PREFACE

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WORLD TRADE AND THE INTERNATIONAL ECONOMY:
TRENDS, PROSPECTS AND POLICIES

This paper examines the recent emergence of the "new protectionism", evaluates the measures applied, and makes policy recommendations for both developed and developing countries. As a background to the discussion, Section I of the paper considers the beneficial effects of postwar trade liberalization on the world economy. In turn, Section II describes the application of measures, such as nontariff barriers, government aids, and cartel-type arrangements, in the period following the oil crisis and the 1974-75 world recession. The adverse economic effects of the application of these measures, subsumed under the heading the "new protectionism", are appraised in Section III, with further attention given to the employment argument for protection.

In Section IV of the paper, recommendations are made for policies by developed and by developing countries. As regards developed countries, emphasis is given to the need for taking measures aimed at raising rates of economic growth, so as to reduce the pressure for protection, and for employing measures of adjustment in the place of import restrictions. Emphasis is further given to the need for an international code of conduct covering adjustment assistance, and government aids in general, as well as safeguard measures and export subsidies. Finally, developing countries are advised to put reliance on the exchange rate mechanism in the place of measures of protection and subsidies, and to make use of the possibilities offered by multilateral trade negotiations.

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WORLD TRADE AND THE INTERNATIONAL ECONOMY:
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I. Trade Liberalization in the Postwar Period

The Progress of Trade Liberalization

The postwar period saw steady progress in trade liberalization until the oil crisis and the world recession of 1974-75. Apart from removing quantitative import restrictions imposed during the depression of the nineteen-thirties and the Second World War, efforts were concentrated on lowering tariffs. Reductions in tariffs originally aimed at reversing the increases effectuated during the depression, but they were subsequently lowered much below pre-1930 levels.1/

Tariff reductions were undertaken in the framework of GATT on the basis of the dual principles of nondiscrimination and reciprocity. Nondiscrimination means that, customs unions and free trade areas apart, reductions in tariff barriers are extended to all member countries under the application of the most-favored-nation (MFN) clause. In turn, reciprocity means that, in negotiating tariff concessions, an attempt is made to balance the interests of the participating countries.

During the nineteen-fifties, trade liberalization proceeded on the basis of item-by-item negotiations, with the participating countries making offers to each other to lower tariffs in exchange for tariff reductions.

1/ While the ratio of tariffs to dutiable imports does not appropriately measure the extent of protection, it may be used to indicate general trends. In the United States, this ratio averaged 38 percent in 1922-29; it was 53 percent in 1930-33 under the Hawley-Smoot law; and it decreased to 25 percent by 1957 (Sidney Ratner, The Tariff in American History, New York, Van Nostrand, 1972, pp. 52-57). The ratio of U.S. tariffs to dutiable imports declined further following the Dillon-round (1960-61) and the Kennedy-round (1963-67) negotiations and reached 8 percent in 1974 (Statistical Abstract of the United States, 1975, p. 22).
on items of export interest to them. After initial successes, this procedure became increasingly cumbersome and was superseded by across-the-board tariff reductions, first in the Dillon round and subsequently in the Kennedy round of negotiations, with exceptions made for so-called sensitive items.

Although most developing countries did not actively participate in trade negotiations in the framework of GATT, they enjoyed the benefits of tariff reductions being automatically extended to them under the application of the MFN clause. Indeed, it appears that the benefits of multilateral trade liberalization for the developing countries far exceeded the benefits they have derived from the application of the General Preference Scheme which, despite its name, has remained limited in scope.\(^1\) And while the elimination of tariffs on intra-area trade in the framework of the European Economic Community and the European Free Trade Association favored imports from the partner countries over imports from outsiders, including the developing countries, tariffs on these imports were reduced on the average by one-half during the nineteen-sixties. At the same time, the developing countries benefited from increased demand for their exports that accompanied the acceleration of economic growth in Western Europe following the success of integration efforts.\(^2\)


Trade liberalization pertained largely to raw materials and to manufactured goods while food imports remained subject to barriers. As tariffs on most raw materials were reduced to low levels by the mid-fifties, in this paper emphasis will be given to trade in manufactured goods.\(^1\) This choice is also warranted by reason of the fact that trade in manufactured products had to bear the brunt of the "new protectionism" since 1973 and that prospective changes in the international division of labor between developed and developing countries affect primarily these commodities.

**International Trade and Economic Growth**

It has been noted that the elimination of barriers to intra-area trade contributed to the acceleration of economic growth in Western Europe. More generally, the expansion of international trade has favorable effects on economic growth. Apart from improvements in resource allocation according to comparative advantage, these effects find their origin in the exploitation of large-scale economies through the construction of larger plants (the traditional form of economies of scale), reductions in product variety in individual plants (horizontal specialization), and greater specialization in the production of parts, components, and accessories (vertical specialization), as well as in technological change that is stimulated by foreign competition. Rapid economic growth, in turn, contributes to increased imports, thereby extending the gains to other countries.

Ragnar Nurkse suggested that the effects of trade on economic growth are indicated not by "the average ratio of world trade to world

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1/ Manufactured goods will be defined as SITC commodity classes 5 to 8 less nonferrous metals (68).
production but by the incremental relationship between trade and production ...

He noted that such a relationship was observed during the nineteenth century, when the expansion of international trade at a rate much exceeding that of domestic production importantly contributed to economic growth in the industrial countries. Economic growth was, in turn, transmitted to other countries of the world as the industrial countries' imports of primary products rose at a substantially higher rate than their national income.

Nurkse claimed, however, that "the world's industrial centers in the mid-twentieth century are not 'exporting' their own rate of growth to the primary-producing countries through a corresponding expansion of demand for primary products" and that the developing countries face difficulties in exporting manufactured goods to the industrial countries. According to Nurkse, "Industrialization for export markets may encounter ... difficulties on the supply side. In the scale of comparative advantage there may be a wide gap, or at any rate a certain discontinuity, between the traditional primary products and the new manufactured goods which a country would seek to export ... Equally serious are the obstacles which industrialization for export is liable to encounter on the side of external demand" due to protection in the industrial countries.


These pessimistic views, subsequently given increased emphasis by writers such as Gunnar Myrdal and Raul Prebisch, were not borne out by the facts. To begin with, the "incremental relationship" between exports and production in the industrial countries obtained also during the postwar period as their exports rose much more rapidly than their gross national product. Between 1953, the first "normal" postwar year, and 1960, when the effects of tariff reductions in the EEC and EFTA began to be felt, the export volume of the industrial countries increased at an average annual rate of 7.0 percent while their combined GNP rose 3.6 percent a year.

The industrial countries' imports of primary products from the developing countries, too, increased more rapidly than their combined GNP. These imports rose at an average annual rate of 5.1 percent between 1953 and 1960, exceeding the GNP growth of the industrial countries by about one-half, with even larger increases shown in regard to manufactured goods. At the same time, the export performance of a number of developing countries was adversely affected by their own policies: the bias against exports in countries pursuing import substitution policies led to a loss in their world shares in primary exports and forestalled the emergence of manufactured exports.

4/ Trade Prospects for Developing Countries, pp. 9-10.
Developments Until the Oil Crisis

The observed trends in trade and growth continued and even accelerated after 1960 when trade liberalization in the framework of the Dillon and the Kennedy rounds, integration in Western Europe, and the adoption of export-oriented policies in several developing countries gave added impetus to world trade. The exports of the developed countries rose at an average annual rate of 8.8 percent between 1960 and 1973, the last year before the quadrupling of oil prices and the world recession, exceeding the growth of their combined GNP, estimated at 4.8 percent a year, by a considerable margin.

Economic growth in the developed nations led to a rapid rise of their imports from the developing countries, with increases averaging 7.2 percent a year between 1960 and 1973. The imports of manufactured goods rose especially rapidly, far exceeding earlier projections. Thus, while the United Nations foresaw an increase of only 60 percent during the sixties, these imports increased fivefold between 1960 and 1970 and their rate of growth averaged 15.7 percent between 1960 and 1973. But, the imports of primary commodities from the developing countries, too, rose at an average annual rate of 7.2 percent, notwithstanding losses in market shares in some of those countries that continued to follow policies biased against exports.

1/ United Nations, Monthly Bulletin of Statistics, October 1977 — Developed countries are defined to include the industrial countries of North America, Western Europe, and Japan, as well as Australia, New Zealand, Israel, and South Africa. All other market economies are classified as developing.

Policy differences were of particular importance for trade in manufactured goods. Thus, within the developing country group, the largest export increases were experienced in countries that adopted export-oriented policies and liberalized their imports. Korea, Singapore, and Taiwan, which first adopted such policies, increased their share in the combined exports of manufactured goods by developing countries from 2.7 percent in 1960 to 32.7 percent in 1973. By contrast, the share of India, a country that continued with protectionist policies throughout the period, fell from 24.6 percent in 1960 to 6.6 percent in 1973.¹/

The rise in their foreign exchange earnings allowed the developing countries to increase their imports from the developed nations at a rapid rate. These imports rose 6.2 percent a year between 1960 and 1973, with manufactured imports growing at an annual average rate of 6.5 percent. As a result, the manufacturing trade surplus of the developed nations with the developing countries increased from $14 billion in 1960 to $43 billion in 1973, when the developing countries provided markets for 37.7 percent of the manufactured exports of the developed nations, excluding trade between the United States and Canada as well as within and between EEC and EFTA.²/

II. Oil Crisis, Recession, and Protectionist Pressures

The Post-1973 Situation

It has been shown that the rapid expansion of foreign trade contributed to economic growth in the developed countries during the postwar period. Growth in the developed countries, in turn, was transmitted to the developing countries through trade. At the same time, imports by the developing countries provided an important market for the manufactured exports of the developed countries.


These developments occurred in an atmosphere marked by progressive trade liberalization on the part of the developed nations and by the adoption of export-oriented policies, accompanied by reduced protection, in several developing countries. The atmosphere was marred only by quantitative import restrictions pertaining chiefly to Japanese exports, and by the adoption of the International Cotton Textiles and, subsequently, Multifiber Arrangement. Nevertheless, the Multifiber Arrangement provided for an annual growth of 6 percent in the exports of textiles and clothing and, as a result of increases in their quota allocation and the upgrading of their export products, the developing countries' exports of textiles and clothing rose substantially faster.¹/

The situation changed as the quadrupling of oil prices aggravated the recession that followed the 1972-73 world economic boom. In adding to inflationary pressures, the oil price increase led to stronger anti-inflationary measures on the part of the developed countries than would have been otherwise the case. The recession was further aggravated by policy reactions on the part of the developed countries to the increase in their combined balance-of-trade deficit vis-à-vis OPEC from $17.2 billion in 1973 to $66.6 billion in 1974.²/

And, while the United States has maintained a steady rate of expansion since mid-1975 without regard to its balance-of-payments consequences, in the other developed countries the desire to lower inflation rates and/or to reduce balance-of-payments deficits has not permitted economic expansion to


proceed at a rate approaching capacity growth following the recession. As a result, unemployment has continued to increase in Western Europe and Japan, while it has not yet declined to pre-1973 levels following the deep recession in the United States.

High unemployment and unused capacity in a number of industries of the developed countries have contributed to the emergence of protectionist pressures, which were intensified by reason of the continued existence of trade deficits in most developed countries. The protectionist measures proposed and actually applied, if not the extent of their application, have a certain resemblance to those observed during the depression of the nineteen-thirties.1/ They may be subsumed under the heading "new protectionism" and include various forms of nontariff restrictions on trade, government aids under the aegis of the "rationalization of industry," as well as attempts made at the establishment of worldwide market-sharing arrangements.

Nontariff Restrictions

As noted above, the Multifiber Arrangement, the principal case outside agriculture where nontariff measures were applied prior to the oil crisis, provided for a 6 percent annual rate of growth in the textiles and clothing exports of the individual countries. The new agreement, pertaining to the 1978-82 period, is more restrictive. While notionally setting a 6 percent annual rate of growth for the exporting countries, taken together, it leaves considerable scope for the importing countries to set lower limits through

bilateral negotiations.

In fact, the European Common Market that forced the adoption of the revised rules at the behest of France and the United Kingdom, has required that the largest developing country exporters reduce their 1978 exports of textiles and clothing to the EEC below the 1976 level (the relevant figures are -9 percent for Hong Kong, -7 percent for Korea, and -25 percent for Taiwan). And while better overall terms are provided to very poor countries, the total imports of eight sensitive products, accounting for 62 percent of EEC imports of textiles and clothing from developing countries, will decline below the 1976 level in 1978 and will increase slowly afterwards, with growth rates in the 1978-82 period ranging from 0.3 percent a year for cotton yarn to 4.1 percent a year for sweaters (The Economist, December 24, 1977). Import growth rates were also set at less than 6 percent a year for another important group of clothing products, so that the rate of growth of the imports of textiles and clothing into the EEC will remain much below 6 percent.

The United States reached agreements with Hong Kong, Korea, and Taiwan to freeze their 1978 exports of textiles and clothing to the U.S. at the 1977 level and to increase the exports of a number of sensitive items, accounting for about 70 percent of exports in the case of Korea, at a rate substantially less than 6 percent afterwards. Taking further account of bilateral agreements negotiated with other countries, it is apparent that the 6 percent annual rate of growth of the imports of textiles and clothing under the Multifiber Arrangement will not be attained in the United States either.

In regard to steel, the European Common Market established guideline prices for five product groups and a mandatory minimum price for reinforcing
bars in 1976. As of January 1978, basic or reference prices were set for all products based on the lowest foreign (i.e., Japanese) production costs adjusted for transport costs. Imports below the reference price come under anti-dumping rules, with a levy imposed in the amount of the price difference. This scheme is assumed to be temporary, to be replaced by bilateral agreements negotiated with steel exporting countries. The Commission has since negotiated agreements with some 20 countries to accept the same share in the EEC market in 1978 as they had in 1976 (The Economist, May 13, 1978), implying an average cut in steel imports by 8 percent from the 1977 level. The cuts would be larger for the new developing country exporters that increased their steel exports to a considerable extent between 1976 and 1977.

In establishing reference prices for steel, the EEC Commission drew on the Solomon-plan in the United States that came into effect in February 1978. Under the plan, the reference or trigger prices have been set on the basis of assumed Japanese production costs and the cost of shipping to U.S. markets. Correspondingly, the reference prices rise, and the chance of effective import competition declines, as one moves from West to East (The Wall Street Journal February 23, 1978).

The adoption of import restrictions in regard to textiles and steel is a manifestation of protectionist tendencies that have emerged in recent years. In the United States, the practical application of the provisions of the 1974 Trade Act also points in this direction. Under the Act, the U.S. Treasury has to reach a decision within one year after petitions are filed requesting the imposition of countervailing duties on exports that are allegedly subsidized
by foreign countries, and countervailing action has been extended to duty free imports, including those entering under the generalized preference scheme. In turn, dumping has been redefined as selling at less than full production cost, including a margin for profit, rather than at less than the domestic sales price as beforehand.

The Trade Act has also weakened the conditions for escape-clause action by requiring only that imports are "a substantial cause of serious injury, or the threat thereof" while previously such action could be taken only if imports were "the major cause" of serious injury and the increase in imports causing or threatening the injury was the result of previous trade concessions. Furthermore, "orderly marketing agreements," representing negotiated restrictions on exports to the United States, have been introduced in the arsenal of protectionist measures. Finally, the two houses of Congress can overrule the President if he rejects recommendations made by the International Trade Commission on anti-dumping and escape clause action.

While the Trade Act of 1974 has also liberalized the conditions for granting adjustment assistance to assist domestic industries adversely affected by imports, it is the possibilities provided for the use of protective measures that have come to be increasingly utilized. To begin with, there has been a substantial increase in positive findings in countervailing duty cases; there were thirty-four positive findings in the years 1974-77 as compared to thirteen in the preceding 11 years. And, at least in one case, the criteria for imposing countervailing duties have been modified to the detriment of foreign exporters. The Treasury plans even stricter enforcement in the future,

1/ The Treasury has countervailed the imports of bromide and bromide products from Israel that benefit from regional aids, although only 3 percent of total production is exported to the U.S.
although in many developing countries subsidy measures only compensate for the effects of domestic protection.

The number of anti-dumping cases has also increased since 1974 and the recent interpretation of production costs in the exporting countries is likely to give impetus to further increases in the future. Thus, the Treasury has established a formula for steel based on the "constructed value" of Japanese production costs plus an arbitrary markup of 10 percent for general expenses and another 8 percent for profits, both of which are much above the industry average (Business Week, November 14, 1977).

At the same time, the International Trade Commission has become active in its investigation of complaints that imports are harming domestic industries -- even if this may involve encroaching on the territory of other governmental organizations.1/ It issued 42 decisions in 1976 as compared to 15 in 1975, with the amount of imports affected rising from $248 million in 1975 to $1.9 billion in 1976, and surpassing $5 billion in 1977 (The Wall Street Journal, November 25, 1977). Finally, although President Carter overruled ITC recommendations in several cases, some important decisions have favored protectionist interests.

1/ It has been reported, for example, that ITC found the Japanese steel producers guilty of "predatory pricing" which has been defined in a similar way as dumping violations that are ruled on by the Treasury (Washington Post, January 15, 1978). It has also been reported that the White House objected to the ITC negotiating consent orders between domestic and foreign color TV makers on its own initiative (The Wall Street Journal, November 25, 1977). Note further that the Message from the Chairman, introducing the 1976 report of the ITC, speaks of "an innovative approach to our substantive and administrative duties and ... considerable progress in meeting the objectives which the Commission had set as a result of its increased role in international trade."
Apart from steel and textiles, particular instances are orderly marketing agreements with Japan on color television sets and with Korea and Taiwan on footwear, both in 1977. In the first case, imports were limited to 1.75 million sets a year until 1980, representing a 40 percent reduction from the 1976 level. In the second case, import limitations apply until 1981 and, despite annual increases in quotas, the 1976 level would not be reached by the end of the four-year period of the agreement. The application of protectionist measures in these well-publicized cases has, in turn, contributed to demands for protection in industries such as citizen-band radios, electric ovens, railroad equipment, bicycle tires and tubes, copper, and zinc, among which tariffs have already been increased on citizen-band radios.

The taking of protectionist measures by the Carter Administration has been rationalized on the grounds that these help to forestall more drastic action by Congress. At the same time, according to The Wall Street Journal (December 29, 1977), "the sentiment in Congress for protectionism is rising again." This reflects increased protectionist pressures emanating largely from labor, with labor and industry joining forces whenever they perceive a common interest.¹

¹ In this connection, a statement made following the December 1977 AFL-CIO Convention may deserve quotation - "Although organized labor lost its last big fight for import protection only three years ago, /when the Burke-Hartke bill went down in defeat/, AFL-CIO officials say that much has changed since then. The steel, electronics, shoe, textile, and apparel industries have been badly hurt by imports, unemployment has soared, and multinational operations have suffered a black eye for overseas bribery. The 'new reality' says a union economist is that the public no longer perceives protectionism as a bad thing" (Business Week, December 26, 1977). In this connection note that the House has already organized a 150-member steel caucus and a 229-member fiber caucus to defend the interests of the steel and textile industries (The Wall Street Journal, December 29, 1977).
It should be emphasized that, whatever the outcome, protectionist demands create uncertainty for exporters. Thus, demands for countervailing or anti-dumping action may induce foreign producers to limit exports to the U.S. for fear of a financial loss in the form of the payment of additional duties for which they have to put up a bond. \cite{1} More generally, even if they ultimately prove unsuccessful, protectionist demands are reportedly initiated in the expectation that foreign producers will cut back their expansion plans for the U.S. market. \cite{2}

Protectionist pressures have also increased in Western Europe, in particular in Britain and France. In Britain, the Cambridge Group has provided theoretical justification for the protectionist attitude taken by the Labor Government \cite{3} while in France protectionism has political backing from the right as well as from the left. Notwithstanding the generally liberal attitudes in Germany and Italy, \cite{4} the position taken by these two countries has apparently greatly influenced the Common Market Commission, as evidenced by the imposition of strict limits on the importation of textiles and clothing as well as by increased reliance on countervailing and anti-dumping legislation. \cite{5}

\begin{itemize}
\item \textit{1/} A case in point is the imposition of anti-dumping duties amounting to $46 million in March 1978 on Japanese-made television sets imported in 1972 and 1973.
\item \textit{2/} An example of apparent harassment of foreign exporters is the simultaneous initiation of countervailing, anti-dumping, and escape clause action against imports of bicycle tires and tubes from Korea.
\item \textit{3/} Cf. e.g. \textit{Le Monde}, April 4, 1978 and \textit{The Wall Street Journal}, April 24, 1978.
\item \textit{4/} On the latter, see the favorable reactions in the Italian press to the author's speech on the "new protectionism" on March 31, 1978.
\item \textit{5/} \textit{The Economist} (December 24, 1977) reports on the increasing number of anti-dumping cases in the EEC and the increase in the "Commission's anti-dumping staff from three to 10 to cope with the burgeoning work load."
\end{itemize}
At the same time, while the application of protectionist measures in the United States is circumscribed by legislation, in Western Europe as well as in Japan, protectionism often takes the form of discretionary measures by national governments. Such "occult" measures, which do not find their origin in legislation, present a particular danger for foreign countries, and especially to developing countries, both because legal recourse is lacking and because they create additional uncertainty.

Limiting attention to protectionist measures actually taken by the industrial countries, one may cite an estimate by the GATT Secretariat, according to which the application of these measures over the last two years has led to restrictions on 3 to 5 percent of world trade flows, amounting to $30-50 billion a year (*The New York Times*, September 23, 1977). Reference may further be made to a list prepared by the Taiwanese government on restrictions affecting manufactured exports. The list includes one item for 1975, nine items for 1976, and 33 items for 1977, of which seven are still under investigation.

**Government Aids to Industry**

Prior to the oil crisis, government aids were used in the major European countries as well as in the United States principally in favor of the shipbuilding industry. Furthermore, regional aids provided in Western Europe benefited certain industries that are concentrated in depressed regions.

Government aids, often granted under the heading "rationalization", have come into greater use since the 1974-75 recession. They take a variety of forms, including direct subsidies as well as preferential tax and credit treatment. These aids provide indirect protection to domestic industry by reducing its production or sales costs.
The German government provides 75 to 90 percent of the difference between the full-time wage and the wage earned by workers who had to be put on a part-time basis because of unfavorable business conditions. This scheme subsidizes weak industries indirectly as they are likely to have proportionately more part-time workers. In turn, other European countries have directly or indirectly subsidized employment. These measures together with the introduction of regulations making it difficult to fire workers, have contributed to labor hoarding.

A case in point is the British Temporary Employment Subsidy Scheme that compensates firms for keeping workers on the job who would otherwise be no longer needed. In 1977, about one-half of benefits under this scheme accrued to textiles, clothing, and footwear industries that reportedly received a subsidy equivalent to about 5-10 percent of their total production cost. At the same time, as The Economist (January 14, 1978) notes, little effort has been made to put pressure on subsidized companies to rationalize their operations. It would appear, then, that the subsidy provides an additional protection to the three industries without contributing to adjustment.

While employment schemes are not industry-specific, they tend to benefit labor-intensive industries which have higher than average unemployment rates. In several countries, government aids have also been provided to specific industries. This is the case in particular in France where the automobile, data-processing, pulp and paper, steel, and watch industries have received various forms of government aids. Whatever their avowed purpose, these aids will shore up, and hence protect, weak industries that find it difficult to face foreign competition. The takeover of insolvent firms by the government, and the financing of their deficits as well as the deficits of other state-owned firms from public funds, have had similar effect in Italy.
Government aids applied by the individual Common Market countries discriminate against imports from member as well as from non-member countries. In turn, in several instances, actions have been proposed, or have actually been taken, on the Common Market level. To begin with, the EEC steel industry has a legalized cartel, Eurofer, which ensures compliance with minimum prices and also sets quotas for market sharing among producers. Furthermore, the Common Market has provided financial aid to the steel industry under the Treaty establishing the Coal and Steel Community; the regional fund will reportedly be doubled between 1974 and 1981, in large part to provide assistance to the steel industry; and the EEC Commission is preparing a sectoral policy for steel.

The Common Market countries have also taken, or contemplate taking, joint action on shipbuilding and synthetic fibers. For one thing, the EEC Commission has demanded that Japan cuts back its exports of ships (The Economist, December 31, 1977) and proposals have been made for establishing a credit scheme aimed at financing domestic shipbuilding. For another thing, it has been proposed to establish a production cartel for synthetic fibers, and "a common market plan to ease the financial pain of redundancies" (The Economist, October 15, 1977) is reportedly in preparation.

Apart from shipbuilding where subsidies have long been used, under the Solomon-plan the United States will use a variety of measures, including loan guarantees, accelerated depreciation provisions, and subsidies to research, to aid the domestic steel industry. Also, a variety of export promotion measures are reportedly under consideration.1/

1/ According to the New York Times, (April 2, 1978), these include "fast writeoffs when companies develop new facilities to serve export markets, tax credits for those that establish foreign sales offices, a new tax program on exports tailored principally for medium-sized companies, a system of information-exchange to promote greater exports, a Government loan program for companies that introduce a new product line for exports, and a beefed-up operation (in money and personnel) for the existing Commerce State export-development activities."
In Japan, a bill containing special measures for aiding certain industries in difficulties was introduced in February 1978. The bill aims at providing assistance to the aluminum, shipbuilding, steel, and synthetic fiber industries, formalizing and extending aids that have been provided in the past. Its application may also be extended to other industries, some of which have been beneficiaries of government assistance in the past.\(^1\) 

**International Cartels and Market-Sharing**

While government aids under the guise of the rationalization of domestic industries have led to moves aimed at cartelization in the steel, shipbuilding, and synthetic fiber industries in the European Common Market, suggestions have further been made for cartelization on the world level. In this connection, reference may be made to statements by Raymond Barre, the French Prime Minister, "to define collective rules for an orderly growth of international trade ...\(^2\) in the framework of "a genuine organization of international trade" and "organized liberalism".\(^3\) It has been proposed that the definition of "collectively defined and applied rules which will generate conditions for growth security and dependability in trade ... should be one of the main objectives of the international negotiations to be held in the coming months; they must not simply repeat the negotiations of the last 20 years."\(^4\)

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\(^1\) It has been reported, for example, that "when the fast-growing computer firms in Japan began to have difficulties with their cash flow situation, the Japanese government organized a leasing company to buy computers and handle the leasing, thus providing a fast injection of cash and reducing the ongoing capital burden." (H. B. Malmgren, "International Order for Public Subsidies," *Thames Essay No. 11*, London, Trade Policy Research Centre, 1977, p. 24.)


\(^4\) *Journal de Genève*, September 15, 1977 -- As noted above, the negotiations of the last 20 years have led to a considerable expansion of trade and economic growth through trade.
Negotiations on the organization of international trade would cover a variety of industries, including steel and shipbuilding that have experienced worldwide overcapacity; some sophisticated industries, such as aircraft and computers, where the United States is in a particularly strong position and infant industry arguments are invoked in favor of European producers; as well as industries such as textiles, shoes and electronics, where competition on the part of developing countries and Japan is feared.

While the French government proposals may have aimed at taking the wind out of the sails of the domestic opposition and have not again been voiced since the parliamentary elections held in March 1978, moves toward the establishment of world-wide cartels have been made in the shipbuilding and steel industries. In the shipbuilding industry, market sharing arrangements have been proposed in the framework of the OECD that would entail a division of new orders between the European countries, Japan, and the developing countries, together with increases in the prices charged by Japanese producers (Business Week, December 5, 1977). In the steel industry, earlier reports that a steel working-group established in the framework of the Organization for Economic Cooperation and Development (OECD) is "planning to unveil a model for an international system to monitor prices, trade, and structural changes in steel industries in the member countries that could provide the basis for 'sectoral' talks on steel ..." (Business Week, November 28, 1977).

1/ According to Raymond Barre, "when a country develops a sector that is indispensable to the structural equilibrium of its economy but unable to meet normal competition until it reaches a sufficient size, that country may rightfully take such steps as are necessary to protect this activity from being destroyed while it is vulnerable" (Journal de Genève, September 15, 1977).

2/ As Raymond Barre expressed it, "France cannot allow international competition to develop under conditions that would throw its economic structures into confusion, bring about the sudden collapse of whole sections of its industry or agriculture, put thousands of workers out of work, and jeopardize its independence by eliminating essential activities" (L'Aurore, March 25, 1977).
1977), have been given credence by meetings of United States, Common Market, and Japanese officials allegedly aiming to establish a "world steel agreement" (The Economist, April 29, 1978).

III. The "New Protectionism": An Evaluation

The Effects of the Measures Applied

The preceding section examined the emergence of the "new protectionism" in the developed countries since the oil crisis and the 1974-75 recession. It has been noted that the "new protectionism" is characterized by the employment of non-tariff restrictions on trade, the granting of government aids to domestic industries, with further attempts made at organizing world trade. This contrasts with the "old protectionism" that involves placing reliance primarily on tariffs. At the same time, various considerations indicate the superiority of tariffs over the measures employed, or proposed to be used, under the aegis of the "new protectionism".

To begin with, tariffs are instruments of the market economy. Consumers make their choice between domestic and imported goods and among alternative foreign suppliers on the basis of price, quality, delivery dates, and other product characteristics, and domestic as well as foreign producers compete in the market without government interference or quantitative limitations. Also, tariffs do not inhibit shifts in trade patterns in response to changes in comparative advantage that are reflected by changes in relative costs.

In turn, nontariff measures interfere with the operation of the market mechanism by restricting consumer choice and limiting competition between domestic and foreign producers. The use of nontariff measures also involves administrative discretion that introduces arbitrariness in the decision-making
process, when the decisions actually taken are affected by the relative power position of various groups. With consumer groups generally having less influence on decision making than pressure groups representing various segments of labor and business, then, the new protectionism involves a bias towards restrictive measures.

At the same time, limiting imports in quantitative terms increases the market power of domestic producers, thus enabling them to raise prices, when restrictions applied to raw materials and intermediate products may spread forward as users seek to offset the higher prices of their inputs.\(^1\)

Also, incentives for improvements in productivity are reduced as a result and there is a tendency to freeze production patterns, thereby obstructing changes in international specialization according to shifts in comparative advantage.

Quantitative limitations on trade interfere with the market mechanism in the exporting countries, too. With allowed exports falling short of the amount producers would like to sell at the going price, they may collude or the government may apportion among them the amount that can be exported. This, in turn, may entail discriminatory pricing, with higher prices charged in export than in domestic markets. Foreign firms may also attempt to evade the restrictions through additional processing (e.g. steel), changing the basic material used (e.g. textiles), or shifting the place of production to countries which enjoy preferential treatment (e.g. television sets).

\(^1\) These conclusions also apply to the use of reference prices as an instrument to limit imports, as evidenced by the 5.5 percent increase in trigger prices on steel as of July 1, 1978 and the demands for the imposition of trigger prices on wire products in the United States. It has been suggested that steel-using industries will also request increased protection, since "distortions arising in steel affect the international competitive position of all steel users -- from producers of nuts and bolts to manufacturers of sophisticated machinery" (New York Times, May 11, 1978).
Apportioning quotas among exporting countries also involves interference with the market mechanism. Maintaining historical market shares in the allocation process discriminates against new exporters while changing market shares is subject to discretionary decision-making. At the same time, the decisions taken will be influenced by the bargaining power of the importing country and the actual and potential exporters, respectively, generally favoring larger countries over smaller ones.

In cases where both parties can inflict damage, the possibility of retaliation will arise. An example is Australia threatening to impose embargo on uranium in retaliation to European restrictions on steel imports. A retaliatory motive is also apparent in the imposition of antidumping duties by the Common Market on kraftliner-paper imported from the United States in early 1978 as the U.S. had used similar measures against European steel products.

There is further the danger of a cumulative process. Thus, while George Meany, the Secretary General of the AFL-CIO called for "fair trade -- do unto others as they do to us, barrier for barrier, closed door for closed door" (Business Week, December 26, 1977), measures taken by the United States for alleged offenses by others are bound to elicit foreign reactions. Apart from retaliation, this may take the form of imitative action as in the case of the imposition of trigger prices in the framework of the so-called Davignon Plan for the Common Market steel industry.

International trade is also affected by government aids to domestic industry, which have come into increased use in recent years. Apart from distorting competition among firms located in different countries, these
aids represent a further increase in the role of the state in economic life and extend the scope of bargaining. Thus, the government may wish to obtain a quid pro quo for its aid in the form of stipulated levels of employment, the regional allocation of production etc. At the same time, within particular industries, inducements are provided for collusive action to divide up the "spoils" and to increase bargaining power vis-à-vis the government.

Moreover, government aids become the subject of policy competition in the international arena. This first occurred in the case of shipbuilding as, Japan excepted, substantial subsidies have been provided to the industry in all producing countries. Policy competition has further been extended to new technologically advanced industries, such as computers and integrated circuits and, more recently, to some "old" industries, such as steel and textiles.

Note may further be taken of implicit subsidies provided in the form of preferential export credits where, despite the efforts made, the coordination of policies has not been accomplished. In fact, export promotion measures are coming into increasing use, as evidenced by a statement made by K. H. Beyen, State Secretary for Economic Affairs in the Netherlands: "Rather reluctantly, we have been forced to give a certain amount of assistance to our exporting industry when it is threatened with distortion of competition by measures taken in other countries." (Barron's, April 24, 1978).

The dangers of policy competition were first recognized by Richard Cooper in the mid-sixties, when this existed only in an embryonic form.1/ More recently, Assar Lindbeck pointed to the dangers of the trend towards greater government intervention and policy competition. In Lindbeck's

view, "It could be reasonably argued that future conferences on international trade should perhaps concentrate on reducing various selective subsidies rather than cutting tariffs. That would have the additional advantage of perhaps stopping, or even reversing, the enormous concentration of economic powers to central planning administration and politicians, which is perhaps the major consequence of our societies of selective interventions."1/

The international organization of trade has been proposed, in part, in order to limit policy competition. It also represents a natural outgrowth of collusive action on the national level, inasmuch as national cartels would have limited power in an international economy characterized by strong trade ties among the countries concerned. Orderly marketing arrangements and other forms of quantitative restrictions, entailing the division of markets among exporting countries, too, gave an impetus to the international organization of trade.

These developments are apparent in the European Common Market, where measures taken on the national level to provide financial aid to particular industries and to limit imports have given rise to efforts at cartelization and trade restrictions on the Common Market level. Proposals for cartelization have come from the EEC Commission in the guise of the rationalization of industry as well as from industries that expect to benefit from cartelization. Apart from the shipbuilding, steel, and synthetic fibers industries, such proposals have been put forward in regard to automobiles, chemicals, and shoes (Business Week, March 27, 1978).

The Common Market experience points to the tendency of cartelization to spread among industries. This may occur along the chain of input-output relationships as the cartelization of an input-producing industry affects the costs of the input-using industry, or, in the form of imitative behavior.

At the same time, cartellization tends to engender price increases\(^1\) while hindering long-run improvements in productivity that may have been its raison d'ètre in the first place. This is because, under market-sharing arrangements, producers would derive little benefit from improving productivity as they are enjoined from expanding their sales, whereas higher-cost firms can continue their operations without having to fear competition from lower-cost rivals.\(^2\)

An oft-cited example is the limitations imposed on the sales of small and medium-scale steel producers in Italy's Brescia region, who produce reinforcing rods and various other steel products in the framework of the EEC steel cartel. In an effort to maintain market shares, larger firms in the EEC countries that had higher production costs objected to sales by the Bresciani producers at low prices. The process of bargaining, in turn, has been affected by political considerations, in part because several of the high-cost firms are state-owned and in part because the governments of the individual countries wish to defend the interests of their national industries.

Similar problems are bound to arise in the framework of the recently established cartel of the eleven largest EEC producers of synthetic fibers, which would freeze existing market shares. With small European producers and the European subsidiaries of American companies not being a party to the agreement, and non-European producers having different objectives, the potential for conflict is considerable.\(^3\)

\(^1\) In this connection, note that prices paid for steel, as opposed to list prices, reportedly increased by 7 to 20 percent in the EEC between November 1977 and April 1978 while there was little change in sales (The Economist, May 13, 1978).

\(^2\) For an excellent discussion, see Jan Tumlir, "The New Protectionism, Cartels, and the International Economic Order," op. cit.

\(^3\) According to press reports, while "one commission official closely involved in the arrangement said he hoped that the United States companies would abide by the rules," the manager of one of the subsidiaries stated that he "will operate on the basis of a free market" (New York Times, May 17, 1978).
The difficulties multiply if the organization of trade or production is attempted on the world level, where the decisions concern not only the division of markets among the producers of a single country or of the European Common Market but among producers of the major developed and developing countries. Bargaining and international politics will now increasingly take the place of market forces, with a tendency to freeze existing patterns, thereby discriminating against new producers, obstructing changes in comparative advantage, and foregoing the benefits that may be obtained from shifts to lower-cost sources.

The Employment Argument

The deficiencies of national and international cartels are well-illustrated by the experience of the depression of the thirties. However, just as in the thirties, the argument has been put forward that there is need for cartelization for the sake of employment that is threatened by foreign competition.

In recent years, employment arguments have been directed largely to the developing countries that are said to be encroaching on the markets of the developed nations and to have contributed to unemployment in the latter. This contention leaves out of account the increase in employment that is generated in the developed nations' through their exports of manufactured goods to the developing countries. In fact, since the oil crisis, these exports have increased more than the imports leading to a substantial improvement in the trade balances of the developed nations with the non-oil producing developing countries in manufactured goods. The relevant figures for 1973 and 1976 are $3.0 and $5.3 billion in the United States, $11.3 and $16.5 billion for the European Common Market, and $7.7 and $13.2 billion for Japan.

It may be conjectured, then, that during the period of the 1974-75 recession and its immediate aftermath, employment in the developed nations actually benefited from trade in manufactured goods with the non-oil producing countries. This result reflects the fact that the developing countries spend


practically all their foreign exchange earnings and that they have borrowed additional amounts on foreign financial markets. Such borrowing, and the continued economic growth of the developing countries, are in turn predicated on their success in exporting.

Note further that the developing countries have assumed increasing importance as markets for the manufactured exports of the developed nations. In 1976, the share in these exports, excluding trade between USA and Canada, as well as within and between EEC and EFTA, was 27.9 percent for the non-oil producing developing countries and 45.7 percent if exports to the oil-producing developing countries are added. 1/

It appears, then, that the developed nations have benefited from the continued economic growth of the developing countries during and after the 1974-75 recession. As these conclusions refer to export and import-competing industries combined, one further needs to consider, however, the employment effects of trade on import-competing industries. Available data indicate that fears on the loss of employment in these industries, too, have been exaggerated.

Thus, the findings of various studies indicate that the decline in employment due to import competition is generally small compared to that due to technological change. According to the results of studies sponsored by the International Labor Office, the total elimination of barriers to

imports from developing countries would lead to a 1.5 percent decline in manufacturing employment spread over 5-10 years in the developed countries. By contrast, technological change associated with increases in productivity entails an annual displacement of labor of 3 to 4 percent.

These findings have been confirmed by studies of British industries that are particularly sensitive to import competition. Thus, "detailed analyses of the Lancashire cotton textile industry and Dundee jute point to the dominant role of technical change -- in the form of competition from synthetics in both cases and, for cotton textiles, from labor-saving investment -- as a cause of labor displacement." On the basis of more recent data, the conclusion is reached that "it is difficult to suggest that any labor-intensive sector except men's shirts and suits suffered between 1970 and 1975 from exceptionally damaging import growth" and that in the textile yarn, fabrics, clothing, and shoe industries, taken together, "productivity growth emerges as twice as important as trade factors in job replacement", when "the job loss annually from ldc import competition (less exports to ldcs) is little more than 1.5 - 2% in the worst case, clothing, 0.8% annually for cotton textile fabrics, 0.4% for footwear, and negligible for textile yarn."\(^3\)

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Also, during the 1963-71 period in the United States, "The loss in job potential in import-competing industries due to foreign trade has averaged about 44,000 jobs per year -- about 0.2 percent of total manufacturing employment and an even more minute fraction of the total U.S. labor force. The loss of job potential due to increased labor productivity was about six to nine times as great as the loss due to foreign trade in import-competing industries." At the same time, one-half of the estimated job loss was related to imports from developing countries.

Employment losses associated with increased imports from developing countries are likely to have been larger in recent years. However, it should be recognized that, with these countries spending practically all their foreign exchange earnings, restrictions on imports from the developing countries only shift unemployment from import-competing to export industries in the developed nations. Now, as the former rely more on unskilled and the latter on skilled labor, the upgrading of the labor force of the developed countries is obstructed as a result, leading to losses in real incomes. As Jan Tumlir eloquently expressed it, "Unemployment is fungible; the jobs which protection could save at the import-competing end of the industrial spectrum would be balanced out by the jobs foregone at the exporting end. The latter are higher productivity jobs requiring better education, high skills ... Protection thus restricts an economy's capacity to provide adequate employment for the higher skilled and better educated ..." 

IV. Conclusions and Policy Recommendations

The Risks of Protectionism

It has been shown that considerable progress was made in trade liberalization during the postwar period until the oil crisis and the recession of 1974-75. The developed countries eliminated quantitative import restrictions imposed during the Second World War and substantially reduced tariffs on raw materials and on manufactured goods. Furthermore, an increasing number of developing countries adopted export-oriented policies, accompanied by reduced protection.

Trade liberalization led to the rapid growth of world trade. The expansion of world trade, in turn, contributed to economic growth in developed and developing countries alike. For one thing, export expansion favorably affected the growth performance of the developed nations. For another thing, economic growth in the developed nations was transmitted to the developing countries through trade and provided opportunities to these countries to successfully carry out export-oriented policies.

The experience of the first three postwar decades contrasts with that of the depression in the nineteen-thirties, when the imposition of nontariff barriers, the "rationalization" of production, and the establishment of international cartels contributed to the decline in world trade.¹ The nontariff barriers employed during the depression included increased reliance on countervailing and anti-dumping duties, as well as formal and informal (or "voluntary") quotas.² Governments also provided aid to their industries in the guise of rationalization and a number of international cartels were formed.³

¹ Between 1926-29 and 1931-35 world trade in manufactured goods fell by 28 percent (League of Nations, Industrialization and Foreign Trade, Geneva, 1945, p. 157) — As beforehand data are expressed in constant prices.


³ Cf. e.g. G. W. Stocking and M. W. Watkins, Cartels in Action, New York, Twentieth Century Fund, 1946.
It has been estimated that 42 percent of world trade between 1929 and 1937 was cartelized or was subject to cartel-like arrangements. The League of Nations reports that "international cartels have actually been established in all branches of industry and at practically all stages of production, from industrial raw materials to different types of producers' and consumers' finished goods; minerals and metals and their products; wood, wood-pulp and different kinds of paper; textiles; chemical and pharmaceutical products; glass, earthenware and porcelain; electrical goods, etc. Among the products covered by international cartels, manufactures are preponderant." Nontariff measures and government aids have again come into increased use since 1974 and efforts have also been made to establish international cartels and cartel-like arrangements. The employment of these measures has, in turn, contributed to a slowdown in world trade. In particular, while world trade rose by 11 percent in 1976, the increase was only 4 percent in 1977 when protectionist actions increased.

The comparisons with the nineteen-thirties should not be interpreted to mean that the measures applied in recent years would be comparable in magnitude. Also, there is still hope that the Tokyo-round of tariff negotiations will succeed. But, tariffs pale in importance compared to the measures of the "new protectionism." Moreover, the experience of the nineteen-thirties indicates the economic costs involved in the application


of these measures and the danger that they will multiply through retaliation and imitation.

**Policies for Long-Term Growth**

Just as in the nineteen-thirties, protectionist measures have been invoked on the grounds that imports are responsible for the loss of jobs. This argument is obviously incorrect as far as trade among the developed countries is concerned as the expansion of this trade does not lead, on balance, to a decrease in employment opportunities in the developed world.

Nor is the argument valid as far as trade with the developing countries is concerned. Between 1973 and 1976, the exports of manufactured goods from the developed nations to the developing countries increased substantially more than their imports of manufactured goods from these countries. It would appear, then, that manufactured trade with the developing countries is likely to have been favorable, rather than unfavorable, for employment in the developed nations. Also, available evidence indicates that in import-competing industries the loss of jobs due to increased imports has been relatively small compared to the effects of technological change.

The high rate of unemployment in the developed nations, then, cannot be attributed to international trade. Rather, unemployment has been the result of the policies applied by these countries, which have unfavorably affected domestic production and investment in particular in Western Europe and Japan.\(^1\) Nor can one expect that protection would reduce unemployment; it will only shift unemployment from lower-skilled labor used in import-competing industries to higher-skilled labor used in export industries.

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Apart from employment considerations, the desire on the part of the individual countries to improve their balance-of-payments position has created pressures for the application of protectionist measures. We find a "fallacy of composition" here as protectionist actions taken by any one country can improve its position only temporarily as the OPEC surplus must be matched by the collective deficit of the non-oil countries.

At the same time, the taking of protectionist actions by a number of countries simultaneously cannot fail to be detrimental to all. National incomes will be lower as a result since resources are not used to best advantage and potential economies of scale obtainable in export industries are not exploited. Furthermore, protection reduces the pressure for productivity improvements in import-competing industries whereas possible improvements in export industries are foregone.

The application of protective measures is also likely to adversely affect investment activity in the developed nations. While protection may not lead to increased investment in high-cost import-competing activities which have a precarious existence, it may discourage investment in low-cost export activities which suffer discrimination under protection. The direct subsidization of high-cost activities from government funds will have similar effects by syphoning off funds that could have otherwise been used for investment in low-cost activities.

While protection tends to lower the rate of economic growth through its adverse effects on national income and investment activity, measures aimed at accelerating economic growth would lessen pressures for protection. Such measures, involving increased inducement to investment and lessening the rigidities introduced through government measures and labor legislation, would have to be carried out with special vigor in the surplus.
countries, particularly Germany and Japan, both to offset the deflationary
effects of the appreciation of their currencies and to reduce asymmetries
in the balance-of-payments of the developed countries.\textsuperscript{1/} At the same time, it should be recognized that the deficit vis-à-vis OPEC is not immutable as there are possibilities for reducing the imports of energy. This would require, in particular, the adoption of appropriate policies in the United States to lower the consumption, and to increase the production, of energy.

\textbf{Problems of Adjustment}

It has been concluded that, in leading to higher incomes and employment, growth-oriented policies would reduce protectionist pressures in the developed countries. In turn, the avoidance of protectionism would contribute to economic growth that requires a continuing transformation of the industrial structure, entailing shifts from lower to higher productivity activities.\textsuperscript{2/} This conclusion also applies to the developing countries whose economic growth depends to a considerable extent on the availability of trade opportunities in the developed countries as well as on their own policies for making use of these opportunities.

More generally, trade permits economic growth to proceed in the world economy through shifts in product composition. This entails the developed countries increasingly specializing in research and technology intensive products; the semi-industrial developing countries upgrading their exports which are now based largely on unskilled labor; and the less developed countries proceeding to export unskilled-labor intensive manufactures.\textsuperscript{3/}

\begin{enumerate}
  \item For a detailed discussion, cf. "The Locomotive Theory: An Eclectic View" \textit{op. cit.}
\end{enumerate}
Structural transformation cannot proceed smoothly and creates problems of adjustment in industries that decline in absolute or in relative terms. Adjustment problems, in turn, have often given rise to efforts to reduce the speed of adjustment. This has been the case, in particular, when adjustment in developed countries was presumed to have been triggered by increased imports.

The objective of reducing the speed of adjustment has been pursued by the measures of the "new protectionism" as well as by adjustment assistance as it has been applied in practice in most developed countries. Thus, in reporting the results of a comparative study, Goran Ohlin concludes that "adjustment assistance seems in practice often designed to bolster the defences against imports rather than to clear the ground for them and public policy has sought to delay the transfer of resources."¹/

In this connection, several questions need to be raised, including the appropriate purpose of adjustment policies, the choice between import restrictions and adjustment assistance, as well as the choice of the particular measures to be employed. These questions will be taken up briefly in the context of the industrial transformation of the developed countries.

As to the first question, adjustment policies that artificially bolster employment and raise profitability in high-cost industries by reducing the cost of labor and other inputs or by increasing the price received by producers, run counter to the process of industrial transformation that is necessary for continued growth. Rather, policies should aim at promoting the movement of resources from lower to higher productivity activities.

Nor should one single out imports as being the cause of reduced employment and profitability as, more often than not, this has been the result of technological change. Also, it is incorrect to argue that losses suffered by domestic nationals due to increased imports require different treatment than losses due to technological change on the grounds that the beneficiaries are foreign nationals in the first case and domestic nationals in the second. In fact, with higher imports leading to increased exports in the process of adjustment, the beneficiaries will be domestic nationals in the first case, too.

In view of these considerations, it is preferable to use adjustment assistance rather than import restrictions to ease the problems of adjustment to changing conditions in domestic industry. The question remains, however, what kind of adjustment measures, and government aids in general, should be utilized for this purpose.

It has been suggested that the measures applied should promote the movement of resources from lower-productivity to higher-productivity industries. This is in the interest of the developed countries as it contributes to improved resource allocation and rapid economic growth. It is also in the interest of the developing countries because of the gains they can obtain through international specialization. The community of interests is further enhanced by reason of the fact that, in contributing to the foreign exchange earnings of the developing countries, the application of the proposed measures would permit them to avoid high-cost import substitution policies that would have adverse effects for all.
The described objectives would be served if, rather than subsidizing production and employment in high-cost industries, the developed countries were to encourage the expansion of efficient activities and ensure the transfer of resources to these activities. Appropriate measures include reducing government-induced rigidities in labor markets, retraining workers, and promoting research and development.

Establishing an International Code of Good Conduct

It has been concluded that adjustment assistance will be preferable to import restrictions for easing the adjustment of domestic industries. Nevertheless, adjustment assistance may not carry the entire burden, especially if sudden changes in trade flows occur, necessitating the use of safeguard measures to limit the growth of imports. At the same time, the application of these measures should be made subject to internationally-agreed rules.

Article XIX of GATT provides an international code for the application of safeguard measures. This article has rarely been applied, however, in part because a country invoking it risks retaliation and in part because import restraints are to be imposed in a nondiscriminatory fashion. Rather, countries have invoked safeguard measures by unilateral action or on a bilateral basis.

Article XIX would need to be reinterpreted, so that it becomes a credible instrument which can replace presently applied national safeguard measures. One should also avoid making it overly restrictive. Finally, safeguards should remain temporary, which is not the case under Article XIX.
These objectives would be served by retaining the "injury clause" in Article XIX while leaving it to appropriately constituted institutions in the individual countries to judge whether injury has been sustained or threatened and to determine the measures to be employed. Decisions by national bodies should, however, be subject to multilateral surveillance in the sense that exporting countries would have the right to retaliate if an international committee established for this purpose finds that safeguard action was not warranted or the measures used were excessive.

Also, while it would be desirable to maintain the nondiscriminatory application of safeguard measures, at the minimum no exporter should be required to reduce its share in the domestic market of the country concerned. At the same time, imports from new developing country producers should not be subjected to limitations. Finally, the temporary nature of the safeguard measures would be expressed by their limited duration in time; the progressive liberalization of import restrictions during the time period of their application; and the exclusion of the reimposition of the safeguard measures.1/

Export subsidies, too, are subject to international rules under Articles VI and XVI of GATT. However, there would be need to establish stricter obligations for developed countries and to introduce exceptions for developing countries. At the same time, these exceptions would be circumscribed so as to ensure that the subsidies applied by developing countries compensate for, but do not create new distortions, with progressively stricter rules

1/ On the last point, the paper follows suggestions made in an unpublished memorandum by Isaiah Frank.
applying when developing countries showed superior competitiveness in some products. And, finally, in regard to export subsidies other than those for which developing countries are granted exceptional treatment, it would be desirable to make claims for injury subject to internationally agreed rules, with international surveillance of the manner in which they are administered.

It would further be desirable if, in addition to safeguard measures and export subsidies, the international code of good conduct covered adjustment assistance and government aids in general. This is because government aids affect foreign producers in domestic and foreign markets and they have increasingly become subject to international policy competition.

As regards adjustment assistance, governments may agree to forego taking measures that hinder the movement of resources from low-productivity to high-productivity industries. In turn, positive measures aimed at encouraging the movement of resources should have general incidence affecting all industries in the same way, so that the choice among alternative activities is left to the market mechanism.

There may be cases, however, when the market does not fully anticipate future needs and the application of measures affecting specific industries could not be foregone. Also, assistance to depressed regions can be considered admissible to the extent that such assistance corrects for existing distortions or serves social goals. Finally, whatever its rationale, there exist in most countries rules of government procurement favoring domestic industry.

An international code of good conduct should provide, first of all, for transparency in the matter of government aids. This would take the form
of making explicit the measures actually applied by incorporating them in public regulations, whenever this is not presently the case. Secondly, the budgetary cost of aids provided to specific industries and regions should be estimated as this is done in the Report on Subsidies in Germany and in Economic Impact Statements in the United States. Thirdly, it would be desirable to undertake commitments to "freeze" the status quo as regards government aids in the same way as tariffs are bound in GATT. Finally, some general rules should be defined on the use of government aids by individual countries.

Greater transparency, estimating the budgetary cost involved, freezing the status quo, and establishing general rules on their application would provide a basis for negotiating reductions in government aids. Such negotiations may be initially undertaken by the developed countries, and patterned on actions taken in the framework of the European Common Market. They would necessitate establishing a machinery, possibly in the framework of the OECD, to provide international surveillance of the application of government aids as well as a forum for continuing discussions and negotiations.

The Tokyo Round negotiations provide an opportunity for establishing an international code of good conduct on safeguards, export subsidies, and government aids. This may take the form of an interpretation of GATT regulations, so as to avoid the difficulties involved in changing the existing provisions of the General Agreement.

Parallel with these efforts, it would be desirable to reach agreement on across-the-board reductions in tariffs and on lessening disparities in tariffs on individual products. Furthermore, it would be desirable to liberalize trade in agricultural commodities, in particular in products of export interest to the developing countries.
Policies by Developing Countries

Developing countries have a considerable interest in establishing acceptable and credible international rules on the application of measures affecting their exports. The exports of these countries have been repeatedly curbed by the imposition of restrictions by the developed countries; they have little bargaining power to forestall the application of new restrictions on particular commodities; and the threat of the imposition of restrictions creates considerable uncertainty for them. Developing countries need a stable environment in which the shifts in the international division of labor necessary for their rapid economic growth can take place.

At the same time, developing countries would be well-advised to avoid demanding unilateral concessions that would jeopardize the establishment of international rules, since they stand to lose more through the continuation and the extension of the "new protectionism" than what they may gain from any concessions. Nevertheless, while individual developing countries have little bargaining power, they could influence the outcome by adopting a joint position. The same observation applies to tariff reductions in the Tokyo Round, where developing countries could press for reductions on items of export interest to them.

In this connection, it should be emphasized that developing countries have much more to gain from multilateral tariff reductions than from maintaining preferential margins, on which UNCTAD efforts have concentrated in recent years. This is because tariff reductions do not involve quantitative limitations on trade and are not reversible while imports under preferences are subject to quantitative limitations and can be revoked on short notice.
Semi-industrial developing countries would also be well-advised to reduce existing protection. To begin with, the existence of high protection in some of these countries is used as an argument for protection in the developed nations. Furthermore, offers made to reduce trade barriers would strengthen the bargaining position of the developing countries in the Tokyo Round of negotiations. Finally, lowering protective barriers would lessen the need for (explicit) export subsidies that are threatened by countervailing action. This would mean putting greater reliance on the exchange rate since one may compensate for reductions in import tariffs and export subsidies by a devaluation.\footnote{For a detailed discussion, see Bela Balassa, "Export Incentives and Export Performance in Developing Countries: A Comparative Analysis," Weltwirtschaftliches Archiv, March 1978.}

Semi-industrial developing countries would also be well-advised to enter into bilateral agreements with developed nations on liberalizing trade as it has recently been done in U.S.-Mexico relationships. This would be of especial importance as far as trade with Western Europe is concerned. In this connection, it should be recognized that several of the semi-industrial countries have sufficiently large markets so that they can offer meaningful concessions.

At the same time, the chances for avoiding the imposition of restrictions would be increased if semi-industrial developing countries upgraded and diversified their exports. In particular, it would be desirable to expand the exports of commodities where firms in developed countries can respond
by changing their product composition, which is not possible in industries consisting largely of one-product firms, such as textiles, clothing, and shoes. The possibilities of expanding exports without encountering restrictions would be further increased by diversifying export markets, in particular by seeking export outlets in the rapidly growing OPEC countries.

Finally, it would be desirable that semi-industrial developing countries gradually abandon the exports of simple, unskilled-labor intensive manufactures for the benefit of countries at lower levels of development. The latter countries, in turn, would have to follow appropriate policies that would not discriminate against exports.
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