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TRADE PREFERENCES AS A UNITED STATES POLICY,
WITH SPECIAL REFERENCE TO SOUTHEAST ASIA

by

THEODORE MORGAN

AID/University of Wisconsin
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Interdependence in Southeast
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Summary--With Application to Southeast Asia

LDC's should be generally well fitted to compete internationally in those commodities that are relatively labor intensive in low level kinds of skills. These can normally be identified statistically as commodities in which the wages component of value-added is relatively large. Among LDC's of the world in general, these include among manufactures: textiles and apparel, wood products, furniture, leather, and "miscellaneous manufactures". From our study of six Asian countries, we would add to the list metallic products, and machinery and transport equipment. Sample calculations for the United States suggest that these are subject to very effective rates of duty. (For example, plywood is subject to 16% nominal duty, but 99% effective duty; metal manufactures 19% versus 75%; clothing 27% versus 136%--see page 18 below.)

LDC's are being handicapped, in their effort to modernize, by DC protectionism--which is much higher than it appears to be, which is erratic, and which handicaps especially exports of LDC manufactures, and so exports of those LDC's that have been most energetic in expanding their manufactures. These manufactures markets are of special interest to LDC's since basic world demand for manufactures is relatively expansive, and since manufactures growth is, for right reasons and wrong, much emphasized in LDC development policy. Among the right reasons, the feedback and dynamic effects of manufactures growth offer especially hopeful vistas.

The extension of trade preferences for manufactures by DC's, especially the United States, to LDC's, specifically to the LDC's of Southeast Asia, would be an offset to the present invidious tariff duties levied against them. A general high tariff duty could be offset by the LDC's through currency depreciation; but a differential impost against manufacutres can be offset only through a special reduction of that impost.[1]

The extension of such trade preferences to LDC's would satisfy their official and emphatic wish, which is more firmly rooted in fact and analysis than their usual arguments have conveyed. The United States could well seriously explore the practicalities of preferences, as a major step toward lower trade barriers generally, rather than remain conspicuous in opposition. The extension of such preferences could be made conditional on a substantial lowering by LDC's of tariffs and related trade barriers <u>to other LDC's</u>, perhaps within regional groupings such as Southeast Asia. Such a policy carries with it a double gain: The present U.S. differentially high barriers against LDC manufactures exports are lowered, at the same time that trade flows among LDC's for all types of commodities are encouraged.

This recommended policy is consistent with the long run U.S. policy maintained since 1934 toward lowering world trade restrictions. It is in the obvious interest of world efficiency of production, statically and still more dynamically.

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[1] Assuming that the LDC's do not set up dual, or even multiple, exchange rates... I am indebted to Dr. Clark Leith for the above point.

PREFERENCES REVISITED

by

THEODORE MORGAN

In the late spring of 1964 a new proposal to advance the fortunes of the less developed countries of the world--temporary trade preferences on their manufactures exports--emerged from the U.N. Conference on Trade and Development (UNCTAD) held at Geneva. The proposal was unitedly supported by the poor countries, but had a mixed reception among high income countries.

Official and unofficial discussions have gone on ever since; in 1968 preferences will be pushed at the second UNCTAD to be held at New Delhi. Two other aims of less developed countries will be discussed--more direct aid, and commodity price support, marketing arrangements, and subsidy against falling earnings from commodity exports. But these two seem to have been devised mainly to encourage the trade union of poor countries to stick together: those too economically backward to hope to gain much from better export conditions, together with those that will. The headlines of the next UNCTAD will center on preferences.

So far in the "Development Decade" of the 1960's, exports from the poor countries have been providing an undistinguished performance: they are not on the road to achieving the seven-fold rise 1960-1970 that at the start of the decade the UN's Economic Commission for Europe judged to be necessary if target rises in their domestic incomes were to be met. When the first UNCTAD meetings were in session, multi-nation trade negotiations to lower trade barriers (the Kennedy Round) had been under way a year. They have continued month after month. Through last May, achieving an eleventh-hour agreement on a wide range of tariff reductions that will be of major benefit to world trade and world efficiency over several years to come. But there will not be in the agreement, any special advantages to the less developed countries.

As for international aid: direct assistance to the poor countries--loans, grants, and technical help--has remained in recent years at about the same total level. Political opposition has increased in the major donor, the United States, and its aid has shrunken somewhat.

The demand for preferences merits being considered seriously--plainly for political reasons, and also, this paper will conclude, on its economic merits.

I The Mixed Reception

More than in any other source, the demand for preferences originated in the active mind of Dr. Raul Prebisch, long time head of the UN's Economic Commission for Latin America, out of his preoccupation with an alleged long-term worsening of the price of less developed country (LDC) exports as compared with the prices of their imports. His analysis has changed its emphasis in the years since its first conspicuous publication in 1950[1] but not its conclusion. Prebisch's views, received critically among professional economists outside of Latin America but influential on official opinion there and elsewhere (less in Asia), are centered around the conviction that the poor countries have been getting the worst bargain in international trading relationships. The poor countries want the rules of international trading changed to their special advantage.

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[1]United Nations, The Economic Development of Latin America (Lake Success, New York: 1950).

From Prebisch came the drive leading to the first UNCTAD meetings. At UNCTAD, the united front of the poor countries in favor of preferences was improbable. Some of them already had preferences: preferred access to the United Kingdom through belonging to the British Commonwealth, or trade advantages in European Economic Community markets because of having been colonies of Community nations. Such preferred countries would lose their special advantage if other poor countries were granted equal access. But unaminity was preserved by a provision that compensation would be granted for any such loss.

In contrast, the developed countries (DC's) were in disarray. The United States was in the extreme wing of opinion: it cast a solitary opposition vote on five of 27 "Principles"[1] It was in near-solitary opposition on a number of other Principles. The United States cast a negative vote 13 times. Its runners-up were the U.K. (7 negative votes), Canada and Australia (6 each), and South Africa (4), France, Italy, Belgium, and the Netherlands cast no negative vote at all.[2]

On the specific issue of trade preferences, the United States has remained opposed, though there has been softening of its stand. The British have been willing to go along with uniform across-the-board preferences.

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[1]Among the "General Principles", the U.S. voted against "sovereign equality of nations", "acceleration of growth, narrowing of income gap", "increase export earnings of developing countries regardless of system", "disarmament-freed resources to be used for development"; among "Special Principles", against "surplus disposal by international rules".

[2]Votes as tabulated in Harry G. Johnson, U.S. Economic Policy Toward the Less Developed Countries (Washington: The Brookings Institution, 1967), Chapter 1.

Australia has broken ranks by unilaterally granting a modest range of preferences. France and Belgium have supported preferences bargained case by case between individual developed and less developed countries. Often this position would lead to international sanctioning of trade arrangements France and some other European countries are already carrying on with their former colonies. It conflicts sharply with the most-favored-nation treatment that U.S. policy has traditionally supported, which presents the same tariff rates, in principle and generally in practice, to imports from every country.

In the effort to make preferences more acceptable, LDC's in the continuing UNCTAD organization have recently proposed a scheme of general preferences open to all low income countries without exception (so avoiding injury to any countries left outside a preferred group); with a normal 10-year time limit on the period preferences can run after a country begins to export under their benefits (so checking the growth of inefficient industries, and ensuring that the most advanced of the less developed countries would lose their advantage eventually, so shifting relative advantage to the less advanced at that time). To soften opposition in the DC's, the scheme further provides that a developed country can exclude a manufactured or semi-manufactured article from preferential treatment if it justifies a claim of "over-riding national economic interest". No import duties are to be levied on handmade or cottage industry goods, on semi-manufactures subject to further processing, on goods processed from supplies originating in less developed countries, and on goods on which the most-favored-nation duty is 10 percent or less. For all other manufactures or semi-manufactures, import duties are to be halved.

II Preferences Pro and Con

The U.S. case against preferences has not always been well presented, and some excuse is given for the tendency among LDC's to feel that vital help to their growth is being sacrificed by the DC's because of actual or feared internal political pressure from their manufacturing interests--and especially from those, like textiles and handicrafts, that are comparatively inefficient and so have the least economic claim to favored treatment.

Gardner Patterson has published[1] a clear exposition of the anti-preference case, and the best public statement of the U.S. position. The following summarizes his argument, and supplements it along frequently reasoned lines:

(1) If a poorer country is to be able to export to a richer country where previously it could not, the delivered price of the LDC producer must be lower than the price quotation of producers in the DC, and lower also than the price of producers in other DC's plus any tariff they must still pay. But the formation of the European Common Market and Free Trade Assoication have been lowering tariffs within the groups toward zero. Soon the most efficient producer in any of the associated countries will hold the market. The effect is sharply to increase the competition any LDC producer outside must meet and conquer.

In addition, present tariff levels in DC's average only about 15% <u>ad valorem</u>, and with the agreements of the recent Kennedy Round of negotiations they will drop to the neighborhood of 9-12%. There will be great

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[1]Gardner Patterson, "Would Tariff Preferences Help Economic Development?", <u>Lloyd's Bank Review</u> (April 1965), pp. 18-30.

resistance among DC's to granting preferences of zero tariff duties: if the often-proposed "half of the most-favored-nation rate" should win out, then preferential duties would be around 5%... The argument continues that there are very few LDC exports that would gain decisive advantage over domestic DC producers and other free-trade-area producers from a 5% price cut, and over external DC producers from a 5% margin (since the latter must still pay a post-Kennedy Round near 10% average duty). The maximum price advantage possible is modest.

(2) Setting up a system of tariff preferences would entail special costs. (a) Political frictions have arisen and would arise between African states that want to continue their existing preferences in the Common Market, and other LDC's that want preferences extended uniformly. United States' granting of preferences to Latin America only, as has been urged, would be vigorously resented by the Philippines, India, Hong Kong, Malaysia, Israel, and all other LDC's outside of Latin America. Differences have arisen among DC's among those that want no preferences, those that want selectively negotiated preferences, and those that want across-the-board ones. (b) Administrative costs can be high of trying to make preferences "fair", adjusting them for different states of development, deciding the cut-off point between LDC's and DC's, and adjusting for different quota and special arrangements. (c) DC preferences will not be granted unless the United States goes along. But once Congress has opened up the Pandora's box of tariff issues, surprising and unwelcome votes may ensue: other abrogations of most-favored-nation treatment, and special safeguards against foreign competition written in for many a domestic producer. The last state may be worse than the first.

It is argued also that (3) the main gain from preferences would go to only a few countries, the present major exporters of manufactures--India, Hong Kong, Israel, and Mexico; and that (4) non-tariff barriers, like restrictions on imports of textiles, are often of major importance.

Counter-Arguments

Do these points hold water? Consider them in reserve order: (4) If non-tarirf barriers are major handicaps to LDC growth, then the plausible moral is that they should be lowered or dropped--if that is politically possible. Tariff preferences offer a possible further gain, to to considered on their own merits. The case for them may be stronger, if one is pessimistic about the chance of significantly cutting non-tariff barriers. (3) Preferences do give advantage to those countries that are near-competitive already, and offer future advantage in proportion as LDC exporters are able to get their costs down. Such a reward for efficiency and energy is desirable: late comers can be considered later, when the present advanced LDC's are themselves DC's and no longer need special help.

In the meantime, a drop in the average level of world restrictionism is a contribution to greater world productivity. And preferences to LDC's might best be considered not something temporary, to be reversed later, but a step toward freer trade generally. Their exception to the most-favored-nation principle, which is a good principle, is to be countered, not by refusing to extend preferences or by revoking them once extended, but by lowering other world trade barriers toward the low or zero preference level.

Point 2 on administrative and political costs of having preferences is a diffuse one, depending on one's judgment of political pressures, and of the kinds of administrative arrangements one envisages. A view sympathetic to preferences would seek to diminish the costs, perhaps along the lines of the present LDC formula. Uniform preferences to all the LDC world, rather than to a group, would minimize both political issues and administrative complications. And the disposition of the U.S. Congress to think solicitously of local interests should be least in a time of high prosperity.

Point 1 is the sticking point. If it is true that protection is now or will be soon so low that future reduction of tariffs can give little added advantage, then certainly the laborious and uncertain routine of negotiation should not be undertaken; and delegations might sensibly say, as one has, "Discussion of preferences successfully avoided." To this point--the issue of what gains and losses preferences would bring--we now turn.

Variants

The problem is not only the magnitude of gains and losses to low income countries from preferences, but also to the United States and other high income countries.

The countries involved are a variable: the United States only, or some, or all high income countries might extend preferences; all low income countries might receive them, or only a group. All LDC exports, or manufactures only, or some other class of products might be covered. How much preference is a variable: tariffs and/or non-tariff barriers might be lowered partially, or lowered to zero. The criterion of gain can be economic, or political, or both; and the time horizon can be very short run, or for a moderate period of some 2 - 5 years, or still longer.

Should there be side-conditions tied to any preference-extension? For example, if a rapid rise of imports into the U.S. is feared, can that cost be softened while hoped-for gains to LDC's are still retained? And if softening of most-favored-nation policy is objected to , can counter-extensions of most-favored-nation treatment be built into a preference scheme?

Finally, the gains and losses of preferences ought to be measured side by side with those of other measures for stimulating the growth of low income countries: aid, most-favored-nation treatment, price-maintenance schemes for their exports, and compensation-for-decline in value of exports schemes.

Middle-of-the-road plausible assumptions are explored below: that the U.S. and the main other high income countries grant preferences, as seems likely in the present climate of opinion; that both tariff and non-tariff import barriers be lowered substantially, as a limiting case to zero, for manufactures from all LDC regions; and that effects be thought of within some moderate period of 2 to 5 years--long enough so that crucial effects on resource supplies and productivity efficiency are not dropped from consideration, short enough so that effects are not lost in the murk of possible but unrelated changes in world productive efficiency and trade patterns.

Central Effects of Preferences

What are the economic results in LDC's? There are significant effects even if preferences have no influence on supply of resources and on productive efficiency in low income areas. On beneficial effect lies in "trade creation": low cost producers in the LDC's expand, in accord with their marginal costs, as net prices received from sales in the DC's extending preferences rise. The windfall price gain will be less than the amount of any tariff remission, since price in the DC's falls with a rise in imports. A critical question is, how much will the LDC producers expand output? A second beneficial effect is implied: more sales will be made by the LDC's abroad at the higher net prices obtainable (depending on elasticities of DC demand and LDC supply). Increased foreign earnings for LDC's will soon be transformed into increased imports. Employment effects in LDC's are also positive, as export industries expand. A third beneficial effect is now being pressed in LDC arguments: that manufacturers in high income countries will be encouraged by the chance of tariff-free importing to invest capital and know-how in LDC industries (as the British invested in India, the French in Africa, the Japanese in Korea).

On the other hand, there will be injurious "trade diversion" outside the preferred area. Exports to the DC's will shrink from outside the favored group--those defined as "under-developed", or those outside a special LDC preferred area, such as Latin America. The non-favored group will view this shrinkage as a disadvantage; the effect also injures world efficiency of production, since previous low-cost producers are forced out of the market through administrative favor granted to the preferred group.

Conversely, in the developed countries there will be some negative balance-of-payments and employment effects, softened to the extent there is flexible shift of resources into relatively more efficient production for home use and for export. There will be some injury also from the rise in cost of some imports to the U.S., as preferences shift sources of supply away from cheaper (non-preferred) suppliers. There will be advantage from checking monopolisitc practices, and in a full-employment world, from discouraging price rises.

The effects above are all "static": no account is taken of changes in resource supplies and productive efficiency. But such dynamic effects are the mainly-important potentialities from a preference system. Export markets will expand for the products of the preferrrd low-income countries. Domestic markets for their products are small, often very small. As the size of the market and the volume of production expand, average costs in many industries fall sharply through a considerable range. Handicraft and small-scale production are outcompeted by mechanization, use of power equipment, specialization in sub-processes, and assembly line fabrication. Expansion of the market develops other economies, feed-back effects in their broadest sense: skills and entrepreneuring abilities in one industry that are useful also in others, better communications (a road or railroad developed for one business can be used by others), simplification and standardization encouraged through producing for a large market; emergence of new industries out of the specialization encouraged by producing for a large market and from more contacts; and finally, growth of sense of momentum and confidence in economic possibilities. Industries differ in their extent of feed-backs: it is sensible, in a preference scheme, to stimulate those that have the most.

Aside from economic effects of preferences, listed above, there is the general political effect. The drive for preference at UNCTAD and other meetings comes not from a reasoned case, marchalling up its pros and cons, but out of profound sense of unjust treatment. Lower trade restrictions in international trade generally is not what the LDC's want. What they want is <u>preference</u>.

The United States' opposition to preferences has been at some political cost in LDC official opinion. Supporting of preferences would therefore bring some political gain. Within such a high income country as the United States, there would be mixed political results: there would be the normal opposition from U.S. producers of products competing with plausible imports, and support from exporter and consumer interests and from groups sensitive to LDC welfare.

Would U.S. competing producers seek to raise non-tariff barriers against imports that threaten to rise rapidly? No doubt--and they would find their task of persuading legislators eased by the conscious departure of policy from the anchor of most-favored-nation treatment. The importance of this risk is a matter of political judgment. The risk does not imply that a preference law and/or negotiations, to be meaningful, should include pledges or checks against raising such barriers. The opposition and threat could be softened by a rule limiting the rate of rise of imports--say that imports of a particular good from one LDC may not be imported in a quantity more than 10% above the level of any previous year without paying a penalty duty, which means that imports from all LDC's of that commodity would normally rise by less than 10%.

Another concern is that the effect of granting preferences might be, within the U.S. or other grantor, a weakening of political support for further most-favored-nation lowering of tariff and non-tariff barriers generally. And LDC's would care less for further MFN lowering of barriers, since the effect would be to diminish their margin of preference.

Nevertheless, a preference system can be fitted into a general world context of MFN lessened protection: the high income grantor nation could demand, as condition for granting preferences to any one LDC, that it should schedule lowering its own tariff and non-tariff barriers to imports from other LDC's, and bargain in good faith in future trade negotiations. Such a condition would then push the LDC world toward this amount of MFN practice. As the years go by, a hoped-for general lowering of trade barriers through repeated trade negotiations would diminish the margin of preference to LDC's.

Lowered trade barriers have a special advantage to low income countries for a reason not often high-lighted. LDC economies are typically thin, subject to sporadic scarcities and surpluses of particular products due to crop failure or abundance, to industrial difficulties of successes where suppliers are few, and to failures of central planning. There is, therefore, specially large gain to their economic life from opening up freer trade channels for supplies and markets; and for this reason they ought to be devout supporters of free trade... But on the other hand, most low income countries are heavily dependent for government revenues on customs receipts; they find it easier, politically and administratively, to obtain the bulk of their revenues from customs duties rather than from any internal source, and so are forced to go slow in lowering customs levies.

III Trade Magnitudes

The economic arguments given above wander in air because no indications of relative importance were offered with them. How much trade is involved, what are its trends; how restrictive are present tariff and non-tariff bars to trade; what changes would preferences make?

The United States has recently been importing at the rate of about $21 billions a year. One-third comes from LDC's; of this most are agricultural items.

Annual Value of Imports into the United States
(in billions of dollars)

	1962	1963	1964	1965	1966
Total imports	$16.2	$17.0	$18.7	$21.4	$25.6
Agricultural	3.9	4.0	4.1	4.1	4.5
Non-agricultural	12.4	13.0	14.5	17.2	20.9
From developed Countries	10.3	10.8	11.9	14.1	----
From less developed countries	6.0	6.2	6.7	7.2	----

Source: U.S. Department of Commerce: <u>Overseas Business Reports</u>, various issues. Data for 1966 are preliminary.

As to exports out of the LDC's: nearly three-quarters go to the high income countries; and nearly one-fifth to the U.S. alone, about the same as the amount they export to all other LDC's put together.

LDC Exports
(in billions of dollars)

	1962 Value	1962 Percent	1963 Value	1963 Percent	1964 Value	1964 Percent
LDC exports to the World	$28.9	100.0%	$31.5	100.0%	$34.4	100.0%
LDC exports to all DC's	20.8	71.7	22.8	72.4	24.9	72.5
LDC exports to the U.S.	5.8	20.1	6.0	19.0	6.4	18.5
LDC exports to Centrally Planned Economies	1.6	5.4	1.7	5.3	1.9	5.6
LDC exports to all LDC's	6.3	21.7	6.6	21.0	7.1	20.6

Source: U.N., <u>Yearbook of International Trade Statistics, 1964</u> (New York: 1966). Table B, pp. 28-29.

During the first half of the '60's, the LDC's doubled the rate of growth of their exports--to 6% a year--over the rate of the last half of the '50's. But their imports (at 4% a year of growth) remained at the level of 1955-1960--much lower than the rate the U.N. estimated necessary to support reasonable development plans. The main explanation seems to be that the non-petroleum exporters had to cover rapidly increasing service charges on their foreign debts.[1] The LDC's therefore have valid grounds for concern about their exports-debt services-imports position.

The recent $24.9 billions of exports from LDC's to all high income countries can be compared with total reported aid from all sources to LDC's now running in the neighborhood of $9 billions a year. Similarly, the $6.4 billions of U.S. imports from LDC's can be compared with recent U.S. aid expenditures to them of about $3.7 billions. (We shall see later these figures much exaggerate the real value of aid.)

In summary on these figures, LDC exports to high income countries have been running between two and three times their receipts of aid from those countries; and exports have been rising whereas aid has remained about constant in the past several yerrs. If preferences could substantially increase the flow of exports from LDC's further, they would make significant additions to LDC foreign exchange earnings.

Manufactures versus Other Exports

The trend of LDC exports by kind of commodity casts a sharp light on the possibilities of preferences. In world trade as a whole, commodities with low skill-and-capital requirements have been making up a falling proportion of world trade and those with high skill-and-capital

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[1] "In Latin America, where the burden is most acute, debt service absorbed 15% of export earnings in 1964 as compared to only 6% in 1956". In contrast, petroleum exporters have been building up their foreign assets. Isaiah Frank, "New Perspectives on Trade and Development," Foreign Affairs (April 1967), pp. 522-523.

requirements a rapidly rising proportion. The value of food and raw materials has been rising recently at less than one-fifth the rate of growth of manufactures. Exports of LDC's to high income countries show this same pattern: Foodstuffs and agricultural raw materials exports have been rising recently at the rates of 2.0% and 1.4% a year respectively. In contrast manufactures and base metals exports have been growing in 1960-64 at the surprising rate of 14% a year, faster even than petroleum exports. Among manufactures, highest growth rates among exports have been for "machinery and equipment", followed by "other manufactures", textiles, and chemicals.

Low income countries have been gaining new markets in high income countries, within the manufactures class, in "the less complex types of producer goods and machine parts, such as electric generators, diesel engines, locomotives, steel frames for furniture, and the like". These have a high labor content, and require less elaborate marketing than consumer goods, especially consumer durables.[1]

Tariff preferences to LDC's turn out to be mainly preferences to manufactures, since rates on primary products are generally near zero already, though quantitative restrictions can be important. Hence granting of tariff preferences would reinforce the present export trend: LDC manufactures would expand still more rapidly than they are now doing.

This conclusion is significant for prediction of effects of preferences: it is easier to go with the current than to fight against it.

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[1]U.N., World Economic Survey, 1962, I., "The Developing Countries in World Trade," pp. 14, 65. T. Morgan, "Economic Relationships among Nations: the Pattern of Commodity Trade", Chapter 5 in B. Hoselitz, ed., Economics and The Idea of Mankind, pp. 156, 174.

Dynamic changes, far more important than static effects, <u>can</u> to some extent be forecast.

IV Trade Restrictions Among the Developed Countries

How restrictive currently are U.S. tariffs and quotas? Consider first primary products whose LDC production has been growing slowly--from 2% a year down to negative levels in recent years. Among them, and free of both tariffs and quotas, are cocoa, hard fibers, jute, and rubber. Coffee is free of duty but export quotas are allocated by the Coffee Agreement; cotton is dutiable at 0 to 8% and there are quotas. Lowest qualities of wool are free, higher qualities at 14% up to 36%; there are not quotas. Wheat and sugar are dutiable at 13% and 12%; there are quotas in addition.[1]

There are also primary products whose production in low income countries has been growing rapidly--7% or more a year recently. Among these are pig iron, steel scrap, unwrought aluminum, zinc ore and metal, and crude petroleum. One of these, steel scrap, enters the U.S. free; the rest are subject to duties from 3% up to (some of zinc imports) 12%. Both zinc and petroleum enter under quotas.

On primary products we can generalize that U.S. tariff levels are low but quotas can be important. Protection afforded manufactured products is at higher levels. The following list follows as closely as possible

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[1]These and the following data on U.S. protection are from the U.S. Tariff Commission, with <u>ad valorem</u> equivalents based on price of various years, 1961-1964. The nearest whole percent only is reported; the Philippines have special concessions by treaty on some products.

European duties on farm products are generally much higher. They are subject [illegible], under Kennedy Round agreements, to reductions over some years to come of about 25 percent (grains excepted).

GATT's itemization of products important in the export trade of LDC's.[1]

A. Simple Manufactures and Semi-Manufactures:

Asbestos products	13%	Linoleum	20%
Bromine and Compounds	10	Mercury	10
Coir products	18	Plywood	16
Cotton textiles	19	Pulp, paper, paper-boards	9, free
Essential oils	12	Quebracho etc.	6
Flax, yarn and fabrics	7	Rugs and carpets	20
Pig iron	3	Pottery	39
Hardboard, shipboard	16	Steel furniture	14
Hard fibre manufactures	15	Soap	6
Hides and skins, tanned	4	Sulfur	free
Jute manufactures	24	Wood, rough, shaped	0, 1
Leather	11	Wooden furniture	14
Leather footwear, etc.	10	Woolen, worsted yarn	19

B. Relatively Complex Manufactures:

Bicycles	20%	Machine tools	15, 20%
Casein	16	Nitrogen compounds	10, 19
Chlorine & derivatives (some organic derivatives valued at (high) ASP levels)	11 - 19	Phosphates, inorganic	10
		Phosphates, fertilizers	free
		Polyethylene, etc.	21, 23
		Radio receivers	13
Cutlery	28	Rubber shoes, tires, etc.	11
Electric motors	13	Sewing machines	11
Electric fans	14	Silk manufactures	23, 24, 34
Ferr-chrome, etc.	3	Sporting goods	20, 27, 28
Glass, glassware	14, 34	Sulfuric acid, etc.	4, 16
Internal combustion engines	11		
Metals, wrought, worked	13, 19		

The pattern is plain. Primary and simple products have low duties, though some have quotas; simple manufactures have higher duties--the median for our group is 12%; and complex manufactures still higher--the group

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[1] GATT Committee III/105, list published March 25, 1963; reproduced in U.N., World Economic Survey, 1963, p. 221. Tariff rates are *ad valorem* equivalents, calculated on 1960 prices. The rates have not changed since the date of compilation of the table in March 1962; but foreign wholesale prices have risen, so that dollars of duty collected on given imports have generally increased. (Exception: many coal tar chemicals and two other commodities are valued for tariff purposes at "American selling price"(ASP). These rates are high; but U.S. wholesale prices have been very stable until recent months. With stable prices, the duty collected for a given physical quantity of imports does not change: when prices go up, the dollars of duty collected rises.) Equivalent *ad valorem* rates are from the U.S. Tariff Commission.

median is 15%. All are subject to the substantial though varied reductions over some years to come of the Kennedy Round agreements. Duties on manufactures in the United States and abroad will, at the end of five annual reductions, be lowered an average of 30 to 35%.

All the rates we have been considering are "nominal" tariffs--what must be paid to get the goods inside the country. For some commodities and some varieties of commodities the rates have no effect because U.S. prices are low enough, quality high, and types appropriate enough, so that foreign goods do not enter now and would not enter even at a zero duty. The tariffs listed are percents of "value", not what is economically more relevant, percents of "value added" in final processing, or perhaps of labor costs in final processing or of profits. These latter comparisons represent windfall gains to resources employed in final processing, including influence on entrepreneural decisions.

U.S. Tariffs as Percent of Final Value-Added

The Table below puts down the present nominal U.S. duty, side by side with the duty as a percent of final value-added, excluding labor costs.[1] We have selected out a few commodities for which the dynamic, or feedback, effects toward higher productivity seem to be specially high. That is, expansion of exports of these commodities from LDC's would, we judge, have a specially stimulating effect on skills, organization, capital formation, and infra-structure.

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[1]And so the latter figure approximates the duty as a percent of profits (actually profits plus rents and interest, as interpreted in corporate accounting). If the labor costs rise as a result of protection, then increment to profits will be less than stated... Data on value-added from 1963 Census of Manufactures, Preliminary Report, December 1964, pp. 5-11.

	SITC class	Present "Nominal Duty" U.S. Duty	Present "Effective Duty" U.S. Duty as percent of final value-added
Chemicals................	512,513	10-19%	25-47%
Plastics.................	893	23	65
Plywood..................	631	16	99
Iron and Alloys..........	671	3	14
Manufacturers of metal...	698	19	75
Cutlery..................	696	28	59
Domestic electrical equip.	725	14	47
Electric motors..........	722	13	56
Cotton fabrics...........	652	19	113 (negotiated quotas)
Clothing.................	841	27	136

In general, higher stages of fabrication carry higher duties. For example, the nominal duties on aluminum, aluminum shapes, and aluminum manufacturers are, respectively, 7%, 7%, and 19%; and the effective duties are 19%, 38%, and 87%.

Just as in hhe United States and other high income countries, so back in the LDC supplier, a given trade barrier will cause a greater discouragement to exports (will cause a greater drop in returns in final processing), the smaller the proportion of value added by the companies that do the final processing. This effect means that in general the discouragement of exports will be greater the more round-about the production processes involved and the more specialized individual companies are. But greater efficiency in productive processes is also correlated with this same round-aboutness and specialization.

Complications: Erratic Effects

The effects of trade protection throughout the world, including the low income countries, are more complex and more erratic than indicated so far. Usually the inputs into productionprocesses are themselves, directly or indirectly, subject to tariffs, or to quotas that will similarly raise their costs to producers.[1] Hikes of the costs of inputs are taxes on production; and the total of these taxes can more than offset tariff protection on the final product.

Some extreme examples for the United States are:[2]

	Nominal Tariff	Effective net Protection
Poultry processing	6%	-10%
Rice milling	14	-28
Textile bags	10	-16
Paper mill products, excluding building	0	-7
Fertilizers	0	-24

In summary, protectionism is important. Trade barriers are far higher than they seem: plywood has a 16% duty and cotton fabrics a 19% duty (plus quotas) in the U.S. tariff schedule, and so it might be contended that the protection is modest; but it is not possible to continue that argument when one realizes that the effective duties run at 99% and 113%. Many effective duties will remain high when, some five years in the future, the Kennedy Round reductions in nominal rates are achieved. Similarly, modest quotas can be surprisingly protective to final processors. And protection effects are erratic. A modest duty on final output can be transformed, when tariffs on inputs into the production

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[1] A quota may require lobbying to achieve, and therefore some cost. Once in effect, it limits supply, and so raises market price of the affected imports.

[2] From tables prepared by Giorgio Basevi, "The United States Tariff Structure: Estimates of Effective Rates of Protection of United States Industries and Industrial Labor," Review of Economics and Statistics (May 1966), pp. 147-160.

process are counted in, into a heavy net tax--rather than the subsidy innocently intended by lawmakers. High and erratic protection means that distortion to world patterns of specialization and injury to world efficiency of production are much greater than traditionally we have thought.

Protection in DC's is relatively high on manufactures, and specially high on more highly fabricated manufactures. Hence underdeveloped countries are especially handicapped in trying to expand sales abroad of manufactures, which they judge have special feedback and dynamic advantage to them in training of skills, improvement of organization, and capital formation.

Underdeveloped countries have more of a right to complain against DC protectionism than they have realized. They are being hurt.

V The Value of AID to LDC's

We have seen above that the possible gains from trade concessions are far larger than usually thought. It is also true that the major alternative source of help to LDC's--direct assistance--is much smaller than reported.

The published figures are those that are reported by member countries to the Development Assistance Committee (DAC), of the organization for Economic Cooperation and Development. There is no reason to doubt the accuracy of the figures, but the impression they give is misleading, exaggerating the value of international aid to the LDC recipients. There are three main reasons for the exaggeration.

(1) From the reported total aid figures needs to be subtracted the present value of loan repayments. For most countries this deduction is

substantial.[1] Plain grants, for which there is no repayment, can be entered at their face value.

(2) U.S. food assistance to the LDC's under Public Law 480 (Food for Peace) is valued officially at world prices, in part at domestic (supported) cost prices. The more valid valuation level is world market prices.[2]

When correction is made for these two overstatements, Free World Aid from the members of DAC (Austria, Belgium, Canada, Denmark, France, Germany, Italy, Japan, the Netherlands, Norway, Portugal, the United Kingdom, and the United States) was recently 52.5% lower in real value than it was reported in the official data.[3]

(3) A third correction is needed. The United States and most other donors "tie" their loans and grants: that is, they require recipients to spend the proceeds in the donor country. Such a provision reduces the value of aid from the recipient's point of view, since he must buy what he can find in one market, rather than the best, cheapest product for his purposes in the whole world.

The amount of deduction needed to account for aid-tying is uncertain, but susbtantial. LDC buyers usually face prices of a competitive level when goods of the specifications wanted are obtainable from a considerable

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[1]Of several possible discount rates that could be used, the marginal rate of return on capital in the receiving country is probably the most appropriate. The rate is assumed, following Pincus, to average 12% in the illustrative calculation below. Cf. John Pincus, Costs and Benefits of AID: A Quantitative Approach (U.N. Conference on Trade and Development, TD/B/C.3/38, dated February 16, 1967), pp. 26 ff.

[2]Or even world market prices that would prevail if U.S. foods were sold freely in the world market.

[3]Based on calculations of Pincus for 1964, op. cit., pp. 26-38.

number of suppliers in one tied-aid country, or when they are obtainable from one or more suppliers in each of a number of tied-aid countries. But heavy industrial equipment for specific development projects often can be obtained from only one or two or three firms, even in a large industrial country like the United States. Pricing for such major items is "custom-tailored, tactical, highly discretionary".[1] Often aid is doubly-tied: proceeds must be spent in the aid-giving country, and they must go for an approved major project. If equipment for that project can realistically be obtained only from two or three firms, the prices quoted are apt to mount skyward. This effect has been a sore subject to Indian government and industrial buyers,[2] and apparently to buyers in other countries too.

Dr. Mahbuh ul Haq of the Pakistan Planning Commission has compared the total cost for 20 projects financed by aid from 6 countries, first, at the lowest quotation from tied-aid sources, and second, at the lowest quotation on international competitive bidding. The tied-aid quotations were 51% more expensive than the competitive bid ones.[3] Dr. Haq's rough

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[1] John P. Lewis, Quiet Crisis in India (Washington: The Brookings Institution, 1962), p. 282.

[2] Ibid., pp. 278-285.

[3] Mahbuh ul Haq, "Tied Credits--A Quantitative Analysis," paper presented at the International Economic Association Conference, Washington D.C. (July 21, 1965). Cf. discussion in Harry G. Johnson, U.S. Economic Policy Toward the Less Developed Countries (Washington: The Brookings Institution, 1967), Chapter 3.

Dr. Haq found, in another comparison, U.S. iron and steel product prices to be 40 to 50% higher than international prices; and freight charges on U.S. ships under tied credits (the requirement is that half of aid shipments from the U.S. travel in U.S. ships) 43 to 113% higher than the lowest competitive international bidding quotations. The worst offenders with respect to tying costs were Japan, France, Italy, and the Netherlands, the United States earned better marks and so did West Germany and the United Kingdom.

figures for Pakistan indicate an increase of the cost of aid through tying of 12%.

George Woods, President of the World Bank group, reports as sample experience a tied bid on a highway program 23% above that of the international competitive price; and a tied cement plant bid 156% above that of a competitive price for similar equipment. He estimated that the present official aid from DAC countries could, if there were no tying, buy about $1 billion (or 16%) more of goods and services than it now buys.[1]

We have so far down-graded reported aid by nearly 70% in the effort to estimate true assistance: 100% minus 53% and (taking Woood's estimate) minum 16%, but a further deduction is in order.

(4) Aid is available to LDC's only for kinds of projects and purposes acceptable to the donor. What would recipient countries have bought abroad if they had been completely free to choose as they liked? The answer is "something different"; not necessarily something more conducive toward economic growth, but simply something they would have wanted more. In other words, a smaller amount of completely free foreign exchange would be as acceptable to LDC's as the amounts of partly restricted support they actually receive. Furthermore, the value of part of U.S. agricultural surplus aid does not serve the purposes of the receiving country, but covers local U.S. expenses abroad, embassy costs being the main item. The United States is the major world supplier of aid to LDC's. At least 7% of free world aid should be subtracted on these two grounds.[2]

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[1]Address to the International Parliamentary Conference on Development Aid (Bonn: April 7, 1967).

[2]Cf. Theodore W. Schultz, "The Value of U.S. Farm Surpluses to Underdeveloped Countries," Journal of Farm Economics (December 1960). From 10 to 15% of the cost value of Commodity Credit Corporation farm products that flow into aid abroad is set aside for meeting local U.S. expenses.

To summarize order of magnitude of these adjustments for a recent year, using the above estimates:[1]

Total official financial assistance from 16 major DC's to LDC's..................	\$6.32 billion	100%
1 & 2 --Adjusted for future repayments, and for over-valuation of agricultural products....................................	3.00	47.5
3 --Adjusted also for higher costs due to tying....................................	1.99	31.5
4 --Adjusted for lack of freedom of choice of recipients, and for value of agricultural surpluses allocated to donor country uses....	1.55	24.5

The purpose of these figures is not to downgrade the contribution of the Free World, which has been uniquely generous by historical comparision. But they do sharply qualify the evaluations often made of the value of aid as compared to the total of LDC exports to high income countries. Those exports have recently been about \$25 billion. With that amount should be compared not the reported Free World official aid of between \$6 and 7 billions, but the real value of aid of something under \$2 billions.

Trade is relatively larger than it has been represented to us, and aid is relatively smaller. The policy implication is that trade policy ought to have more emphasis compared to aid policy, than it has conventionally claimed in official and private discussions.

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[1]The 16 countries tabulated are International Development Association Part I members. International Bank for Reconstruction and Development and International Development Association Annual Report for 1965-66, p. 38.