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TAX-LIKE FEATURES OF DEVELOPING COUNTRY TRADE REGIMES[1]

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I INTRODUCTION

The aim of this paper is to explore the tax-like effects of developing country trade regimes. The term 'tax-like' refers to unintended effects of trade-related policies on resource allocation, income distribution, growth, and other aspects of economic performance; the same effects which are often attributed to taxes as inevitable, and usually undesirable, by products of their revenue-raising function.

With most of the key elements of the trade regime, such as quotas, rationed foreign exchange, export bans, free trade zones and the like, no direct revenue-raising functions are involved. The paper tries to identify what some of the more important of these tax-like effects are, analyze how they compound or offset effects attributable to formal taxes in developing countries, and assess what implications the current trade liberalization underway in many developing countries may have for these interactions. As such, the paper draws on the experience of eleven developing countries which have been the subject of a recent cross-country Ford Foundation-supported project on trade policies in the developing world, and in which the present author has been involved.[2]

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[2] See the forthcoming Final Report (1989) from this project, and the two volumes of research studies (Whalley (1989a, 1989b)). Earlier papers from the project are contained in three research monographs published by the Centre for the Study of International Economic Relations, University of Western Ontario (see Whalley (1987) and Whalley (1988a, 1988b)).

A number of themes emerge from the paper. One is that both the form that tax-like effects of trade regimes take and their size depends critically on the wider policy system within which it operates, including conventional tax policies. Policy instruments compound and interact with each other, making some redundant as far as resource allocation is concerned, but elevating the income distribution effects of others. Thus, a tariff in the presence of a binding quota has no effect on trade flows or resource allocation, but does take rents away from the owners of the quota. If, however, a quota affects trade, it also affects domestic production and consumption through its trade effects. In turn, if rent-seeking effects are associated with quota allocation schemes, even in the presence of quotas, tariffs can reduce the value of quota rents and hence the amount of resources devoted to rent seeking. The paper emphasizes that these policy interactions are central to assessing what the tax-like effects of individual policies are, and that the model chosen to analyze them further determines their perceived effects (such as using models with or without rent seeking). Generally speaking, the paper suggests that binding instruments have their largest effects on resource allocation; non-binding instruments have larger distributional effects.

The paper also emphasizes that it is often difficult to determine the precise effects that policy systems have in various countries. Information is sparse, and what the effects are depends upon the structure of the model used to analyze them as

well as parameter values. Often these are little more than guesses, and the substantial and continual change over time in policies in most of the countries at issue makes assessments of effects even more difficult. All of this makes it that much harder to know precisely what the tax-like effects of trade policies are, and how substantial is their influence on economic performance.

II KEY CONCEPTS

Prior to elaborating what the tax-like effects of developing country trade regimes are, and how they interact with formal tax systems in these countries, it is helpful to first clarify a few key concepts.

Tax-Like Effects

The term "tax-like effect" may seem relatively straightforward, but has hidden subtleties when applied to a discussion of policies which impinge on developing countries' trade performance.

Taxes themselves have a range of effects. Primarily they raise revenue, but in the process they also affect economic performance. A convenient way of categorizing these effects is in terms of the three branches of justifiable policy intervention developed by Richard Musgrave in his classic public finance text (1959).

He suggested that government policies motivated by allocation, distribution and stabilization objectives all provide legitimate arguments upon which to base government intervention in the economy. Allocation-driven justifications cover externality, market structure, public good (jointness of consumption) and other areas of policy, where improvement of resource allocation is the goal. Distributional justifications rationalize those policies (such as a progressive income tax) whose main objective is to make a market-determined

distributional outcome more closely aligned with a socially desirable outcome. And stabilization justifications cover anti-inflationary policies, pro-employment and pro-growth policies, balance-of-payments-driven policy actions, and other macro objectives.

In adopting this same classification in this paper to group the tax-like effects of trade policies, I assume that each of the Musgravean branches of government objectives can also be used to categorize broad classes of effects of trade-related policies. I further assume that when we are discussing the tax-like effects of trade policies, we are dealing with instruments which either have no direct revenue implications for government, or if a revenue impact occurs it is the tax-like effects which are the central focus. To complicate matters, I also note that for some of the instruments we will discuss here, there are tax-like effects which feed back on revenues, because they indirectly increase or decrease a revenue source for government. Thus, for instance, an import quota may increase the profits of a protected industry, and, therefore, increase collections under corporate and other taxes.

Hence, using this classification of tax-like effects of trade policies suggests that policies can change the use of factors by and outputs from the various sectors in the economy (allocation effects), change the distribution of income (distributional effects), and affect macro performance (stabilization effects). Individual policy elements of the trade

regime may simultaneously have all of these effects, one may dominate the others, or it may have only mild effects in all three categories.

While the approach I follow here is different from Musgrave's original classification of objectives of policies, to classify their effects in this way nonetheless provides a convenient organizing framework for the discussion which follows.

Trade Regimes

As with many policy sub-systems, trade regimes in developing countries are both complicated and substantially more so than comparable regimes in developed countries. Table 1 sets out some of the more central elements which can be found in typical developing country trade regimes, and outlines what some of their more important tax-like effects are.

We can begin our discussion of developing country trade regimes with the tariff, the form of trade intervention most widely considered by trade theorists.[3] A tariff is an ad valorem tax on importation, and traditionally has been a major source of revenue in all countries at early stages of development. In developing countries, tariffs currently range from very high

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[3] See the Lectures on International Trade by Bhagwati and Srinivasan (1984) for an extensive discussion of the effects of tariffs. This, one of the leading advanced texts in the area, devotes six chapters out of twenty-four to the effects of tariffs, and only two to other trade policy instruments. Other leading texts such as Ethier (1985), Caves and Jones (1985), and others, also give only limited coverage to non-tariff trade barriers.

Table 1

TAX-LIKE EFFECTS OF ELEMENTS OF DEVELOPING COUNTRY TRADE REGIMES

Policy Elements in Trade Regime	Resource Allocation Effects	Distributional Effects	Stabilization Effects
Tariff	If quotas or FER binding: none If quotas or FER non-binding: draws resources into protected industries; withdraws resources from export and non-traded good industries.	Raises prices of protected commodities (typically luxuries). Typically pro-poor, anti-urban effects.	If trade taxes are significant revenue source, expenditures on luxury imports are pro-cyclical, and revenues are destabilizing not stabilizing.
Quotas (Quantitative Restrictions)	If FER binding: none If FER non-binding: draws resources into protected industries; withdraws resources from export industries; Under either regime, resource loss from rent-seeking behaviour.	Raises prices of protected commodities (typically luxuries). Typically pro-poor, anti-urban effects, but benefits received (rents) to those who receive quotas.	Quotas usually adjusted during periods of import compression. As such, they are a direct instrument of stabilization policy.
Rationed Foreign Exchange (FER)	Effects are similar to a tariff, except that (i) typically zero revenue raised since exporters are required to surrender foreign exchange at below free market exchange rates and importers receiving foreign exchange do so also at below free market rates (effectively a zero revenue raising tax (transfer scheme), (ii) rent seeking for foreign exchange allocations occurs.	Effects broadly similar to those of tariffs and quotas. Rent transfers to recipients of quotas; losses to exporters forced to surrender foreign exchange.	FER tightened during periods of import compression. Severity of FER tightening, if any, depends upon whether devaluation also occurs.
Advanced Import Deposit Schemes	Effects similar to a tariff, but if rationed foreign exchange is the binding import restriction, advanced import	Effects broadly similar to rationing of foreign exchange, since advance deposit acts as a	Length of deposit adjusted during times of import compression or liberalization.

	deposit schemes act as a tax on recipients of foreign exchange and a quota.	rationing device. Cost of compliance acts as tax on recipient of foreign exchange.	
Export Taxes	Forces resources out of taxed industries. Encourages resource flow into import competing and non-traded goal industries. Effects typically not offset by quantity constraints. Effects typically compound those of tariffs.	Typically depresses prices of taxed commodities. Frequently primary commodities heavily purchased by poor, but workers in taxed industry partly bear burden through lower wage rates.	Occasionally used as stabilization device (tea in India) to stabilize domestic price if world prices are vola-volatile.
Export Bans	Used sometimes to encourage more fabrication in local market (rattan in Indonesia). May or may not increase export earnings, and pull resources into export sector.	Typically depresses price of banned item. Other income distribution effects uncertain, since these are often intermediate items.	Not used as stabilization device. Minor stabilization impacts on economy.
Export Promotion Policies (Import Duty Remissions/Free Trade Zones)	Various schemes are used to promote exports, and if successful pull resources into export industries from non-traded good and import-competing industries.	Typically raise prices of non-traded goods and import substitutes. This is typically pro-poor if these are luxuries.	Not used for stabilization purposes. Commitment to these instruments is usually for longer term developmental reasons.
Export Prioritization (Credit Rationing)	Prioritization in favour of exports pulls resources from non-traded good and import industries into export industries. Under credit rationing, rent-seeking effects may follow.	Similar effects to export promotion schemes.	Stabilization programs (especially under World Bank or IMF auspices) may well involve change in prioritization of credit rationing. This may be in favour of, or against, export industries.

levels, such as India where tariffs rates of 300 percent are not unknown to developing countries where tariffs are much lower such as Korea and, more recently, Mexico.[4]

Tariffs and trade taxes are a major source of revenue in developing countries, but the picture is varied and rapidly changing. It is typical for countries to rely heavily on trade taxes at early stages of development. In the United States in the 1920s, for instance, the tariff still accounted for well over 30 percent of revenues.[5] And in low-income developing countries today, tariffs remain a significant source of revenue.

Table 2 presents recent IMF data for a sample of developed and developing countries, reporting the share of trade taxes (tariffs and export taxes) in government revenues. For lower income countries in Africa (Gambia, Benin, Rwanda) shares in the 40-70 percent range occur, while in African countries with a small or modest manufacturing base (Kenya, Tanzania, Nigeria), the range is smaller, 10-20 percent. In Asia, countries in the Indian subcontinent are in the 20-30 percent range; higher income NICs such as Korea are around 15 percent. Latin America reports the lowest ratios, with Brazil and Mexico being below 5 percent.

After the tariff comes quotas (quantitative restrictions). These are outlawed under the GATT[6], but developing countries,

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[4] See Young (1987), Chang (1989), and Bucay and Perez Motta (1989).

[5] Destler (1986), page 12, states that "the tariff supplied about half of federal revenues as recently as 1910".

[6] This is under GATT Article 11.

Table 2

TRADE AND OTHER TAXES AS A PERCENTAGE OF GOVERNMENT REVENUE FOR SELECTED COUNTRIES, 1986

Country	Individual	Corporation	Gen. Sales Turnover or VAT	Taxes on International Trade	Other
Developed Countries					
United States	42.27	7.76	--	1.56	48.41
Canada	36.34	10.96	9.06	5.26	38.38
Japan	--	--	--	--	--
New Zealand	52.43	8.12	11.39	4.78	23.28
Germany	13.48p	3.52p	12.26p	.02p	70.72p
Sweden	15.22	3.33	16.86	.54	64.05
United Kingdom	26.83	11.53	14.74	.01	46.89
Africa					
Benin	3.28	5.82	2.85	53.44	34.61
Gambia, The	9.84	6.07	--	68.73	15.36
Kenya	--	--	28.55	20.40	51.05
Madagascar	7.88	6.07	22.86	20.01	43.18
Nigeria	.06	59.71	--	22.35	17.88
Rwanda	6.91	9.80	--	42.39	40.90
Tanzania	12.23p	19.86p	52.38p	10.81p	4.72p
Zaire	15.93	17.42	16.63	25.70	24.32
Pacific					
Bangladesh	11.80p	.01p	8.57p	32.20p	47.42p
India	6.00p	9.37p	.93p	24.07p	59.63p
Indonesia	2.41	63.35	4.69	3.32	26.23
Korea	13.25	11.71	20.84	14.01	40.19
Pakistan	--	--	6.51	30.94	62.55
Philippines	8.30p	13.65p	7.72p	23.72p	46.61p
Latin America					
Argentina	.11	.48	11.95	13.31	74.15
Brazil	.81	6.13	2.22	4.22	86.62
Chile	3.37	7.89	29.36	10.81	48.57
Colombia	--	--	15.27	11.58	73.15
Costa Rica	13.94	3.00	16.61	22.38	44.07
Jamaica	17.45	8.19	18.23	4.13	52.00
Mexico	11.29	13.23	18.96	2.73	53.79
Uruguay	3.04	3.73	27.56	12.19	53.48
Venezuela	3.63	55.51	--	18.00	22.86

Notes:
Owing to adjustment items and unallocated transactions, components may not add to totals.
The letter p indicates that data are in whole or in part provisional, preliminary, or projected.

Source: Government Finance Statistics Yearbook, IMF (1986)

nonetheless, use them widely because of special rules which apply to their use by developing countries under Article 18-B of the GATT.[7] This GATT Article allows developing countries more latitude than developed countries in using quantitative restrictions to deal with their balance-of-payments problems, including the use of product-specific restrictions. The use of quantitative restrictions has been in relative decline in many of the higher growing Asian economies for some years, and at present their use in Latin America is also in a state of flux with significant current reductions.[8]

The trade-restricting components of trade regimes in developing countries do not, however, end with tariffs and quotas. In most countries, there are fixed exchange rate regimes, non-accommodative domestic monetary policies, and foreign exchange shortages. As a result, foreign exchange is usually rationed, and the rationing scheme used, as well as the forced surrender of foreign exchange earnings of exporters, have major effects.

The rationing of foreign exchange typically works in the following way.[9] Any firm generating export earnings through export sales is required to surrender the resulting foreign

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[7] See Anjaria (1987), Eglin (1988) and Roessler (1988).

[8] In Mexico, for instance, quantitative restrictions in 1986 only apply to around 35 percent of imports; sharply down from figures (100 percent) for the early 1980s. See Bucay and Perez Motta (1987), page 228.

[9] See also the discussion in Clarete and Whalley (1988a, 1989).

exchange to the central bank at the official exchange rate, even though the same firm could, in all probability, obtain a better rate were they to sell the foreign exchange on the black market. This, of course, is illegal under the foreign exchange regulations.

The foreign exchange generated in this way is then allocated by the central bank on a priority basis to importers of particular products. Usually an import licence justifying importation of specified products is required before any foreign exchange can be allocated, and the rules are such that anyone receiving an allocation of foreign exchange is supposedly not allowed to resell either the foreign exchange or the items (typically intermediate raw materials, or capital goods and machinery) which they are authorized to import.[10] Advanced import deposit schemes are widely used as part of this rationing process.[11]

Besides these, other policy elements often appear in the trade regime in developing countries, as Table 1 indicates. It

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[10] But foreign currency black markets are common, and in most countries with these controls, endemic. See the series of papers presented at the Harvard Institute for International Development, Workshop on Parallel Markets, November 10-12, 1988, by Glen, Pinto, Azam and Besley, Harris and Culbertson. Also see Nguyen and Whalley (1988).

[11] These require deposit of purchased foreign exchange for a specified period (between six months and two years) before importation is authorized. Such schemes were widely employed in Africa before the recent move of liberalization (see Leith (1974), for instance, for discussion of the Ghanaian case in the 1960s and early 70s) and are still used in some Latin American countries (Whalley (1989c) notes their current use in Argentina)

is common,[12] for instance, to find export taxes in many countries.[13] These typically apply to agricultural items and raw materials exported by developing countries, and often reflect the rationale that ownership of agricultural land is heavily concentrated in a relatively small number of landowners.[14] This is the case in many Latin American countries and in parts of the Pacific.

Beyond export taxes, there may be export bans. These include bans such as India uses on the export of tea from time to time in order to stabilize domestic prices in the internal market,[15] or that Indonesia uses on the export of rattan in raw form in order to encourage processing of rattan into furniture in their own economy rather than abroad. Export bans are sometimes justified by developing countries as helping to encourage higher levels of domestic production and processing in their own economies, and hence to increase the value-added content of their trade.

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[12] According to Bird (1974), between the years 1962-71, export taxes ranged from 1 percent to 18 percent of the total tax receipts in Latin America and between 2 and 12 percent in the Pacific.

[13] See the discussion of the Philippine situation with coconut and copra export taxes in Clarete and Roumasset (1983), for instance.

[14] See the discussion in Todaro (1985), for instance.

[15] See the discussion in Cohen (1977). He states (page 600) "until late 1961 the central government set annual maximum export quotas for tea in order both to stabilize domestic tea prices and to subsidize the smaller tea estates".

A further commonly used set of instruments, opposite in intent to export taxes and bans, are various schemes used to promote exports. One widely used scheme is to remit duties on imports used for processing and re-export, or to remit indirect taxes (often cascading turnover or wholesale taxes) applying to exports.[16] Such remission schemes were widely used by Korea in the early to mid-1960s as part of their initial thrust towards an outward-oriented trade policy,[17] and are widely believed in Korea to have been highly successful in propelling the economy towards a more outward-oriented stance and higher growth rates. This change in policy stance has, in turn, generated substantial increases in export volumes.

Export zones are a further export promotion device now widely being used by China,[18] India,[19] and other countries with similar intent in mind. Generally speaking, however, these free trade zones have not been so successful as the Korean remission

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[16] India uses such schemes, which has in turn resulted in countervailing duty cases against Indian exports in the U.S. market. Korea adopted such a scheme in the 1960s and 70s, and was one of the key Korean export promotion policies, but has since been phased out. See Kim and Westphal (1977).

[17] See Hong (1979).

[18] See Guo (1989) for a brief description of how the Special Economic Zones in China operate.

[19] Wadhva (1977) describes how the (Indian) "government has directly supported development of 'new non-traditional' exports such as setting up 100 percent export-oriented ventures in free-trade zones like the Kandla Free Trade Zones and the Santa Cruz Electronic Export Processing Zone"

schemes.[20] Under these free trade zone schemes, imports into the zone are duty free if used for further fabrication for export. It is also common in some of these schemes to allow exporters to retain a portion or even all of the foreign exchange they generate for use in importing raw materials and capital goods for production.

Besides these policy elements which make up a typical developing country trade regime, are further policy components which, while not usually considered as part of the trade regime, link the trade regime to policies affecting the rest of the economy. For instance, it is common in many countries for the banking system to be under centralized control, and credit rationing with prioritization towards exports to be used to generate export-oriented activity in the economy.[21] This is akin to a form of forced mobilization which drives resources into export-oriented production. The effects which follow are tax-like, insofar as a significant reallocation of resources can result. At the same time, they are non-tax-like in the sense there is a forced mobilization component to such schemes; i.e. central direction rather than market-induced changes in behaviour in the economy.

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[20] One claim sometimes heard is that existing exporters, already trading abroad, move into the free trade zones and continue their existing operations but, in addition, receive duty remissions on intermediate inputs. These claims suggest that free trade zones may, in part, simply confer lump sum benefits to existing exporters, as much as they create new export activity.

[21] See the discussion of financial institutions in developing countries in Shaw (1973) and MacKinnon (1973)

Registration schemes have also been used at various times in some economies, such as Korea[22], under which to repeatedly qualify for import licences and allocations of foreign exchange, one has to export a particular target value of production. Continuation of registration has then been conditional upon export performance.[23]

Together, therefore, all these policy elements make up the trade or external sector regime in developing countries. They all have tax-like effects through resource allocation, income distribution and stabilization impacts. Their precise form, of course, differs from country to country, but complexity and interaction between the policy elements involved is the norm.

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[22] See Hong (1979)

[23] Although the use of these registration schemes has not been given a high profile in the literature which seeks to explain how Korea managed to grow so quickly both in GDP and trade terms, these instruments may have been one of the more important.

III TAX-LIKE EFFECTS OF THE TRADE REGIME IN DEVELOPING COUNTRIES

The various elements identified above which together define the trade regime in developing countries have many tax-like effects. These are summarized in Table 1 which also emphasizes that the precise effects attributable to any one given policy element depends upon the form other policy elements take, and how they interact.[24]

There are, for instance, overall effects on trade performance which can be attributed to various elements in the external sector policy mix. Those which tend to limit import volumes, such as tariffs, quotas and rationed foreign exchange, have the effect of drawing resources from elsewhere in the economy into protected industries, making fewer resources available for exports and ultimately reducing exports.[25] In that sense, these devices operate to some extent as a tax on exports, although these effects are weaker if resources can also be drawn from non-traded goods industries.

Other tax-like effects are also anti-trade in their bias, because the objective of the instrument used is to insulate the economy from external sector shocks. Many developing countries have exports which are concentrated in a relatively small number of product categories and have exchange markets which, if allowed

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[24] Interactions between policy elements, and the ways in which the effects of one depend on the form others take, is also a theme stressed in a recent modelling piece by Clarete and Whalley (1988b).

[25] See Bhagwati and Srinivasan (1984), page 117.

to find their own level, would do so in an extremely thinly traded environment. Much of the desire for insulation from external shocks which one sees in developing countries is, therefore, a reaction to the perceived instability of their external environment, and the large adjustment costs which they would otherwise see themselves as facing.[26] Developing countries often have such restrictions as rationed foreign exchange and quotas in their trade regimes because, in the past, they have been directly affected by terms of trade and other external sector shocks which, if left unattended, would imply major adjustment costs for the economy.[27] In evaluating the tax-like effects of the trade regime in terms of the Musgravean stabilization category stressed above, one therefore has to also focus on these insulation-driven components of trade policy.

Other tax-like effects of these policy elements reflect the limited availability of other instruments for governments in developing countries for achieving particular ends of policy. One can, for instance, partly justify the structure of the foreign trade regime in the Philippines as being a partial redistributive scheme which reflects the inability of the government to use a wider tax transfer system to redistribute income in favour of rural households.[28] The Philippines is often

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[26] Also see the discussion in Oyejide (1989).

[27] See Whalley (1989) and Clarete and Whalley (1988a).

[28] See further discussion of this characterization in Alburo and Shepherd (1986) and Clarete (1989)

characterized as having a large and restive urban population which can potentially destabilize the regime in power. Governments have to keep the support of urban groups and do so, in part, through price controls on agricultural production from the rural population. Bans of luxury import items in the trade regimes are, therefore, in part, a quid pro quo for these arrangements, since conspicuous consumption of luxury imported items in urban areas would lose political support in rural areas. In turn, import prioritization in the trade regime targeted towards basic necessities more heavily purchased by the rural populations can partially correct for redistribution taking place elsewhere in the policy regime through price controls.

Tax-like effects emanating from the trade regimes also have clear sectoral effects. The usual impact is a substantial bias in favour of manufacturing industries, through protection applied to imports of manufactures. Thus, imports of consumer goods are either effectively banned or at least sharply restricted, leaving these as the most heavily protected industries in these economies. The effect is to draw significant amounts of resources into manufacturing behind the protective barrier.[29] Capital good industries are typically less heavily protected, since prioritization in import licensing usually operates in favour of capital goods and raw materials. Although preferentially treated compared to other manufactures in terms of

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[29] See Clarete's (1984) analysis of the effects of tariff protection on manufacturing in the Philippines.

allowable import volumes, they are still protected compared to agriculture, resource and service industries.

Related to all these broad-ranging tax-like effects is the issue of urban/rural bias in the trade regime and the induced effects on the urban/rural population mix and production composition. This has already been alluded to in the Philippine case through possible offsetting effects from the trade regime to those attributable to price controls. Discussion of such tax-like effects, however, also focuses on the impacts of the trade regime on urban/rural migration. In the well known Harris-Todaro (1970) model of urban/rural migration, for instance, migration occurs up to the point where the expected wage across urban and rural sectors is equalized. An important tax-like effect of the typical developing country trade regime is to protect manufacturing, raise urban sector wages, and encourage additional migration into urban areas. As far as tax-like resource allocation effects from the trade regime are concerned, these can be some of the most serious because of the added unemployment in urban areas that can result.[30]

Tax-like effects from the trade regimes can also show up in the growth performance of various countries. Duty remission schemes, credit rationing, export-related import licensing, and

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[30] Thus when Clarete and Whalley (1989) include Harris-Todaro urban/rural effects in their model of tariff liberalization in the Philippines, much larger effects occur than when Harris-Todaro effects are excluded. See also the analysis of incidence of effects of sector-specific minimum wages in a Harris-Todaro framework in Imam and Whalley (1985)

other devices are widely believed to have been central to both the sharp growth in exports in Korea in the 1960s and 1970s, and the higher GDP growth rates.[31] High growth in Korea is generally thought not to have been significantly affected by the tax policies used.[32]

The tax-like effects of these various elements of the foreign trade regime are set out in more detail in Table 1. The effects of tariffs are well known and widely discussed in literature (see Bhagwati and Srinivasan (1984)) They have the effect of increasing the prices of products produced in protected industries, drawing resources into these industries and reducing the volume of imports. An important tax-like effect of the tariff is that, where there are no non-traded goods, it operates akin to a tax on exports. In the presence of a non-traded goods sector, however, if it is large enough, the main effect can be to draw resources from the non-traded goods sector rather than from the export industries.

The income distribution effects of the tariff reflect any changes induced in relative prices domestically. Since tariffs in most developing countries are heavily concentrated on luxury items rather than on basic necessities, these effects are usually taken to be anti-rich and also anti-urban, which, in turn, are frequently assumed to be synonymous.

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[31] See Kim and Westphal (1977) and Lee and Naya (1988).

[32] See Kwack (1989)

Quantitative restrictions are widely thought to have tax-like effects similar to a tariff. They raise prices of protected products in the domestic economy. This has the effect of yielding higher prices for domestic producers, drawing more resources in protected industries and ultimately, like a tariff, also operating as something akin to a tax on export industries. The interactions between quantitative restrictions and tariffs are important, because with binding quantitative restrictions, the main effect of the tariff is to operate as a redistributive device taking income away from the recipients of quota rents. In turn, with quotas, the income-distribution effects depends upon whether quotas are auctioned or sold by government, and, therefore, whether the government receives the revenues from quotas or whether they are directly allocated to individual citizens or firms. Related to this is the issue of whether rent-seeking activities are thought to accompany whatever quota allocation scheme which is used.[33]

Foreign exchange rationing is a further import-restricting element of the trade policy regime, and is an especially good example of a policy component which has pronounced tax-like effects. Foreign exchange rationing operates, in effect, as a tax transfer scheme which raises zero revenue for governments. It taxes exporters and transfers rents to importers through the

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[33] See Krueger (1974) who suggests that for India around 7 percent of GNP could be dissipated in rent seeking for import quotas, and around 15 percent of GNP for Turkey. Mohammed and Whalley (1984) put rent-seeking costs of all controls in India at around 30 to 45 percent of GNP.

allocation of foreign exchange. Its effect is much like a tariff or a quantitative restriction. It raises prices in the domestic market. This draws resources in industries which are protected in this way, with differential protection reflecting the way in which foreign exchange is prioritized among different import categories. In the long run, it also has the effect, like a tariff, of operating as a tax on exports in the economy.[34]

Foreign exchange rationing can also have the effect of making both quotas and tariffs redundant instruments of trade policy. Thus, with binding foreign exchange rationing quotas and tariffs may have no effects on trade volumes, since rationed foreign exchange becomes the effective restriction within the trade regime. In periods of major foreign exchange shortage in developing countries, such as the early 1980s and following the onset of the debt crisis and higher oil prices, foreign exchange rationing schemes within developing countries typically become the most crucial part of the whole trade regime. On the other hand, if there is growth in the developed world, such as has taken place more recently, and if devaluations occur, then a weakening of the foreign exchange constraint will eventually imply that other elements of trade policy become more critical.

The tax-like effects deriving from export taxes and bans are much the same as those associated with tariffs. These have the effect of reducing export volumes and through the displacement of domestic resources, pulling resources from those sectors into

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[34] See also Clarete and Whalley (1988a).

import-competing industries. In turn, the effect is to raise the relative price of import-competing products through the depressing effect of the export tax, since, in the small open economy case which characterizes most developing countries, these taxes are typically fully borne by producers of export items. Export taxes and bans, therefore, have the effect of compounding those tax-like effects attributable to the tariff.

On the other hand, export promotion schemes such as import duty remissions, free trade processing zones and other similar devices, operate in an opposite way to a tariff. These are sometimes employed in economies which want to move closer towards trade neutrality while at the same time leaving the structure of protection in the form of tariffs in place. This approach has been widely used in the Asian economies, and has been adopted by them as a mechanism of consciously moving in a trade-liberalizing direction while not removing polically sensitive protection. As such, the tax-like effects of these instruments operate in the opposite direction to those of trade-restricting measures. Things become somewhat more complex when licensing schemes and credit rationing come into play since the tax-like effects here operate in ways which tend to offset the quantity rationing components associated with the foreign exchange and quota regimes. Which effects dominate depends on which constraints are binding, and which are larger.

All of these tax-like effects, however, have to be understood in the context of the overall policy system which

operates in developing countries. The tax-like effects of any individual element depends crucially upon what the other components of the trade regime, and indeed the wider policy regime, are. The tax-like effects of a tariff in the presence of a quota are different if the quota is binding, compared to the case where the quota is non-binding. Similarly, binding foreign exchange rationing will change the tax-like effects of both a quota and a tariff, and also affect the tax-like effects attributable to export promotion, export tax and prioritization schemes.

Indeed, it is tax-like effects attributable to these instruments which, in many cases, have made them the binding instrument in the trade regime and the policy instrument most widely used to affect change. Thus, those economies which have recently used alternative foreign exchange retention programs, under which exporters can retain a fraction of their foreign exchange earnings and keep them in foreign currency accounts to finance imports, have revealed their understanding of their trade policy regime, and which are the key instruments. These schemes have been recently widely used as mechanisms to promote exports in a series of countries.[35]

Thus, tax-like effects attributable to individual elements in the trade regimes in developing countries can only be evaluated with some caution because of the interactions which take place between all these elements and the wider policy

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[35] See the discussion of China, for instance, in Guo (1987).

network. Disentangling this network of interactions, and examining one policy instrument in isolation can be both dangerous and potentially misleading.

IV TAX-LIKE EFFECTS OF THE TRADE REGIME IN THE WIDER POLICY SYSTEM

Given the discussion of the tax-like effects of the trade policy regime above, it is helpful to consider these tax-like effects in a broader context in order to obtain a more complete sense of how these effects operate and where these trade systems may be headed. This is what I attempt in this section by discussing interactions of the trade regime with formal tax systems in developing countries,[36] and what may be happening on the trade liberalization front.[37]

Compounding Effects Between Tax and Trade Regimes

All of these tax-like effects listed above compound with the effects of the tax system. For instance, generally speaking they tend to reduce the distorting effects of trade taxes. In lower income countries, trade taxes are especially important in accounting for a large and significant portion of revenues raised.[38] To the extent that other elements of trade policy come into play such as quotas and rationed foreign exchange, it tends to result in trade taxes having largely lump sum effects. These apply more in the case of imports where quotas and rationing of

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[36] See the discussion of developing country tax systems in Bird (1987), Dewulf (1974), Greenaway (1981) and Shoup (1966).

[37] See the discussion of recent liberalization in The Final Report (1989) and World Bank (1989).

[38] See the discussion of Table 2 on page 10.

foreign exchange applies than they do for exports where export bans and restrictions are less pervasive.

Another tax-like effect reflecting the compounding of taxes with the trade system involves the agricultural and manufacturing situation in developing countries. In most countries, agriculture is largely or wholly tax free while protection tends to benefit the manufacturing industry. The agricultural/ manufacturing terms of trade in many developing countries is an ongoing topic of policy debate. There have been, for instance, active debates on these matters in India since Independence in 1947.[39] However, to the extent that the manufacturing sector is more heavily taxed, the tax-like effects of the trade regime in generating higher prices of protected manufactured products probably have the effect of increasing revenues under the tax system. The tax system thus tends to offset the effects of the trade regime on the intersectoral terms of trade.

A third effect of the trade regime which compounds with effects of the tax system is that the trade regime typically has the effect of creating taxable rents. This, in turn, raises revenues for the government, but at the same time generates increased evasion. Black market activity in countries such as

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[39] See Mohammed and Whalley (1985) and the discussion there of Indian literature on the intersectoral terms of trade.

India may be heavily tax-generated, but its size and scope is influenced by the trade regime.[40]

A fourth compounding effect between taxes and the trade regime affects both recent tax reform and trade liberalization efforts. Trade liberalization as has been noted in a number of recent papers, has accelerated rapidly in developing countries in recent years, and trade and tax liberalization interact in important ways. As trade liberalization occurs, the effects of tax policies on resource allocation become more important compared to taxing rents associated with policies. In turn, as tax reform occurs through such moves as broadening of the base of sales taxes and lowering tax rates, it tends to weaken the interaction between tax and trade policies.

Some Implications of Recent Trade Liberalization

The tax-like effects of trade policies are also changed by reform, and the ebb and flow of policy change in developing countries. Developing countries, more so than developed countries have, seemed to experience wide oscillations of policies in recent decades, with attempts at liberalization which then regress into arrangements closer to the original form, while other changes take place elsewhere in the policy system.[41]

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[40] See the discussion of tax evasion in India in Goswami (1988), and black market-official market linkages in Nguyen and Whalley (1988).

[41] See the discussion of experience in Southern Cone countries in Corbo and de Melo (1987).

Because there are so many policy elements which affect the tax-like effects of the trade regime, and because change is so rapid, it makes disentangling the tax-like effects especially difficult. Thus, where domestic price controls apply, the tax-like effects of tariffs can be quite different because the resource misallocation effects induced by an increase in prices which follow from the introduction of a new protective barrier can be offset through effective price controls.

One of the more remarkable sets of changes currently going on in developing countries is liberalization in the external sector itself. The recent Ford Foundation-supported project on developing countries mentioned earlier in this paper, has tried to document how extensive this is.[42] An appendix to this paper attempts to summarize the liberalization experiences of the eleven participating countries.

What seems to emerge is that a series of pressures has grown in developing countries in recent years which has forced them to re-evaluate their trade and development strategies and, in some cases, dramatic change has resulted. In others, changes thus far are more localized to re-evaluations of strategies and evidence of the changes in thinking. But in all cases, change is evident.[43]

Many developing countries who, through the 1950s and 60s, were strongly wedded to the ideas associated with import

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[42] See the Final Report (1989).

[43] See the discussion in Appendix A.

substitution trade strategies, emphasizing growth behind a domestic protective barrier, have seen the relative success of the more outward-oriented economies, such as the Asian NICs, and the relative lack of success of countries opting for the import substitution route. As a result, many have begun to re-evaluate the desirability of their own import substitution strategies, and the intellectual climate has changed substantially. Economists and key decision-makers in many countries no longer so reflect the tradition from the 1950s and 60s in which the ideas of Prebisch and others associated with import substitution approaches were particularly influential.[44]

Furthermore, developing countries suffered substantially during the 1981 recession as regards their trade performance. Many of them became convinced in the mid-1980s that they had to prevent any future threatened closing of the international trade system, and were genuinely concerned about threats to their access to developed country markets for manufactures. They were, therefore, more willing than earlier to consider liberalization as a way of ensuring access abroad through a bargained approach as in the GATT. There have also been pressures for liberalization operating through conditionality from the IMF and the World Bank, particularly in the African economies but also in some of the Asian and Latin American economies.[45]

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[44] See Prebisch (1962), Lewis (1954), Chenery (1960), Myint (1958), and Myrdal (1957).

[45] See this discussion of conditionality in Williamson (1983) and Helleiner (1986).

All these factors, therefore, combined with the strong growth of developed countries from 1982 onwards and the growth in export earnings of developing countries that this has generated, has created a new climate of trade policy in the developing world. This, in turn, has allowed for liberalization of foreign exchange arrangements in many countries.

As the summary of the liberalization experience from the Ford Foundation-supported project in the appendix makes clear, liberalization is now extensive in the developing world. It ranges from dramatic cases (such as Mexico, Nigeria and Korea) to intermediate cases where clear steps have been taken (such as in the Philippines, Costa Rica, China and elsewhere) to cases which are more tentative but in which a direction in favour of liberalization is clearly emerging (such as India, Brazil and Argentina). In most of these countries, there has first been liberalization of foreign exchange arrangements, followed by a slow relaxation and withdrawal of quota restrictions, followed finally by reductions in tariffs. Mexico, for instance, now has less than 24 percent of its trade covered by quantitative restrictions compared to 80 to 100 percent in the early 1980s. The maximum tariff in Mexico is 20 percent compared with 50 percent when Mexico first came into the GATT in 1986.

This wave of liberalization, clearly changes the tax-like effects of the trade regime in developing countries. Because of

the sequencing implicit in this liberalization process,[46] what were previously non-binding instruments of trade policy become binding. As foreign exchange arrangements are liberalized, so first quotas and then eventually tariffs become the binding restrictions on trade. The tax-like effects of the trade regime, therefore, get rearranged in light of these developments.

Is this trade liberalization sustainable? The Ford Foundation-supported project report discusses this in some detail, and suggests that despite their progress, in the medium to longer term these liberalizations could prove somewhat frail. They are still lacking widespread domestic political support, since few of them have yet demonstrated enough concrete positive results through improvements in economic performance in the economies involved. Also, political support is strongly needed for these reforms in the guise of reciprocated actions by developed countries in the current GATT Round, and especially in the areas of tropical products, provisions for credit in GATT negotiations for prior liberalization made before the negotiations, and implementation of standstill and rollback provisions. Wider issues such as textiles, safeguards and agricultural also need urgent attention from the developing country point of view.

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[46] Also see the discussion of timing and sequencing of trade liberalization in developing countries in Edwards (1984) and Wolf (1986).

The sustainability of this liberalization is also clearly dependent upon macro economic conditions in the developed countries. A recession in the developed world and an elimination of the current U.S. trade deficit would undoubtedly adversely affect developing country trade prospects, and could potentially reverse much of the liberalization which has been underway in the last few years.

All of this, therefore, indicates how policy arrangements in developing countries are in constant flux, and as this occurs, instruments which were previously non-binding on decision-making become binding and vice versa. As a result, the tax-like effects of components of the trade regime can change quite remarkably. This, in turn, emphasizes the difficulties of disentangling and firmly demonstrating what the tax-like effects of individual trade policies actually are.

V CONCLUSION

This paper evaluates the tax-like effects of the trade regime in developing countries. The key effects are those which affect resource allocation income distribution, growth, and other performance criteria of economies. The paper discusses what is meant by the term "tax-like effects", and traces through how these effects arise with tariffs, quotas, rationed foreign exchange, advance import deposit schemes, export bans, export taxes, free trade zones, credit rationing and other components of trade regimes.

It suggests that the tax-like effects from trade regimes can be pronounced, but at the same time they differ both by continent and by trade policy component. They can compound or offset the effects of trade taxes, and importantly operate as part of a wider policy system in which only binding instruments have major and significant effects on resource allocation. Such instruments as tariffs will largely have only income distribution effects in the presence of tariffs.

Finally, the paper notes that recent trade liberalization seems to be accelerating in the developing world, making tax design more important as the tax-like effects of trade policies become weaker.

APPENDIX A

RECENT TRADE LIBERALIZATION MEASURES UNDERTAKEN BY ELEVEN DEVELOPING COUNTRIES[1]

Argentina

The most recent trade liberalization in Argentina was initiated in 1987 in an effort to better integrate the industrial sector into the international economy. Measures included in this first phase focused on creating free trade status for Argentine exporters and removing substantial numbers of quantitative restrictions. The product coverage of quantitative restrictions was reduced from 62.3 percent to 36.8 percent of imports. Under the trade reform program of 1988-89, it is expected there will be further removal of non-tariff barriers to imports. On September 21, 1988, the coverage of quantitative restrictions was further reduced to 18 percent and is expected to decline to 15 percent in early 1989. There has also been substantial reduction in import licensing. Additional liberalization measures to be implemented in the near future include the reduction and rationalization of tariff protection, deregulation of exports and a tightening of the industrial promotion regime.

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[1] This material draws on the discussion of trade liberalization in eleven developing countries in the Final Report of a Ford Foundation-supported project on Developing Countries and the Global Trading System (1989).

Brazil

Trade liberalization in Brazil is relatively recent and still tentative. In May 1988, the Brazilian government introduced a tariff reform program. The aim was to eliminate several types of special import restrictions. Additional reforms included the consolidation of all taxes on imports into the tariff, and a general reduction in tariffs. While it is expected that these reforms will make the Brazilian trade regime more transparent and predictable, quantitative and administrative controls over imports thus far remain largely unchanged.

China

The Chinese government policy of opening its economy to the outside world began in 1978 along with other economic reforms in agriculture and other sectors of the economy. Four special economic zones were established during 1980-81, followed by the opening of fourteen coastal cities and the entire island of Hainan in 1984. Towards the end of 1987, a major foreign trade reform package was announced. Reforms included giving more decision-making power to foreign trade and export-oriented enterprises, reduction or exemption of taxes on exports, redistribution of foreign exchange earnings in favour of enterprises making finished products, and encouraging an agency system that strengthens links between foreign trade corporations and manufacturers. As China has undergone a transition from a closed economy to a more open economy, it has consistently

attempted to maintain imports at the level of export earnings. However, a large increase in imports in 1985 combined with a deterioration in terms of trade due to poor export demand also resulted in an increase in tariffs on a range of manufactures in 1987.

Costa Rica

Costa Rica revised its trade policy in 1982, with a major emphasis on improving export capacity. As part of its stabilization program, the foreign exchange market was reorganized and stabilized in 1982 and 1983. Since 1983, a policy of mini-devaluations has been followed, aimed at maintaining a constant real exchange rate so as not to harm exporters. As a member of the Central American Common Market, Costa Rica applies a Common External Tariff (CET) which went into effect January 1986. The aim of the CET was to reduce the dispersion of tariffs both among countries and within industrial branches. Costa Rica uses three major export promotion instruments: the export contract, a regime of temporary import admission, and free export processing zones.

India

In recent years trade liberalization in India, while tentative, has nonetheless progressed steadily. The most visible component has been a movement of an ever larger number of imports to open general licensing; which, in effect, allows for quota-

free importation if foreign exchange can be obtained. In India's foreign trade system, this is significant change, although tariffs on many items remain high. At an intellectual level, more debate now appears to be underway than formerly on what direction trade policy in India should take.

Kenya

Kenya's recent trade liberalization stems, in part, from a structural adjustment program in 1980 which involved a number of trade reforms. These included the lowering of some import duties, reduction of non-tariff barriers and depreciation of the Kenyan currency. In 1986, duties on a range of imports were eliminated or reduced. In the last two years, while not being reversed, the pace of liberalization has slowed.

Korea

Korea's import liberalization began in 1978. It further accelerated in the early 1980s as part of a policy reform package aimed at generating overall structural adjustment in the economy. The liberalization process has been helped in recent years by current account surpluses. Bilateral pressure from the E.E.C. and U.S. have produced further changes. Recent liberalization measures include a three-year plan to be finalized before the end of 1988 to free all manufactured goods of discretionary import licensing along with as many agricultural products as possible. Between 1989 and 1993, tariffs will be cut annually to an overall

average level of 8 percent. The average tariff on non-agricultural products will come down to 6 percent by 1993, while the average on agricultural products will be lowered to 17 percent.

Mexico

Between 1983 and 1985, Mexico experienced a moderate liberalization of import controls. In July 1985, however, a significant import permit liberalization program was launched. At this time, 3,600 out of 4,400 tariff items controlled by quantitative restrictions were liberalized. By the end of 1987, the coverage of quantitative restrictions (import licensing and/or official reference prices) had been reduced to 24 percent of trade. During this period, the maximum tariff was reduced to 20 percent from 100 percent, while the average tariff declined to 10 percent from 23 percent.

Nigeria

A structural adjustment program introduced in mid-1986 by the Nigerian government has changed import policy drastically. The previous import licensing system was abolished in September 1986. A 30 percent import levy has been discontinued. Reform of the tariff structure initiated at the same time has resulted in substantial cuts in import duties. A major restructuring of the exchange rate system took place in October 1986, in the form of a second-tier foreign exchange market. The exchange rate is now

market-determined. The 1987 budget included a reduction in the advance payment of import duties from 100 percent to 25 percent. In addition, import of raw materials and intermediate goods for use in the manufacturing industry and the production of exported goods is free of duty or other indirect taxes and charges. A further tariff review went into effect January 1988, and import procedures are now relatively simple.

The Philippines

The Philippine import liberalization program was initiated in 1981 as part of a medium-term structural adjustment program. Phase 1 of the import liberalization program covered the period 1981-87 during which time import controls on 2,185 items were liberalized. Import liberalization was temporarily suspended in 1984 due to a balance-of-payments crisis, but was reinstated in 1985. Phase II of the program covers the remaining 673 items on which import controls are still imposed. These items have been divided into three lists. List A contains 104 items which should be liberalized before the end of 1989. List B covers 455 items requiring further study, with the decision to liberalize being taken before the end of 1989. List C contains 114 items which will remain restricted indefinitely for health, safety and national security reasons.

A Tariff Reform Program was also undertaken between 1981-85. The program involved an overall review of the tariff system which included the rates of import duty and classification. The

objectives of the revision were to lower excessive levels of protection and to even out the dispersion of levels of protection across industries.

Tanzania

Tanzania's recent liberalization began in 1984 with the implementation of an own-funds imports scheme. In mid-1986, the government launched an Economic Recovery Program. Objectives included achieving a positive growth rate in real per capita income, reducing the rate of inflation and restoring a sustainable balance-of-payments position. Measures initiated at the same time included: significant exchange rate adjustments, adjustment in interest rates, increases in producer prices in real terms for export crops, and a significant reduction in the number of price-controlled items.

The government remains committed to trade policy reform and in 1989 expects to implement further reforms that include: a movement away from the system of import restrictions and administrative allocation of foreign exchange, rationalization of tariffs and sales taxes, liberalization in internal trade and pricing, and improved export incentives.

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