Trade Policies & Developing Countries

Alan Roe

EC205

2005-06

Some materials from Elwyn Grainger – Jones, World Bank

Trade Policies & Developing Countries - Topics

1. A Few Facts/Trends
2. The Evolution of Attitudes to Open Trade 1950-2004
3. Typical Developing Country Policies pre-circa 1980
4. The Negative Consequences of these
5. The Reform Agenda 1980 through today (important but not discussed in lectures)
6. Trade Issues Today, WTO and China

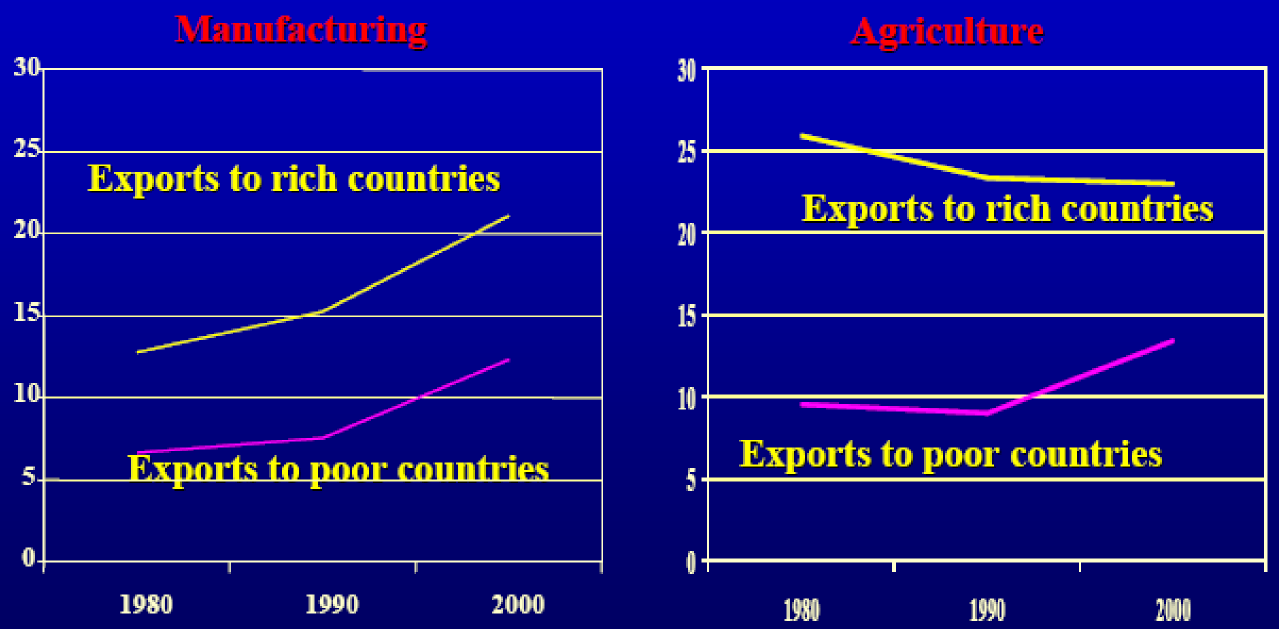
Topic 1: A Few Facts and Trends

- Subsequent rounds of GATT and WTO agreements have brought Industrial Country tariffs to very low levels & with few quantitative controls (2-3%)
- Exceptions are Agricultural Goods and Textiles via Multi-Fibre Agreement
- In addition most developing countries receive significant tariff preferences on Industrial Goods.

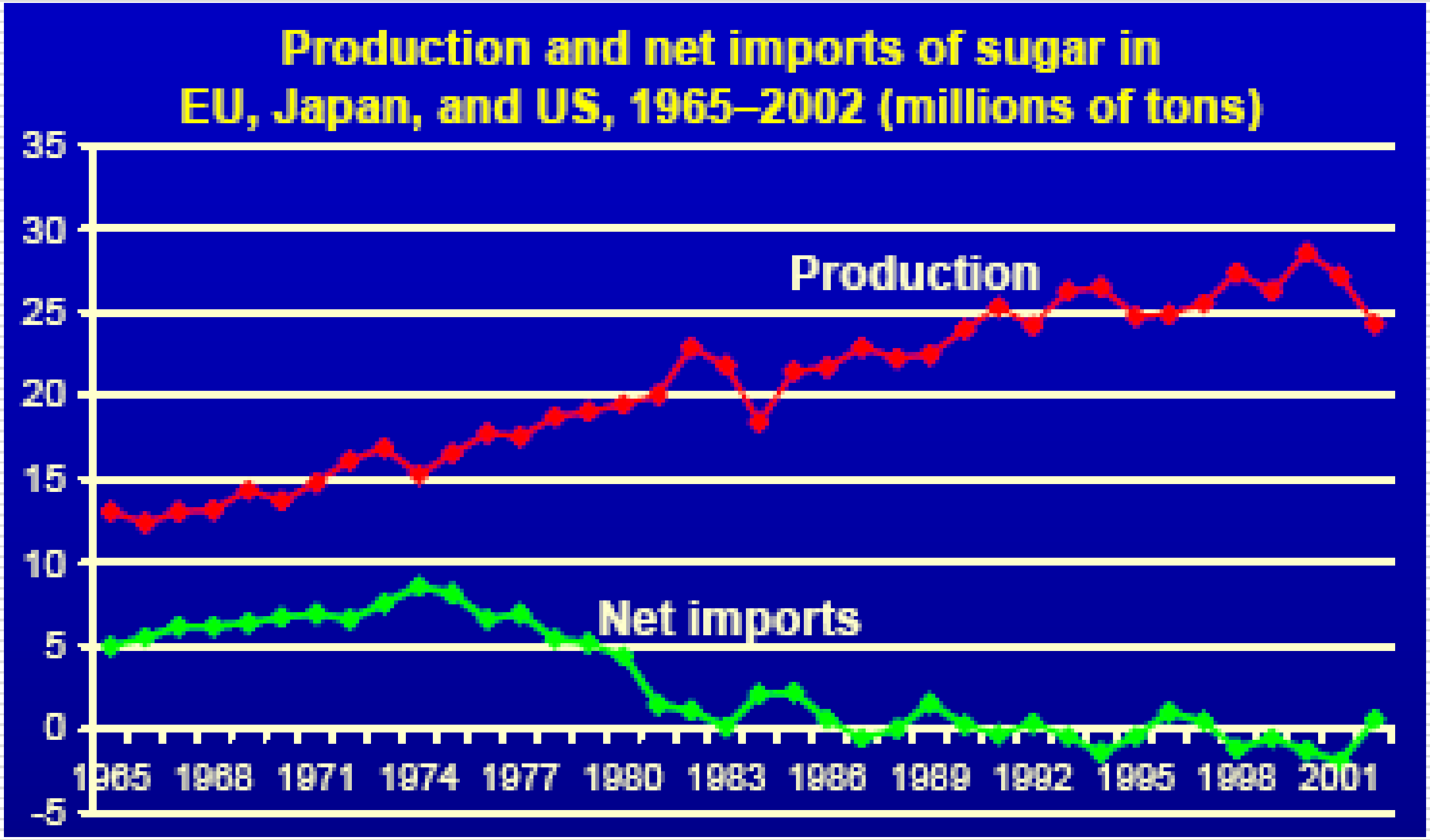
Realizing the Promise of the Doha Agenda

Developing countries have failed to penetrate agricultural markets of rich countries

Developing countries' share of total world exports



Western Protection pushes net imports to zero for some agricultural commodities



A Few Facts
(Source M. Moore, *A World Without Walls*, 2003)

- Tariffs on INDUSTRIAL products are far lower in rich developed countries than in poorer developing countries (the average “bound” tariff in 2001 was 3% and 3.6% in US and EU respectively versus 12 % or more in developing countries (much higher in the non-liberalising ones)
- But inequities unfavourable to poor countries are huge (e.g. in USA 50% of all tariff revenues come from *foods,clothing and shoes* that account for only 6.7% of all US imports. Cambodian imports to the USA of T-shirts and baseball caps paid $150 million in tariffs on £942 million of imports. Singapore sold **$15 billion** of semi-conductors, medical equipment etc and paid only $96 million in tariffs)=HUNDRED TIMES AS MUCH

Continued

- Developing country exports accounted for 15% of rich country imports in 1990 but 25% by 2000. For the USA and Japan those shares are now 45% and 50% respectively. HUGE SUCCESS BY ANY STANDARDS - But huge concentration on successful exporters such as China
- In the past decade the export growth of developing countries has persistently exceeded that of the richer countries (10% per annum versus 5% per annum) and trade between developing countries is growing even more quickly.
- The environment of global protection was substantially more restrictive in the 1960s and 1970s when Hong-Kong, Korea, Singapore etc made their big break through in export growth (see table attached) c.f POPULAR PERCEPTIONS
- The fastest growing exporters are much less protectionist than countries/regions that fail in this regard (see table attached comparing Africa and East Asia)
- The annual CHANGE in Korean exports is typically larger than the total VOLUME of all non-oil exports from Africa

WTO/GATT Membership

- The proposed World Trade Authority of the 1940s was aborted and instead the General Agreement on Tariffs and Trade (GATT) was launched in 1947 alongside the IMF and the World Bank
- In 1947 it had only 23 members and failed to embrace any of the countries of the USSR or Eastern Europe as well as China
- Today membership totals 144 countries many countries of Eastern Europe joining in the past five years. China has been a member since 2003. Discussions with Russia and Ukraine have begun
- Membership of 170 countries or more is anticipated by 2010

So WTO rules and authority increasingly cover the World as a whole

WTO mandate and methods

- From 1947 until 1995 when the WTO was established, GATT operated through periodic “Rounds” of tariff reduction negotiations (e.g. Kennedy, Tokyo, Uruguay rounds) narrowly focused on trade in ***industrial*** goods. These have achieved a huge overall reduction in levels of protection of industrial goods (with the notable exception of textiles)
- Negotiations then and now involve :
  - Consensus decision-making (**one country one vote**)
  - “**Most-favoured nation**” principle of non-discrimination in tariff setting (note that this is not the same as harmonisation of e.g. tariffs)
  - **“reciprocity”** in tariff/quota reduction offers albeit with explicit understandings since 1964 that poorer economies are not expected to offer full reciprocity
  - A strong preference for tariffs as the means of ongoing protection rather than import quotas

The extension of the mandate by the Uruguay Round (1994)

The long-drawn out Uruguay Round (begun in 1986) finally concluded in 1994. This agreement extended the WTO mandate to include:

- Trade in Agricultural Goods
- Trade in Textiles
- Trade in Services (e.g. telecoms and finance)
- Rules about Intellectual Property
- Rules about subsidies that could impact trade

Significantly Uruguay also

- Formally established the WTO (in 1995)
- Established a formal **Disputes Resolution Mechanism** (that was lacking in GATT)

The breakthrough for developing countries with the Doha Development Agenda (Nov. 2001)

This Ministerial Conference successfully launched the first major new trade Round since Uruguay in 1986. If offers developing countries:

- Agriculture. The negotiating agenda provides for the phasing out of all forms of rich country export subsidies and domestic farm support (a cost to the budgets of rich countries of around $1 billion per day) and huge unfair competition for competing *developing* country products
- Services. A developing country sensitive faster liberalisation of trade in services such as telecomms, finance, transport and other business services that has huge potential to lower the costs of doing business. Gains of around 2-4% of GDP are likely for countries such as India and Thailand
- Large number of resolutions designed to make implementation (a) easier for and (b) more favourable to developing countries plus major strengthening of Technical Assistance support in trade.

WTO Current Round – Doha – ends 2005

Big Ministerial Meeting in Hong Kong in December

……….– so watch this space and read the Economist or the Financial Times

Topic 2: The Consensus of the 1950s and 1960s

This was very much based on

- The prevailing global context of controls that was a legacy of World War 2
- The experience of the USSR that autarky could be an effective way to transform and agricultural society to an industrial one *(But how big is the USSR compared to, say, Tanzania)*
- The dominant role of the early Indian philosophy of development based on the thinking of J. Nehru

The Indian Congress Consensus 1945-1974?

Industrialisation and New Technologies was Key to Development. And it Would Happen Much Faster than in C19th W. Europe

- **A Socialist State was Essential – Capitalism/Big Business were Suspect**
- **USSR had shown that State Planning was the route to Transformation from Agriculture to Industry**
- **International Trade was also Suspect – Autarky was preferred Route – Vent for Surplus was main mechanism**
- **Agriculture important for Poverty Alleviation but Price Mechanisms de-emphasised (Ghandi versus Nehru).** ***So OK to tax agriculture to help build industry.***

Factors that gradually Eroded Faith In “ICC” (1970-1982?)

1. **Schulz’s Results (1964) - the Recognition that Agricultural Decisions are Price Sensitive**
2. **Increasing Awareness of the great success of a few Export-based economies and the emergence of the “Four Dragons Consensus”**
3. **The in-depth Documentation of the Inherent Inefficiencies of the ICC Approach to achieve industrialisation – Little, Scitovsky et al (1970)**
4. **The Chronic Failure of the Developing-Country Response to the 1970s Oil Shocks and the Culmination of these in the 1982 Debt Crisis**
5. **The Model’s Failure to Improve Many Dimensions of Poverty/Deprivation (Inequality, Basic Needs, Employment etc)**

Comparing China and India 1980-2001

	1982-1986		*1987-1991*		*1992-1996*		*1997-2001*	
	China	India	**China**	India	**China**	India	**China**	India
Growth of Income per capita	**9.8**	2.8	**6.2**	3.3	**10.9**	4.7	**6.8**	3.3
Industrial Value-Added (% of GDP)	**44.0**	26.1	**43.0**	26.9	**47.5**	27.0	**50.3**	26.7
Agricultural Employment (% of GDP)	**62.5**	na	**55.3**	68.7	**50.0**	66.8	**46.6**	na
Exports (% of GDP)	**9.7**	6.0	**15.3**	7.1	**21.4**	10.3	**23.7**	12.4
Foreign Direct Investment (% of GDP)	**0.4**	0.0	**1.0**	0.1	**5.1**	0.4	**4.3**	0.6
Domestic Savings (% of GDP)	**34.4**	19.6	**36.6**	21.4	**41.5**	21.0	**41.1**	20.7
Fixed Investment (% of GDP)	**29.3**	20.0	**28.2**	22.0	**34.8**	22.7	**35.6**	22.0

Structural Aspects of China's Success

These data show that China's much higher growth of income per capita relative to India has been associated with:

- A far more rapid transformation of China's production *towards industrial products and a rapid decline in those dependent on agricultural employment* A very *rapid growth of Chinese exports* so that relative to GDP these are now twice the level of those in India
- A rising Chinese savings rate from a level already much higher than India's in 1982
- The successful attraction by China of much larger and *expanding volumes of FDI* ***($50 billion versus $5 billion for India)***
- Rising investment levels in China relative to GDP and relative to those achieved by India

Announcements

1. Evaluation form can be downloaded and submitted using “my.economics”. Please do this before the end of term or very early in the New Year

2. NO Lecture on Thursday this week Dec 1st

Topic 3: Typical Trade Policies in Developing Countries 1950-1990

1. Developing Country Import Barriers (Tariffs And Quotas) Have Often Been High
2. The Structure Of Effective Protection Has Often Been Irrational
3. Protection Of Industry Has Often Been Much Higher Than The Protection Of Agriculture
4. Protection Has Frequently "Taxed" Exports

Continued

5. Methods Of Protection Have Frequently Given Rise To Unproductive “Rent-Seeking “ Activities And Corruption

6. Protection Has Frequently Resulted In The Emergence Of Parallel “Black” Markets

Examples Of Protection Levels

Source 1. Little, Scitovsky And Scott, 1970 (Industry and Trade in Some Developing Countries, OUP)

(Averages)	EFFECTIVE.R.P (Slide 22)
Argentina	162%
Brazil	118%
Mexico	27%
India	313%
Pakistan	271%
Philippines	49%
Taiwan	33%

Typical Levels of Protection

Source 2. Balassa And Associates, Development Strategies in Semi-Industrialised Countries 1982

	Industry NRP (%)	Industry ERP (%)	Agriculture NRP (%)	Agriculture ERP (%)
BRAZIL	47	79	9	-7
MEXICO	10	21	-6	-11
PAKISTAN	31	92	-21	-43
PHILIPPINES	13	34	7	0
MALAYSIA	5	4	4	7

Source 3. World Bank 1997

	Tariff Average (%)	Tariff+ Other Charges (%)	Non-Tariff Coverage (%)
LOW INCOME AFRICA	28.6	34.3	40.6
SUB-SAHARAN AFRICA	26.8	33.4	34.1
FAST GROWING EXPORTERS	8.7	11.1	3.7
KOREA	11.1	12.3	2.6
SINGAPORE	0.4	0.4	0.3
THAILAND	8.5	8.5	5.5
Indonesia	17.0	20.1	2.7
MEXICO	13.4	16.9	3.9
HONG KONG	0	O	0.5
OECD	6.1	6.1	3.8

Negative Protection of Agriculture

See World Bank Box 5.4 from World Development Report 1982

Example of Effective Rate of Protection (ERP)

	Without Tariffs or Quotas		With Tf or Qf	add Tinput
			at 30%	at 10%
	World Price	Domestic Price	Domestic Price	Domestic Price
Shirt (Final Product)	100	100	130	130
Input Costs	60	60	60	66
Value-Added	40	40	70	64
Gross Output	100	100	130	130
		NRP = 0%	NRP = 130/100-1 or 30%	NRP = 130/100-1 or 30%
		ERP = 0%	ERP = 70/40-1 or 75%	ERP = 64/40-1 or 60%

Methods Of LDC Protection Of Trade

1. Frequent Preference For QUOTA Rather Than Tariff Protection

Consequences Include:

(I) Tighter Administrative Control Of Import Volumes

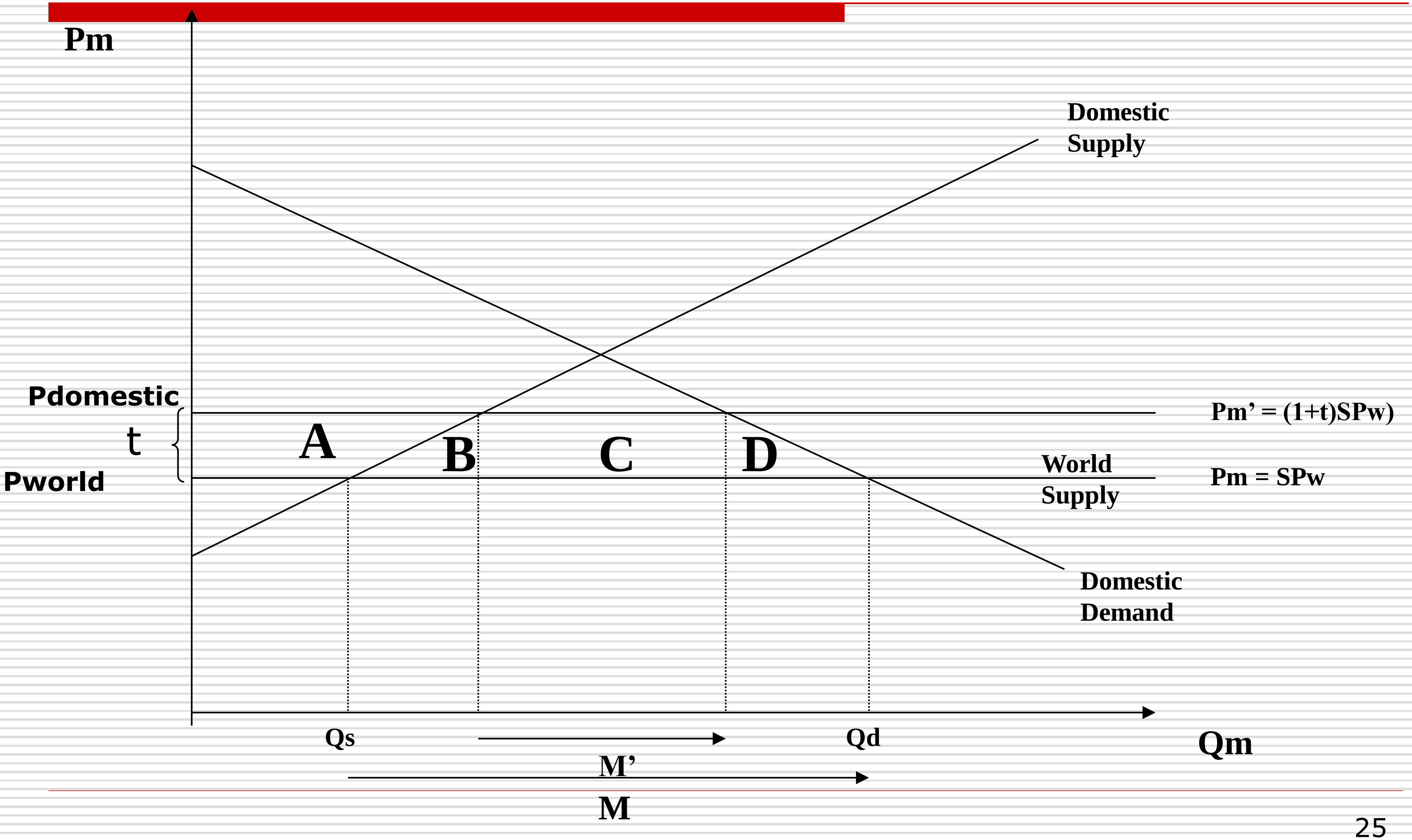
(Ii)Diversion of Tariff Revenues To Quota Rents - Private Incomes)

Main Down-Side

(A) Loss Of Potential Government Revenue

(B) Neutralisation Of Prices As A Means To Allocate Resources (Including Exchange Rate)

The Impact of Tariffs and Quotas



Topic 4: Consequences

Selected Consequences of the typical Trade Policies of the 1950-1980 period

See studies by Bhagwati and Krueger, Little, Scitovsky and Scott, and Balassa for more details on particular points

Common Effects of Quota Protection (QRs)

see Bhagwati and Krueger, Anatomy and Consequences of Exchange Control Regimes, 1978

1. **Proliferation of bureaucracies to adminster the QRs**
2. **Goods deemed "essential" by the bureaucracy come in at low prices (e.g. with low or zero tariffs and at the more favourable of two dual exchange rates)**
3. **"Inessential" goods become more scarce because of very high protection achieved via restrictive quotas. this gives a huge incentive to either produce these goods or to smuggle them.**
4. **The greatest production incentives are accorded to goods whose import is actually prohibited (i.e. effective rate of protection = infinity).**
5. **The smuggling of such goods is also accorded a very high incentive.[in short, the ranking of production incentives is the inverse of the priorities on imports assigned by the bureaucrats].**

India today as an Example –Jayanta Roy in Financial Express December 2003

"We still have poor infrastructure, cumbersome administrative procedures and below-average logistics. The administrative procedures associated with trade are probably the most primitive in the world. Even to just export, we require 257 signatures, 118 copies of the same document taking 22 hours to key-punch. This involves dealing with a multitude of GOI agencies separately! This evokes hardly a protest from established exporters who have mastered the knack of going around the system and having prompt clearance by paying bribes. But for new global players this is posing a major irritant. Clearance of shipments takes days in India as against hours in most successful exporting countries.

What has been our performance in relative terms? I am afraid, there is nothing to be excited about. Our annual export today is about $44 billion of goods as against $88 bn by Malaysia, $65 bn by Thailand, $160 bn by Mexico, $40 bn by Poland and $458 bn by China including Hong Kong. Our share in world exports is a dismal 0.7% as against 7.4% of China. Excluding Hong Kong, China's share is till over 5%.

The story is as dismal when we consider FDI. In terms of total FDI flows during 1997-2002, India attracted a mere $11 bn as against $165 bn by China, $115 bn by Brazil, $63 bn by Mexico, $20 bn by Thailand and $12 bn by Russia. Also, we still have the highest tariff wall with average tariff level of 30%, one of the highest in the world."

Active Use Of Explicit And Implicit Export Taxes- L. Sjastaad and K Clements, How Protection taxes Exporters,1984.

Why?

1. Primary exports provide one of the few easily accessed tax bases in developing countries. Examples include explicit export taxes, controlled pricing schemes including state marketing board arrangements.

2. Such taxes are consistent with the objective (of some developing countries) to favour new (industrial) activities over traditional export activities in the primary sectors

N.B in a two good world, an import tariff (subsidy to an import-competing industry) will have symmetrical resource-allocation effects to a tax on exports (the TWO goods are a locally produced good that can also be imported and a DIFFERENT export good).

Why Is All This Inimical To Growth?

Second and third stage import substitution requires progressively higher tariffs and quotas as production moves beyond

- **The Natural Resource Base**
- **The Available Technology In The Country**
- **The Established Skill Base**

In the country concerned (See Williamson And Milner Table 15.1)

Results Of The Escalating Protection Include

1. **Very Large Welfare Costs (See Tariff Diagram) hitting consumers hard**

2. Domestic Resource Cost (DRC) Ratios Well in Excess Of Unity (e.g. > 2 In Some Many Studies).

3.Lower Growth Rates Because Of The Inefficient Use Of Resources.

Summary to date

- Countries that adopted high rates of protection and the distortionary methods just described have invariably seen very poor growth performance and persisting poverty
- The need to reform (liberalise) is obvious but far from easy. Spectacular results where it has been done (East Asia including China) with major reductions of poverty incidence achieved
- But countries/regions that have reformed unsuccessfully or not at all face ongoing problems

The Real Exchange Rate In A Three Good Model

The Three goods are Exportables(exp), Importable (imp), Non-Traded goods (nt) (or "Home" goods)

The international ($) prices of both Importables (Pimp) and Exportables (Pexp) are set internationally

Their levels in local currency with ZERO protection/taxes/subsidies are:

Importables Pimp($) x Sn = Pimp(loc)

Exportables Pexp ($) x Sn = Pexp (loc)

where Sn is the nominal exchange rate

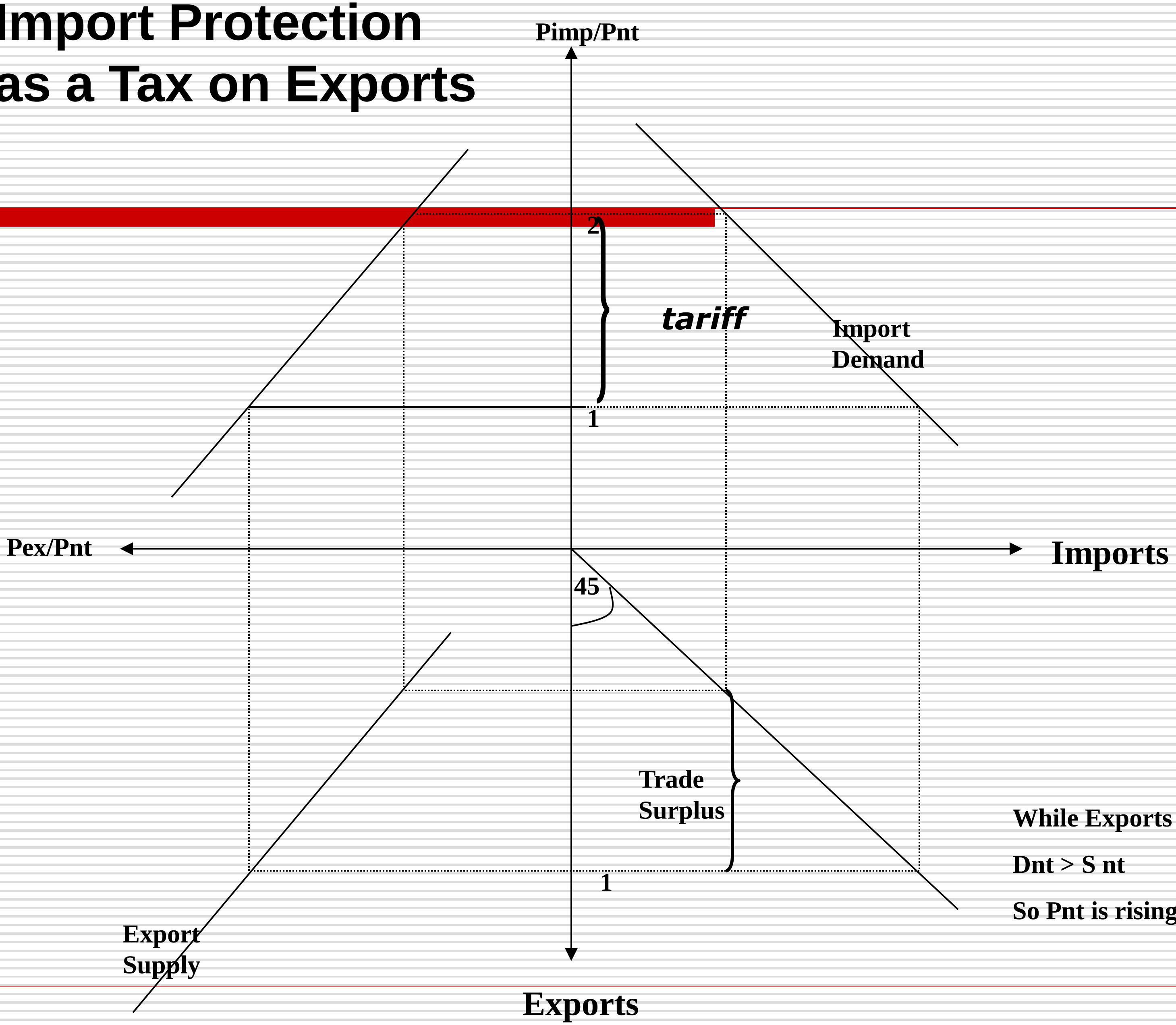
Continued

Devaluation/depreciation of Sn will increase these local currency values for any given $ price

But it is their <u>relative</u> prices (e.g. Pimp(loc)/Pnt) which determines the incentive to produce particular goods. with three goods defined we have <u>three</u> relative prices - two of these involve Pnt.

if there is any change in Pnt, the export and the import performance of the economy can be changed for any given values of Pimp(loc) and Pexp(loc)

Import Protection
as a Tax on Exports



While Exports >Imports

Dnt > S nt

So Pnt is rising

The Real Exchange Rate for Exports and Imports (Er(exp) and Er(imp))

These Are Defined As:

[Pexp ($) X Sn)/Pnt] and [(Pimp($) X Sn)/Pnt]

Policies which can affect the Real Exchange Rates without changing Sn include

A Tariff Or Quota On Imports will raise Er(Imp) = A depreciation but lower Er(Exp) = appreciation.

An Export Subsidy will raise Er(Exp) = A depreciation but an Export Tax will Lower Er(Exp)

Expansionary Monetary or Fiscal Policies by raising Pnt will lower both Er(Exp) And Er(Imp). That Is It Appreciates the Real Exchange Rates For Both Imports And Exports

Problems

Contradictory Policies Include:

Tariffs And/Or Quotas On Imports (= Depreciation Of Erimp) Combined With Fiscal Deficits And Rapid Monetary Expansion (= Appreciation Of Both Er(Imp) And Er(Exp).

But This Is A Package Favoured By Many Developing Country Governments.

Results Of Over-Appreciated Real Exchange Rate

- **Cumulative Decline Of Both Imports And Exports**
- **Elimination Of Profits Margin In Traditional Export Activities**
- **Great Incentive To Produce And Invest In Home Goods Production (Including Importables) Rather Than Non Traditional Exports**
- **Chronic Foreign Exchange Shortages Leading To Rationing Of Forex And Black Markets**
- **Collapse Of Fiscal Revenues From**
  - **(I) Import And Export Taxes**
  - **(Ii) Direct Taxes Due To Lower Incomes**
- **Increased Pressure To Finance Budgets Via Inflationary Methods**

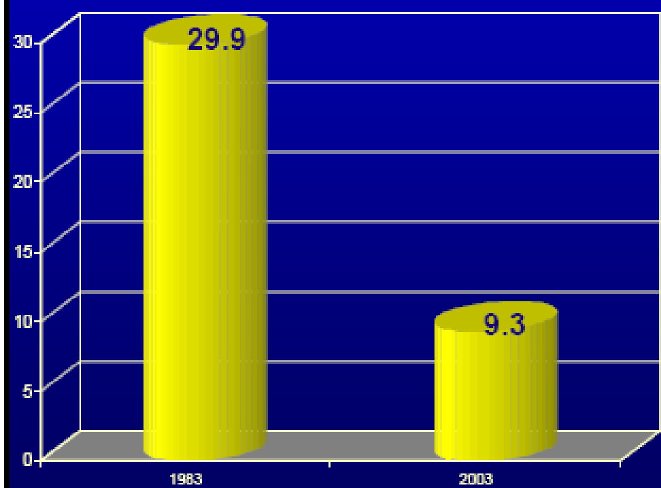
Topic 5: Liberalisation Tendencies 1980 to 2005

- These have been very substantial under the pressures of IMF and World Bank adjustment agendas (following the first debt crisis
- Liberalisation has been enhanced by the rapid moves of China to liberalise its economy and eventually join the WTO in 2002
- Similar trends are evident in the countries of the former Soviet Union and in Eastern Europe more generally
- But many lower-income countries have either held back from this trend or implemented it with very poor results (notably Sub-Saharan Africa)

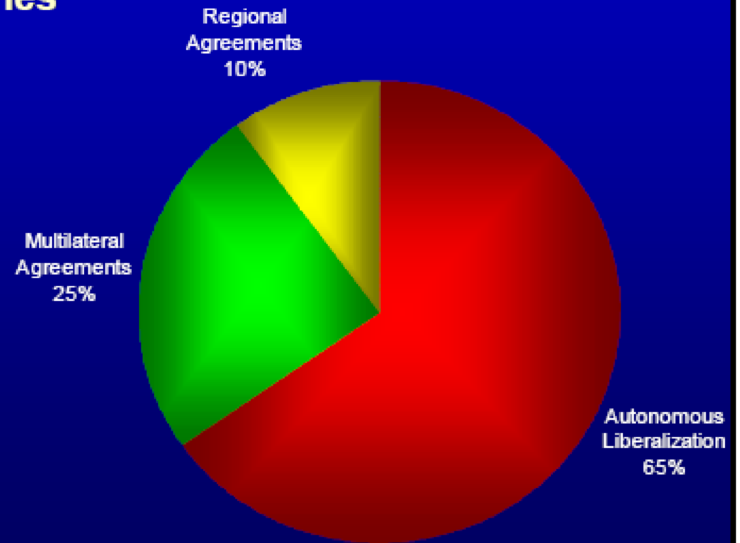
Developing country liberalisation

Not being asked to do much in WTO – most opening unilateral:

Av. Tariffs in Developing Countries



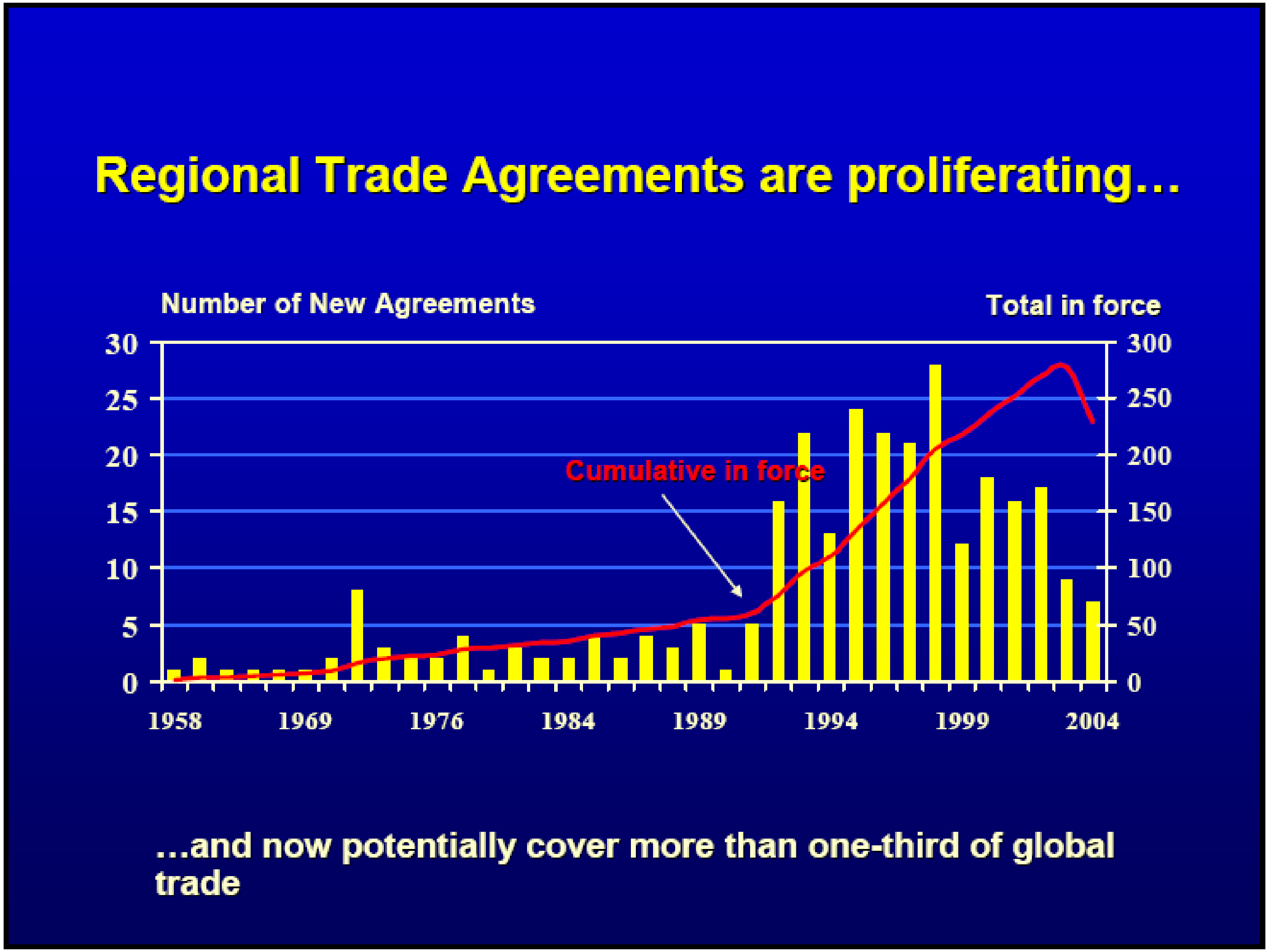
Share of tariff reductions



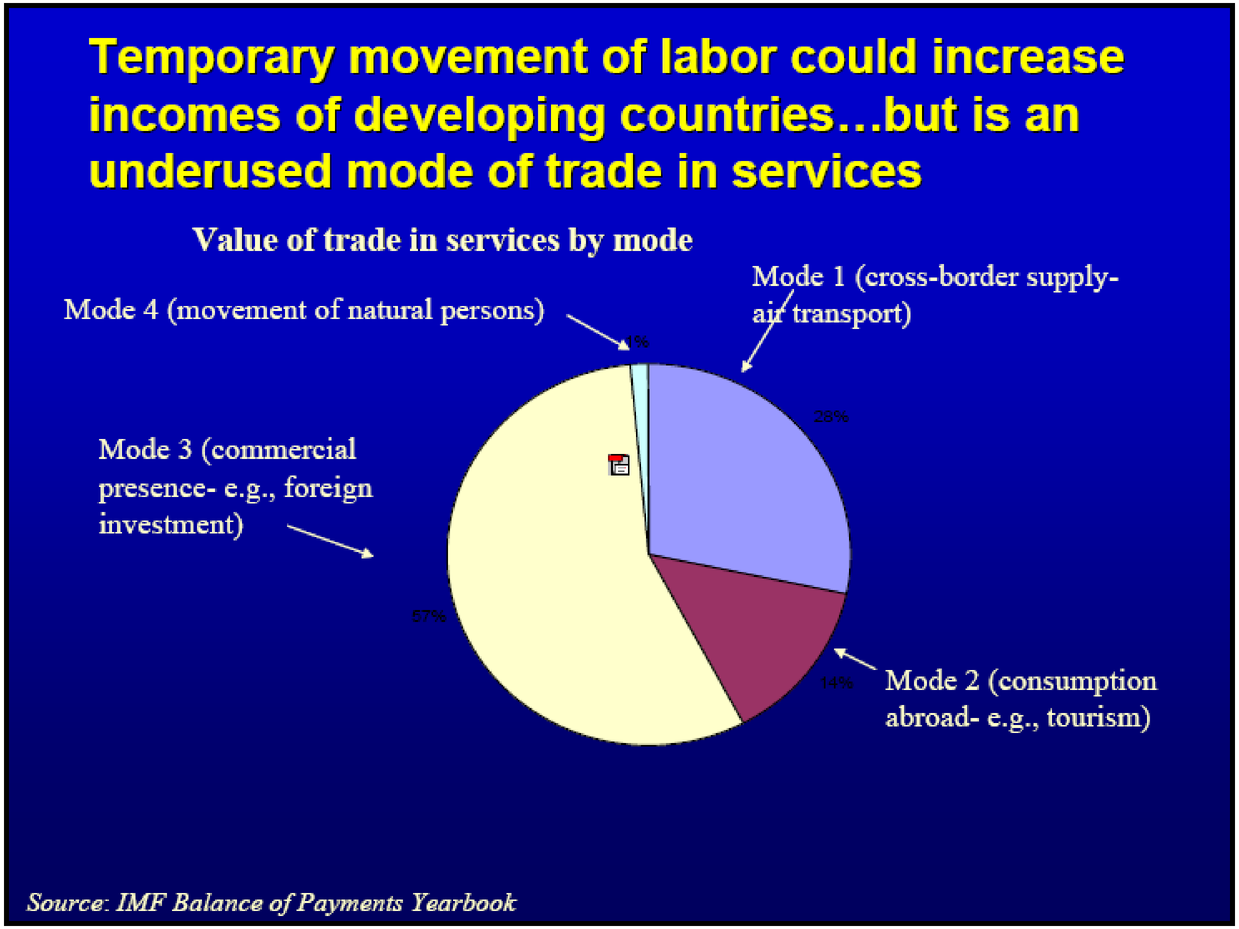
Source: Martin and Ng, 2004

Topic 6. Trade Issues today and the WTO

- Today's increasing globalisation is based on increasingly liberal trade
- More and more developing countries are participating in such tendencies via general liberalisation and the locking-in of lower trade barriers via their membership of WTO (China for example joined the WTO in 2003
- But THREE main categories of trade problems continue to hinder developing country growth and poverty-reduction ambitions namely
  - Their OWN excessive protection in some cases
  - The unemployment and other transitory costs of liberalising trade when they chose to adopt such an approach
  - The excessive OECD country protection of agricultural commodities of direct interest to developing country producers

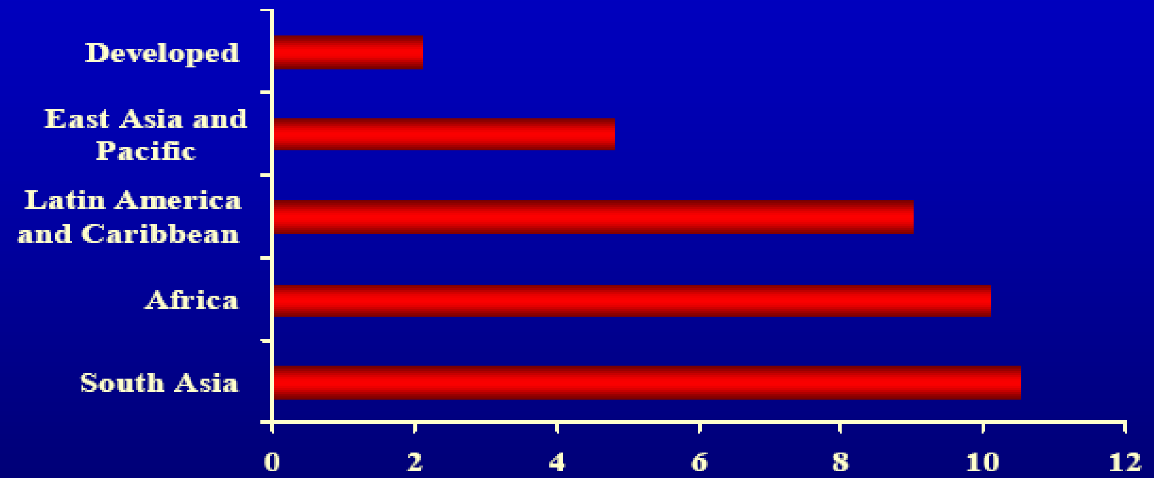

Regional Trade Agreements are proliferating…
Number of New Agreements
Total in force
30
25
20
15
10
5
0
300
250
200
150
100
50
0
Cumulative in force
1958
1969
1976
1984
1989
1994
1999
2004
…and now potentially cover more than one-third of global trade

Trade in Services



Improving trade logistics can be as important as cutting tariffs…ports, customs, transport

Average number of days to clear customs for sea cargo



Development assistance is key to improving ports, customs and trade infrastructure

Source: International Exhibition Logistics Associates, based on a sample of countries in each region

Is WTO good for Developing Countries?

- Sustained growth of international trade is demonstrably good for overall growth (c.f. the ZERO growth of global trade in period 1929-1950 when GATT/WTO rules did not exist versus a 3000% increase since 1950 (30 times)
- The WTO is a “rules-based organisation” and as such gives weaker countries far more leverage and a better chance of a fair deal than any alternative
- The huge biases in today’s trading regime (e.g. biases against textiles and agricultural exports) are the product of *national* politics not the multi-national organisations. They are more likely to be eliminated by WTO-type arrangements than by bilateral national bargaining
- WTO Disputes Resolution Mechanism (established with WTO in 1995) does seem to be helping low-income countries. E.g. 80% of all complaints filed in 2001 were from developing countries and 20% of these were against richer countries. Peru won against the EU over sardines, Costa Rica defeated the USA over underwear
- Doha seems to demonstrate that WTO can adopt a genuinely developmental agenda. The Hong Kong meeting will show whether it can also deliver

To realize a pro-poor outcome, an agreement has to reduce barriers to the products the poor produce

- In agriculture, reducing border protection and subsidies
- In labor-intensive manufactures, reducing tariffs, quotas and anti-dumping
- In services, increasing temporary migration under mode 4
- And increasing donor assistance in trade facilitation and other areas
- …as well as an agreement on intellectual property in medicine.

China’s entry – “the last great untapped market on earth”

- China wanted and has now achieved a rules based system and a disputes mechanism so that its huge and rising export volumes were no longer vulnerable to *ad hoc* political decision in, for example, the USA
- China took it seriously (6000 volumes about WTO rules now available in Chinese languages) – membership surely locks in the liberalising reforms of the past 25 years
- Under its accession commitment, the average bound tariff will fall to 8.9% (with zero on many goods) so huge potential market for other countries to tap. Also massive revision of economic laws
- China may even become the most important global advocate for even freer trade (a role presently held by the USA)
- But pressures will be large and notably a big adjustments for Chinese farmers as protected markets are increasingly liberalised

Continued – a huge shift in global economic balances?

- China already received huge FDI flows in 2001 (around $45 billion versus $4 billion for India) but this could increase hugely given the stability coming from WTO membership
- So expect China's share of world trade to increase even further (it has doubled to more than 10% of the total in 25 years)
- Chinese economic control of other developing countries is also significant. Collective GDP of the 25 million Chinese resident in Southeast Asia (32% of populations) is $ 450 billion – the world's ninth biggest economy
- Offsetting that is the large and rising foreign control of Chinese industry (17 million workers in foreign-owned industry is a larger number than total employment in France and Italy and accounts for 12% of Chinese GDP