Anne Krueger: LDC Manufacturing Production and Implications for OECD Comparative Advantage, 1979, p. 34.

Table 4
Degree of Subsidization of Textiles and Clothing
in Germany, 1973-82

	Subsidies as Percentage of Net Value Added		Subsidies in 1980 DM per Employee	
	Textiles	Clothing	Textiles	Clothing
1973	1.2	1.2	328	260
1974	1.2	1.3	352	277
1979	1.2	1.3	397	339
1980	1.1	1.4	358	357
1981	1.2	1.4	380	380
1982	1.2	1.5	398	395

Source: E. Gerken, K. H. Jüttemeier, K.-W. Schatz and K. D. Schmidt: Mehr Arbeitsplätze durch Subventionsabbau, Kiel Discussion Papers, No. 113/114, Institute of World Economics, October 1985, p. 13.

Table 5
Import Penetration Ratios for Germany,
1970 vs. 1980

Country or Country Group	Total MFG	Textiles	Clothing	Leather Goods	Leather Footwear
OECD Total	16.5 25.6	17.5 26.1	19.8 33.1	25.4 45.5	21.5 48.3
EEC	11.2 17.0	14.8 19.6	17.5 26.8	21.7 34.6	19.5 37.3
Italy	2.3 3.2	3.1 5.4	9.3 12.1	6.1 18.4	14.5 29.8
Japan	0.5 1.3	0.4 0.7	0.5 0.4	0.3 0.9	0.3 0.1
Non-OECD	2.8 5.3	2.7 8.0	7.0 27.0	6.0 20.1	2.3 10.0
Comecon	0.7 1.4	0.3 0.8	1.4 4.0	0.5 1.4	0.6 2.1
NICs	0.6 1.6	0.4 1.5	5.0 15.1	1.7 10.1	1.4 6.2
World	19.3 31.4	20.4 34.4	26.8 60.2	31.4 65.6	23.8 58.2

Note: The upper numbers refer to 1970, the lower numbers to 1980. NICs stands for "Newly Industrialized Countries" and includes Brazil, Hong Kong, Mexico, South Korea, Singapore, Taiwan and Yugoslavia. MFG denotes "Manufacturing".

Source: D. Blades and W. Simpson: The OECD Compatible Trade and Production Data Base, Economics and Statistics Department Working Papers, No. 18, OECD Economic Statistics and National Accounts Division, January 1985.

Table 6
Average Annual Percentage Change in Employee
Productivity in Textiles, Clothing, and Total
Manufacturing, Germany, 1960-1982

	Textiles	Clothing	Manufacturing
1960/65	5.6	3.4	4.3
1965/70	4.6	0.2	4.6
1970/75	5.6	4.2	2.6
1975/80	4.1	1.0	3.8
1980	0.6	-1.9	-0.4
1981	-2.1	0.6	1.0
1982	6.8	1.0	0.9

Source: M. Breitenacher: Die Textilindustrie in der Bundesrepublik Deutschland, Cologne 1983, p. 19.

The second point raised above is that imports are often said to lead to unemployment because domestic firms have to increase productivity much faster than without the "unfair" import competition of the NICs and others. In referring to figures on actual productivity increases (in Germany, Table 6) however, the trend in textiles was perceptively above that of total manufacturing in most periods. For clothing, above average growth was only observed during 1970-75. Whatever the case, three questions must be answered:

- ☐ If productivity increased because the industry was inefficient, then higher productivity is a positive result of increased competition.
- ☐ If higher productivity was the result of defensive investments due to imports and pushed factor intensity beyond what would have otherwise existed, then a misallocation has occurred.
- ☐ If higher productivity was induced by new technology which had just become available, lower employment is not due to increased imports.

Lending support to the last aspect is a recent OECD study¹³ where it is concluded that the observed productivity growth in textiles can be attributed to a large extent to exogenous improvements in technology. The poor productivity performance of the clothing industry, on the other hand, points to the fact that – so far at least – the scope for such changes is indeed very limited in this industry in a country like Germany or the United States. This is understandable, since, as pointed out recently by GATT,¹⁴ the manufacture of clothing has remained very labor intensive with labor's share accounting for 90 percent or more of total value added, whereby sewing alone accounts for about 90 percent of labor costs. This is also the part of the production process which has so far been the major obstacle to modernization and rationalization. Given this constellation of limited productivity growth and high wages in OECD countries, the "danger" that imports from NICs or developing countries represent for the long-run employment prospects in that industry is apparent. Nonetheless while the employees of this industry seem to have a solid reason for asking for import protection, the question whether this applies to the entire economy is by no means answered.

¹² Displacement by imports, however, does not necessarily imply that employment decreases in absolute terms. For instance, as concerns leather clothing the strong increase in demand more than compensated for the job losses due to imports, so that employment actually increased over the period analyzed.

¹³ OECD: Costs and Benefits of Protection, Paris 1985.

¹⁴ GATT: Textiles and Clothing in the World Economy, Geneva, July 1984, Appendix III, p. 51.

Table 7
Effects of Voluntary Export Restraints on the
Clothing Industry in the US and the EC, 1980

	US	EC
Welfare Cost to the Economy (\$ mill.)	1,509	1,409
Jobs Saved Through Protection (1,000)	8.9	11.3
Welfare Cost per Job Saved (\$ 1,000)	169.6	124.7
Average Labor Compensation (\$ 1,000)	12.6	13.5
Ratio of Welfare Cost to Average Compensation	13.5	9.2

Source: O. K. Kalantzopoulos: The Cost of Voluntary Export Restraints for Selected Industries in the U.S. and the EC, World Bank, Washington D.C., mimeo, January 1985.

Economic Costs of Import Restrictions

An answer to the above question is often given by proponents of import protection who argue that import restrictions – like the MFA – impose only negligible costs on the economy if they are compared to the benefits in terms of jobs saved. Unfortunately for these proponents the empirical evidence collected on this topic substantiates conclusions to the contrary.¹⁵

One immediately obvious result of protection is an increase in the domestic price of the products or product groups concerned. If this were not the case, many of the labor intensive products in the clothing industry could not be profitably produced, as they are, in the US or the EC because manufacturing costs in the NICs are a third to one half lower. The ad valorem tariff equivalents mentioned in the first section are a good indicator of the price increases attributable to the import restrictions. The welfare loss to consumers of these price increases is substantial. As already mentioned, the increases reach far beyond 100 percent of the comparable world market price. What this implies for the welfare of consumers can best be understood with a concrete example. The price increase in excess of 50 percent, for example, which the authors attributed to the effect of the restrictions of the MFA II, translate into a welfare loss of between DM 600 and DM 700 million per year depending on the assumptions made. This sum equals about 80 percent of the value of total imports of these products.

But prices do not increase evenly for all products. Since restrictions are the most severe for those products that are the most labor intensive, such as children's wear, these products also show the largest price increases. Severe quantitative import restrictions can even force foreign suppliers to move out of these

products and to upgrade to market segments with a higher value added leaving the low end of the market to high cost and thus high price domestic producers. Strong support for this argument was gathered in Britain, where a study by the British Consumers' Association found an average increase of UK clothing retail prices attributable to the MFA of about 20 percent. Lower quality items, however, such as jeans, increased by about 30 to 50 percent in price. The prices of children's wear even doubled.¹⁶ These findings further underline Jenkins' conclusion¹⁷ that import restrictions in textiles and clothing hit the poorer segments of the population the hardest, i.e. because they are more likely to buy the lower quality products and because they spend a greater share of their income on textiles and clothing. This being the case, it can be logically contended that the impact of the restrictions of the MFA is equivalent to a regressive tax.

By comparing their impact with the supposed benefits of the restrictions in terms of jobs saved, it is possible to arrive at a net change in welfare for an economy. Research on this issue has recently been published in a study conducted at the World Bank,¹⁸ the main results of which are presented in Table 7. The welfare costs shown in the table are the sum of increased payments on imported goods, the loss in consumer surplus due to the higher domestic price and the resource cost of producing the additional quantity domestically. The main conclusion derived from this evidence is the considerable welfare cost of *one* job saved in the industry. In the EC it amounts to approximately \$ 125,000, a value almost ten times as high as the average annual compensation of a worker in the clothing industry.

However, even these calculations are incomplete, as the estimates still do not take into account the fact that protection in one sector has the effect of an export tax on other non-protected industries with a consequent loss of employment. This causal link has recently been studied in more detail by Groß.¹⁹ Using a general equilibrium model of the ORANI type, he shows that, under reasonable assumptions, an increase in the protection of the clothing and textiles industries actually reduces

¹⁵ See OECD, op. cit., p. 109.

¹⁷ G. P. Jenkins: Costs and Consequences of the New Protectionism: The Case of Canada's Clothing Sector, North-South Institute/World Bank, Monograph, 1980.

¹⁸ O. K. Kalantzopoulos: The Cost of Voluntary Export Restraints for Selected Industries in the US and the EC, World Bank, mimeo, January 1985.

¹⁹ M. Groß: Auswirkungen der Protektion im Textilbereich auf Produktion und Beschäftigung in der Bundesrepublik Deutschland, in: Die Weltwirtschaft, No. 1, 1984, pp. 79-94.

¹⁵ For an extensive overview see M. Wolf et al.: Costs of Protecting Jobs in Textiles and Clothing, London 1984.

the overall employment prospects of unskilled workers in the economy, this being due to the negative secondary effects of protection on other export oriented sectors. But as it happens, the unskilled workers just represent the group that was intended to be the main beneficiary of import protection.

Conclusions

The gist of the above is clear: MFA has developed into a bureaucratic hydra which has little in common with its initial short-term intention. It has been responsible for inflicting considerable injury on industrialized as well as industrializing countries by misallocating factors of production and inducing tax-like price distortions, many of which are of a regressive nature. While proponents of MFA argue that without managed trade the industrialized countries will be swamped with articles produced under unfair conditions and thus endanger those employed in MFA industries, after 25 years the time has come for the firms to stand on their own competitive abilities. This is interpreted as meaning that MFA should be allowed to disintegrate over a set time period, and that trade in textiles and clothing is subjected thereafter to closely monitored basic GATT rules (i.e. non-discrimination).

What would happen if MFA is allowed to continue as in the past? In this connection it should be pointed out that – should MFA be extended – neither will additional employment be forthcoming nor will current levels be maintained given the capital-intensive path followed by the textile industry in the past years and given future trends projected for the clothing industry, where low-wage jobs may well be taken over by automated facilities run by skilled workers. Thus should MFA protection be allowed to continue, jobs in industrialized countries may have been saved for a few, but the many (i.e. the consumers) will be footing the large bill. It might

also be added that the employment argument is incompletely specified since the jobs maintained by protection in industrialized countries are no doubt but a fraction of the jobs which are not created in developing countries because textile or clothing industries were not established or expanded due to MFA trade barriers. Given the wide-sweeping development ramifications of allowing textile and clothing industries to expand under an efficient international division of labor, it is probable that the feedback to ICs of rising income levels in DCs will more than compensate for any reallocations of industries (or parts thereof) which might take place.

To assist structural adjustment in industrialized countries (i.e. to allow resources to be smoothly reallocated and jobs to be created) governments – as a step towards establishing true free-market economies – should permit those areas particularly hard hit to rid themselves of all those barriers to entry which have either hindered economic activities from being created or caused potential entrepreneurs to migrate to countries less burdened with regulations. This implies the establishment of free economic activity zones, i.e. areas relatively free of regulatory distortions and not involving protection or subsidies.

To help ensure that existing barriers to trade can be eliminated and do not reappear again in other forms it seems essential to make the public fully aware of the costs involved. By requiring governments to provide information on all forms of barriers to entry and subsidies, protection balance sheets can be set up for all to clearly see the costs involved.²⁰ Had such calculations already been required, it is doubtful that the MFA would exist today in the form it does.

²⁰ See GATT: Trade Policies for a Better Future – Proposals for Action, Geneva 1985, pp. 35-37 and 52-56.

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