TRADE POLICY AS A MEANS OF IMPLEMENTING OR PROMOTING ECONOMIC DEVELOPMENT

Note by the GATT Secretariat

1. In most countries of the ECAFE region, the main objective of economic policy is the economic development of the country which aims primarily at a diversification of the economic activities of the country through industrialization. In view of the urgent need to implement economic development in order to raise the general standard of living of that region, it is not surprising that all other aspects of economic policy, including trade policy, should be framed in the light of that paramount objective. Trade policy can assist in promoting economic development if its objectives and methods of operation are defined in close relation to the objectives of economic development. Trade policy may even be considered as an integral part of any rational policy for economic development and not, as it is sometimes felt, as a policy which is governed by principles inconsistent with the objectives of such development. The purpose of this note is to examine how, in practice, trade policy may contribute actively to the implementation or promotion of economic development. Trade policy will be considered in its broadest term as the sum total of measures which governments may take in order to influence the flow of imports and exports. These measures may determine the volume or value of total imports or, in certain classes of imported or exported goods, the price at which exported goods are sold on foreign markets or at which goods are sold on the domestic markets, or the direction of import or export trade. The principal methods which governments may use are, on the import side, the imposition of quantitative import restrictions, the levy of duties or similar charges, or the collection of other charges (exchange or otherwise) which may increase the cost to the domestic consumer of imported goods or limit the demand for such goods; on the export side, the government may impose quantitative restrictions, levy duties or similar charges, or grant subsidies or other export incentives. These measures may increase, limit or reduce the volume of export trade or influence their cost to foreign consumers. Trade policy also includes the conclusion of bilateral or multilateral agreements or arrangements with other governments concerning facilities granted to trade. Trade policy also includes the assistance which governmental or official bodies may give in the marketing of goods abroad or the supply of foreign goods.

2. Trade policy affects in many ways the implementation of economic development programmes; it seems, however, that its contribution is particularly welcome in so far as it enables the country

(a) to maximize the foreign exchange earnings derived from exports;
(b) to allocate the foreign exchange available in the best interests of economic development;

(c) to obtain the greatest possible supply of each category of goods for the amount of foreign exchange allocated to that category;

(d) to secure a reasonable protection to the industries set up within the framework of development, while safeguarding the interests of the community;

(e) and to neutralize excessive inflationary pressures.

I. TRADE POLICY AS A MEANS OF MAXIMIZING THE FOREIGN EXCHANGE EARNINGS DERIVED FROM EXPORTS

3. The studies prepared by the Regional Commissions of the United Nations concerning the planning of economic development have shown clearly that any economic development programme involves a substantial expenditure in foreign exchange. The amount of foreign exchange expenditure involved as compared with the total outlay may vary from country to country and from project to project, but experience and analysis suggest that, on an average, one-third or more of the total expenditure has to be paid in foreign currencies. The adoption of any large project presupposes therefore an addition to the current earnings in exchange. In most countries, the monetary reserves are not large enough to meet this demand; the import programmes have been pruned so drastically that there is very little scope for further reductions; and the implementation of the development project will not usually yield appreciable savings at the beginning. Additional income in foreign exchange has to be found, either through additional exports or through loans and commercial credits. Unless financial assistance takes the form of grants, the repayment of loans or commercial credits will oblige the recipient country to increase its exports in the following years, so that the financing of economic development programmes will require a determined effort to obtain additional current income, either immediately, or in the very near future, which, in present circumstances, means usually that the country has to increase its exports abroad.

4. In order to meet this essential requirement, the department responsible for trade policy will try to influence the flow of exports in such a way as to produce such additional income as and when it is required to service the loans or repay the commercial credits used for the financing of economic development projects.

5. The planning of such an export programme will normally take place before the programme or project is finally approved. It requires an assessment of the trends on the world markets for the products which may be exported, and an
assessment of the capacity of those markets to absorb such increased supply and of the probable effects on prices of such an export drive. This assessment will enable the government to choose among the products coming into consideration, those which are likely to bring the best results, either because the demand is comparatively elastic or because the price trends are favourable. The government would then devise appropriate measures with a view to promoting an increased production of the goods if they are already exported, or to initiate production, if the goods selected are not yet exported.

6. In present circumstances, and for some time to come, it may be assumed that the export programme will concentrate on a number of primary products, either raw materials for industrial processing, or agricultural products for consumption. The world markets for such products are generally characterized by the low elasticity of demand in the short-run, and, as regards agricultural products, by the existence of severe import obstacles and export incentives. A closer analysis of the situation of the various markets shows, however, that certain products have been far less affected than others by such adverse factors and that this situation is likely to remain in the future. One of the objects of trade policy should therefore be to give priority, as far as practicable, to those products which appear to meet less competition and to face less formidable trade barriers. In particular, when the country depends on the export of a small number of primary products, it should avoid excessive reliance on the products whose market is thus more vulnerable, since any over-optimistic assessment of the prospect of a single product would jeopardize the implementation of economic development projects. Experience has shown that such miscalculations are not always avoided and it may be that the encouragement given by Uruguay to the production of wheat at the expense of meat has contributed to financial difficulties facing that country at present and that the reliance of Turkey on a substantial increase in its exports of wheat and cotton as a main source of additional foreign exchange, has reacted adversely on the prospect of achieving its economic development without excessive delay or cost. Other countries have been able to lay a particular emphasis in their export programmes on commodities such as iron ore, non-ferrous metals or oil, whose market has been more resistant and the implementation of their development programmes has been smooth and economical.

7. Another point which the departments responsible for trade policy may have to consider is whether it would be in the interest of economic development to encourage the processing of the primary products before they are exported. It is clear that, other things being equal, the value added by processing would increase the foreign earnings derived from the export of a given quantity of raw materials. However, the substitution of processed products for raw materials is limited by two factors. First of all, it should not involve the exporting country in foreign exchange outlays for the setting up and the maintenance of the new industry exceeding the additional exchange income expected from the export of the processed product. Secondly, the substitution should not react adversely on the export possibilities of that part of the raw material which continues to be exported without processing.
8. As in the case of the granting of protection in favour of a new industry supplying the domestic market, the promotion of an industry processing a raw material for export should be considered in the light of its exchange earning or saving capacity. If the setting up of the processing industry involves, on balance, substantial outlays in foreign exchange, it may not be profitable to promote an industry which may, in effect, reduce the available supply of foreign exchange for a number of years. It may also be that, in order to penetrate export markets, this new industry would have to be subsidized in order to enable it to reduce its export price in terms of foreign currencies. If the raw material has a good market, the subsidization of the processed product may involve a net loss in foreign exchange. This may not be apparent when, as is sometimes the case, the subsidy is granted in the form of a privileged exchange rate.

9. The substitution of a processed product for the raw material may embarrass the foreign producers of that product, who were accustomed to buy their raw material in the country engaging in such substitution; they may be less willing to buy their raw material in the country which has become their competitor and this factor may adversely affect the export possibilities for the raw material which continues to be sold in a crude form, especially when the conditions of the market are not particularly favourable to exporters. What is perhaps more important is the fact that the capacity of absorption of world markets for the processed product may be less than for the raw material. When the processing is limited to the first stages and the material is exported in the form of a semi-manufactured product, the danger may not be very serious. But when the intention is to go beyond that point and to export what may be considered as a finished product, the risks of substitution may be more real. There have been cases in which the exporting country enjoyed a more or less complete monopoly of the supply of the raw material and was in a position to reduce the supply of the material in its crude form and to oblige the foreign customers to buy the processed product instead. It may be said that this is what happened in the case of jute. But when the raw material is in abundant supply, this substitution would not be very successful. It would, for instance, be clearly advantageous for the United States to transform its surplus of cotton into piece goods and to try and sell it on world markets. In present circumstances, it is likely that such a policy, if it were adopted, would not be beneficial to the United States since it would not be in a position to increase substantially its sales in cotton piece-goods and would lose the earnings otherwise derived from the sale of its raw cotton.

10. Another way of maximizing the earnings derived from the export of a primary product is to improve the quality and the grading of the products exported. Sometimes, the exporting country does not receive the full benefit of these exports because the material has to be sent abroad to a central place where it is graded, blended, packed or otherwise prepared for sale to the consumer. The use of a central market arrangement may be the best solution in certain
cases, but in other cases, the location of these marketing operations in the exporting country would bring additional exchange income to that country without affecting the disposal of the exported goods or impairing the competitiveness of the exporter. In those cases, the assistance which governments might give to their producers in order to improve the grading and presentation of their goods for export may result in a substantial increase in the foreign exchange earnings which they may earmark for the financing of their development projects.

11. The main task, however, of the departments responsible for trade policy is to minimize the obstacles which the marketing of exports encounters in the importing countries. The first consideration will of course be to secure equality of treatment in those markets. Experience has shown that the best protection lies in obtaining unconditional most-favoured-nation treatment and the benefits of non-discrimination. It may be tempting to contemplate the conclusion of agreements designed to obtain certain privileges for one's exports. Such agreements may give a temporary stimulus to such exports but the advantages which may thus be obtained have to be tested against the long-run disadvantages which may result from them. As this point will be considered again in paragraph 14 below, it may be sufficient to indicate that the main disadvantages of such agreements lie in the price to be paid in the form of import privileges for the partner's goods, in the distortion in the normal channels of trade and in the incentive it gives to other exporting countries to secure similar privileges from their partners.

12. The desire to eliminate import barriers leads to an active effort to obtain from the importing countries a reduction in their import duties in so far as they affect the staple products of the exporting country and a guarantee that these duties will not be raised in the near future. As a general rule, industrial countries do not levy duties on raw materials for their industry, but frequently levy high duties on agricultural products, even when those products are further processed by their industry. The existence of such duties may result in a reduction either of the volume of exports or of the earnings derived from such exports. In order to obtain a reduction of those duties in the importing country, it is generally necessary for the exporting country to accept commitments regarding its own import policy.

13. Another factor which affects the market of raw materials is the recent increase in the production of substitutes, i.e. of "manufactured" raw materials such as synthetic rubber, artificial fibres, synthetic detergents. As a protection against excessive competition from these substitutes, it will be of interest for the exporters of natural raw materials to obtain from the consuming countries guarantees that competition with these substitutes will not be altered by tariff or other trade measures in favour of these substitutes. The producers of nitrate in Chile have found that the policy followed by their Government in seeking such a protection against chemical fertilizers was particularly effective. Such guarantees, however, may not be sufficient to ward off the competition of substitutes and, as will be outlined in paragraph 17 below, the relative price of the natural and synthetic products plays an important part.
14. Another obstacle which has become often more intractable than tariffs is the resort to quantitative import restrictions and the discriminatory application of such restrictions. This obstacle seems to be less serious now than during the immediate post-war period for the trade in primary products, but there are still a number of cases where, in order to maintain a market for its exports, the country exporting primary products is obliged to pay a certain price in the form of import facilities for the export trade of its partners. It is clear that the maintenance of import restrictions of that kind may seriously affect the earning capacity of the primary producing country and that any assistance which that country may find in international organizations for the elimination of those restrictions would facilitate its exports and improve its exchange receipts.

15. Although bilateral agreements such as those referred to above, i.e. list agreements, providing for "single-country quotas", tend to disappear gradually, another form of arrangement has become popular in recent years. These might be called long-term barter agreements, since the main feature of these agreements is that one partner offers to sell, for instance, capital goods against a repayment over a number of years through the supply of agreed quantities of specific primary products. Usually, the exchange of goods is balanced and no payment is involved; in order to achieve such a balance, it is necessary either to fix the prices of the goods supplied or to establish a ratio between the prices of the goods sold by each partner. Such agreements have the advantage of enabling the exporter of the primary products to assess in advance and with a certain degree of precision the foreign exchange earnings which it will derive from the export of a certain quantity of goods and the corresponding imports which it will be in a position to purchase without any net outlay in foreign exchange. When such arrangements are considered, however, their possible disadvantages should not be overlooked. Any long-term arrangement which has the effect of tying a substantial part of the export surpluses of a staple product to a particular market has the disadvantage of obliging exporting countries to leave the field open to competitors on world markets and if the arrangement is not renewed when it comes to an end, the exporting country may find that, having lost its former connexion with the market, it has difficulty in regaining its former position. Moreover, it is likely that the price to be paid for the attractive features of such arrangement may be greater than the advantages which would be gained in effect if the exporting country had remained free to take advantage of the conditions on world markets. An important point which should be taken into consideration is clearly that such arrangements represent a net addition to the total earnings derived from the sale of the products in question and not merely a shift from one destination to another.

16. It would seem that the choice to be made as between the various methods of disposing of export products either on world markets, or by means of bilateral list agreements, or through long-term barter agreements will largely depend on conditions prevailing on world markets. It is to the advantage
of a country exporting primary products as of any other country to purchase its imports in the cheapest market, and therefore to sell its exports in a currency which may be used in a wide range of markets, and, unless conditions on the world market of its export products are abnormal, there would seem to be little advantage in resorting to bilateral bargaining as a means of husbanding its foreign exchange resources.

17. It may be said, however, that bilateral bargaining has a distinct advantage over other methods in so far as it guarantees a fairly stable price for the sale of one or more primary products during a period of years. The violent fluctuations which have affected the prices of a number of primary products during and after the Korean boom have underlined the difficulties which instability in the prices of primary products may cause to countries which rely on the export of such products. There is little doubt that such fluctuations are detrimental to economic development. The primary producing countries have been anxious to protect their economy against such fluctuations. It is clear that the task of a country engaged in a process of economic development would be greatly facilitated if it could expect that the prices of its export products would remain remunerative and comparatively stable. The emphasis lies on the stability of prices rather than on the particular level around which those prices would fluctuate moderately. In this connexion, the competition of a substitute raw material has to be considered in assessing the optimum price level for natural raw materials. The maintenance of such prices at a level which would, in the long run, adversely affect the marketing possibilities of the primary producing countries would clearly be at the expense of their economic development programmes. The price instability of natural raw materials and their relatively high price level as compared with the prices of substitutes has been instrumental in reducing the requirements for imports from primary producing regions. If prices of natural raw materials were to be maintained at a level encouraging substitution, there would be a serious danger for these regions. It may be useful to quote in this connexion the following passage from International Trade, 1955: "If, as may be expected, the production of manufactured substitutes continues to grow at the expense of natural products as in recent years, the advantages reaped by the non-industrial areas from the improved terms of trade they have been enjoying as compared with prewar may vanish rapidly and the export proceeds of these areas may even diminish in absolute terms."1

18. In view of the situation which has developed on the market of a number of primary products, it would seem that one of the main objectives of trade policy should be to influence export prices in such a way as to limit the risks of substitution. This may be achieved by various means. When, as is

1 International Trade, 1955, page 14; published by the G.TT secretariat.
often the case, the exporting country levies an export duty, or restricts in any other way the export of a product, that government would have to follow closely the trend in the markets in order to adjust the export duty or the incidence of its restrictive measures in order to maximize the earnings derived from this export without jeopardizing the prospects of future disposal.

19. Although, for the time being, the export programmes of the governments in the LACIE region have to rely essentially on the disposal of primary products, it is to be expected that, as soon as the economic development projects come into operation, new industries will produce manufactured goods not only for the internal market but also for export. Indeed, it seems that in certain cases already, these new industries have found that they could produce efficiently only if they were in a position to export part of their production. It may be that in certain cases the export surplus may result from the fact that the domestic demand for those products is lagging behind the capacity of production and that, as soon as the general standard of living rises in the country, the apparent surplus may gradually be absorbed by the domestic market. In other cases, the industry, to operate in optimum conditions, requires a permanent export outlay.

20. The natural tendency of such producers of manufactured goods will be to sell in neighbouring countries, especially if the economic development of those countries is not far advanced. But it is possible that governments would be led to encourage the export of these goods to industrial countries in order to obtain additional foreign exchange to purchase capital goods in those countries. It would clearly be more difficult than in the case of raw materials to enter these markets. The additional supply of manufactured goods will increase competition on the markets supplied by these industrial countries and the producers of those countries will try to ward off this increased competition. The experience of Japan before the Second World War shows clearly that the appearance of new exporters of industrial consumer goods on world markets may lead to serious trade conflicts.

21. Even after the War, it has not proved possible for Japan to obtain most-favoured-nation treatment from all countries. As is known, fourteen contracting parties to GATT (including some non-industrialized countries) have resorted to Article XXXV of the Agreement and reserved the right to discriminate against Japanese goods. The agitation in a number of countries to obtain from their governments protection from what they consider to be unfair competition from countries where wages are lower than in Europe and the United States shows that if Asian countries were to develop their exports of manufactured goods, there might be a strong pressure to deviate from most-favoured-nation treatment and to discriminate against goods exported by those countries. This growing pressure will be felt more particularly if the exports of those countries are in the textile sector. As a result of the growing disappearance of the export outlets of the textile industry of industrial countries, there is a strong resistance on the part of producers who have not enjoyed, after the War, the favourable conditions which obtained in other sectors of production.
An active effort on the part of those responsible for trade policy in the EEC/EEA countries will be necessary in order to preserve the advantages derived from the unconditional most-favoured-nation clause obtained by them within the framework of their trade agreements and some ingenuity in devising reasonable safeguards for the countries which may be open to conviction on the part of their sectional interests.

II. TRADE POLICY AS A MEANS OF ALLOCATING AVAILABLE FOREIGN EXCHANGE IN THE INTERESTS OF DEVELOPMENT

22. On the assumption that the implementation of an economic development programme obliges the government concerned to limit imports in order to give priority to the requirements of economic development, it may be useful to consider what criteria should be used for the achievement of that purpose and what methods should be selected to obtain the desired result. There have been many cases in which the implementation of economic development programmes has been frustrated or made more difficult by a lack of coordination between the departments responsible for the allocation of resources and those which decide on the creation of new industries or the adoption of development projects. Often enough, new industries set up with the approval or the assistance of the government are not in a position to operate normally because they do not receive the necessary allocation of foreign exchange to purchase abroad necessary raw materials or intermediate products or spare parts. In those cases part of the valuable capital invested is lying idle or the cost of production is increased in such a way as to result in a serious wastage of resources. In some cases even, projects cannot be completed and machinery already imported is lying idle and buildings already started become rapidly a dead asset because the initial capital outlay had been made without ascertaining that the necessary foreign exchange would be available for the completion of the project.

23. There is a natural tendency to underestimate the expenditure in foreign exchange which will be necessary for the operation and maintenance of new industries. In the same way as it is easier for a government to get budgetary authority for building offices than for maintaining these buildings when they are completed, it seems to be easier to include in a foreign exchange budget the amounts necessary for the purchase of capital equipment needed for the creation of an industry than the smaller amounts which are essential for its effective operation.

24. Another consideration which appears to be important in this connexion is that the development of a new industry in its initial stage increases the demand for consumer goods which may not be entirely met by domestic supply. If the allocation of foreign exchange for the setting up of that industry means that this additional demand cannot be met by imports, there is a serious danger of strengthening the inflationary pressures which are inherent in economic development and eventually of frustrating the objectives of such
development. The departments responsible for import programming have an essential part to play in this respect and it would be advisable if their opinion were obtained before a decision is taken on any specific economic development project involving substantial outlays in foreign exchange. A close collaboration between those who are responsible for the planning of economic development and those responsible for import programming, i.e. for the provision of foreign exchange for the implementation of these projects, should avoid the difficulties which have been mentioned above.

25. Once the targets for the allocation of foreign exchange are accepted or defined, there remains the question of the machinery best suited to achieve the desired result. In most countries at present the rationing of foreign exchange is effected by the use of quantitative import restrictions. The government decides to allot a certain amount of foreign exchange for the various categories of goods, taking into account the relative priorities of these goods in relation to various objectives, more particularly to the requirements of economic development. This allocation of resources for a year or six months may take the form of a definite programme or foreign exchange budget, or may consist in guiding lines for the officials who will later on issue individual licences. The amount allotted to the various types of goods is then distributed among the importers in accordance with definite criteria, either by reference to the import trade of the importer in a representative period, or by some other method. The adoption of such a system of allocation obliges the government to decide for each category of goods what quantities are going to be imported during the licensing period, and also to decide who is going to import the various quantities of the various products. In other words, it obliges the government to take decisions which normally should be taken by the individual consumers or importers.

26. Such a system was introduced in order to meet balance-of-payment difficulties; so long as these difficulties could be considered as temporary ones, the system had many advantages. If, as appears to be the case, those difficulties may last for some time in countries which are embarking on long-term economic development programmes, it may be in order to consider whether this system is the most appropriate in the interest of such development. It is admitted that the system of quantitative import restrictions has two main disadvantages. It obliges the government to determine in detail the requirements of the community for each particular product or group of products and to decide on the particular import machinery to be operative. On the other hand, it creates a monopoly for those who receive import licences and, in so far as the consumer has to pay a fee to the monopolist, it diverts substantial capital which could be received by the government and earmarked for the financing of economic development.

27. Like all rationing systems, the quantitative restriction of imports deprives the authorities of the assistance of the play of economic forces. It may even encourage importers to use to the full the import permits where, in normal circumstances, the demand would be less. Such a system would be efficient if the licensing officers could have a perfect knowledge of the actual needs of all consumers. Moreover, the priority given to capital goods
has the effect of reducing the turn-over of the importing agencies which normally deal only with consumer goods. If, as is to be expected, this reduction becomes permanent, the system of allocating exchange to importers on the basis of a representative period leads to the maintenance of an excessive importing apparatus in relation to the turn-over and therefore to an excessive distributing cost. Such a system prevents the contraction of this apparatus which is essential if the cost of distribution is reduced to a normal level.

28. The maintenance for a comparatively long period of such a rigid system of controls is bound to lead to serious distortions. The experience gained in Europe has shown that these distortions may make it more difficult to return to a normal system of trading when the balance-of-payments difficulties disappear. One of the main distortions resulting from the system is the incidental protection which it affords to the domestic producers of goods similar to those whose import is restricted. In certain countries, the domestic restriction of non-essentials and luxury goods through import controls has led to a substantial diversion of available resources or the production of similar goods in the country of import and to the detriment of more important development projects.

29. For these reasons, in order to avoid these defects, a number of schemes have been suggested, or even adopted. The main feature in these devices is the classification of the various import products into four or five categories and the imposition of a graduated premium levied in one form or another for the import of goods in the various categories. The consumers and/or importers are free to compete for obtaining the exchange and are also free to select in the category the goods which they want to import. With the adoption of these devices, the intervention of the government is limited to the determination of the amount of foreign exchange which the community may use for the total imports of the goods in each category. The level of the premium in each category corresponds to the degree of essentiality of the goods. Generally, the governments keep the right to allocate exchange on an individual licensing basis for goods imported by official authorities or by industries owned by the State or sponsored by it. This system of allocation of exchange does not oblige the government to go beyond what is necessary for the protection of its balance of payments and, as a by-product, enables it to receive instead of the importer the profit which the possession of an import licence gives to the importer under the traditional system. The secondary features of the system may differ; for instance, the premiums may be fixed by the State once and for all, or may be revised from time to time; the categories of products may be defined for a long period or for shorter periods; the premiums may be fixed by the government or may be the result of free auctions. In certain cases, the system may be even more simple; the imports of consumer goods may be restricted, but the importers may be obliged to get the exchange from a free market which is supplied by non-trade receipts (tourist traffic, capital imports, etc.), and partly only by the proceeds of exports. The system of premiums may be replaced by a system of
graduated deposits which may be repaid some time after the import is actually effected. The main feature, however, is that the rationing of the imports is done through the price element instead of being done by physical restrictions.

30. It is too early to determine whether the introduction of such new devices will be conducive to a better use of available foreign exchange in relation to the requirements of economic development. One of the reasons which make it difficult to pass judgment on these schemes is that they have often been applied in countries where the national currency was over-valued, and such devices had the double object of getting around the psychological resistance to currency devaluation as well as to effect a reasonable allocation of foreign exchange. Only in a few cases has the system been limited to the second objective. In those cases, it has been comparatively simple, eventually, to work in the system of premiums into the customs tariff and to dispense with a special method for the allocation of foreign exchange. It is true to say, however, that those cases were comparatively simple, and the countries which were able to solve their problems in this way had only to face temporary balance-of-payments difficulties. This experiment shows, however, that there may be some advantage in reconsidering the methods of applying import controls with a view to adjusting these methods to the requirements of economic development and to avoiding the distortions and other inconveniences which a prolonged maintenance of quantitative import controls may bring about in countries which are engaged in an active programme of economic development.

III. TRADE POLICY AS A MEANS OF ENSURING THE MOST ECONOMICAL USE OF AVAILABLE FOREIGN EXCHANGE

31. As the implementation of economic development programmes increases the demand for imported goods and exerts a pressure on the balance-of-payments situation, it is essential to see to it that the foreign exchange available is used as economically as possible; in other words that each necessary purchase is made on the cheapest market. Trade policy has an important part to play in this respect. As a general rule, there are better chances of achieving this result if the importer is given the possibility of choosing among the largest number of supplying markets; insofar as trade policy is able to maintain a multilateral pattern of import trade, there is reason to believe that the importer, in his own interest, will buy as economically as he can without needing any special direction from governmental authorities. It may however not be always possible to grant these facilities to the importers. So long as all currencies are not convertible, it may be necessary for the government to restrict the expenditure in hard currencies more than the expenditure in soft currencies. Moreover, the situation on the export markets of certain commodities is such that bilateral channels have to be used for the disposal of part of these goods, and the government may have to oblige importers to buy certain products in one country or in a group of countries.
32. If the choice of suppliers is limited, it should be necessary to avoid, as far as possible, that this restriction of competition should not lead to substantially higher import prices. In certain cases, governments of the ECAFE region have inserted in their bilateral agreements the clause which enables them to refuse the issue of "single country licences" if the prices quoted were higher than world market prices, in other cases, they have limited the operation of the single import licensing system to cases where their own export reached or exceeded a certain level. Whatever may be the methods used for limiting the price effects of bilateral arrangements, it is clear that these defects cannot be entirely eliminated. Even in the case of separate licensing regulations for hard and soft currencies, governments have usually provided that if important capital equipment or other essential goods were more expensive in soft-currency countries, a preference would be given to suppliers of a hard-currency area. In each case, the departments responsible for import programming have to decide whether it is preferable to spend less in a hard currency than more in a softer currency. It would seem in the general interest of economic development to widen as far as possible the choice of the countries of supply, and to introduce for as many products as is practicable an open general licence covering a wide range of countries rather than adopting a system of single country licences when this is not required by the payment arrangements in force.

33. The choice of the methods of implementation of import controls may also have a bearing on the actual cost in foreign exchange of imports in that it may make it easier or more difficult for the importers to take advantage of the conditions of the market and to obtain from their suppliers the rebates which are normally granted for the purchase of substantial amounts. It would seem that in some cases the costs in foreign exchange of machinery or essential raw materials have been appreciably reduced, or the licensing procedures have been more flexible. If, for instance, an importer may obtain a licence covering its requirements for a comparatively long period, he may obtain better prices than if the licences are given in installments for periods of one month. If the licences are granted sufficiently in advance, the importer may wait for better conditions on the market than if he is obliged to use immediately his authority to import. Needless to say, any unnecessary expenditure in foreign exchange resulting from the rigidity of the licensing procedures may eventually frustrate the objectives of economic development by reducing the foreign exchange which would otherwise have been available for the financing of essential projects. It may not be easy to reconcile the provision of such facilities to importers with the paramount requirement of keeping total expenditure within reasonable limits; it would, however, seem that careful consideration of the improvements, even of a minor character, which may be introduced in the operation of licensing procedures may bring in substantial results.

34. Finally, the experience gained by the diplomatic and commercial service abroad may be of particular assistance to the importers who would be in a better position to be on the various markets. In all countries, but more particularly in countries which have not been accustomed to make important
orders abroad, the contribution of the external services of their governments will help them to get the best type of information on the specifications, relative quality and prices, of the producers in the various markets. It may be said also that the regular contacts which the high officials responsible for commercial policy may have with their colleagues of the other continents in the annual meetings of the CONTRACTING PARTIES to GATT have been particularly fruitful in imparting to the countries of the ECAFE region valuable information on conditions abroad.

IV. TRADE POLICY AS A MEANS OF AFFORDING REASONABLE PROTECTION TO INDUSTRIES SET UP WITHIN THE FRAMEWORK OF ECONOMIC DEVELOPMENT PROGRAMMES

35. When a new industry is set up in a country engaged in an active programme of economic development, that industry generally requires assistance from the government in the form of protection against the competition of similar products from abroad. The justification for such protection is to be found in the fact that, during the early stages of operation, the new industry is not fully efficient; the volume of production is usually below the optimum level and the cost of production is abnormally affected by overhead charges; the labour and technical staff have not acquired the necessary skills to avoid stoppages, breakages or wastage, the product of the new industry may face consumer's prejudice. The government, however, will usually not be prepared to grant protection unless it is satisfied that the substitution of domestic products for imported goods is in the general interest of the country. In other words, it will have to be satisfied that, after a temporary period of breaking in, the new industry is in a position to produce efficiently. The best test of it will be its ability to compete with foreign products.

36. The two main methods of affording protection to domestic industries are protective tariffs and quantitative restrictions. The trend in the industrial countries after the War has been a gradual disappearance of quantitative restrictions as a protection device and all countries parties to the GATT have accepted that philosophy and recognized that tariffs are the appropriate means of granting protection to their industries. On the assumption that tariffs are to be eventually the normal means of protection in the countries of the ECAFE region, it may be useful to consider first whether the tariff and the tariff policies in those countries are adequate to meet the requirements of economic development. In most of the countries of the ECAFE region, as in other countries producing mainly primary products, the tariff has been and is still used for fiscal purposes. So long as these countries were importing practically all the manufactured goods which their consumers required, there was no reason to restrict the demand for such goods in order to protect their national industries. On the other hand, for reasons of convenience, the levy of revenue duties on the import of consumer goods enabled the governments to obtain substantial income without incurring high administrative expenses. The purpose of the tariff is naturally reflected
in the structure of the tariff itself, and in particular in the tariff nomenclature. It may be said that in most countries of the region today, the tariff and its nomenclature are no longer appropriate to serve as an instrument of tariff protection and, as a matter of fact, a number of countries have already started a revision of their tariff and their tariff regulations with this in mind.

37. These changes however cannot be limited to the structure of the tariff and to tariff regulations such as valuation rules, etc. A fiscal tariff is different from a protective tariff. The object of a fiscal duty is to bring in as much revenue as possible and it should be so designed as not to restrict unduly the amounts imported; on the other hand, a protective duty has a restrictive effect on the volume of imports, and therefore on the revenue. The selection of the items on which a fiscal duty is imposed is different from the choice of items on which protective duties are levied. In the case of a fiscal duty, the government will usually select good revenue earners and for reasons of convenience it will define the items in a very broad way. In the case of a protective duty, the government will try to limit the effect of the protection to those varieties or subclasses of goods which are produced and to exempt partially or totally the imports of the goods which are not so produced. Finally, a fiscal duty may have to be modified from time to time without much advance notice being given, whereas a protective duty, in order to achieve its purpose, must have a certain degree of stability. In view of these conflicting objectives it may be difficult to move rapidly from a fiscal to a protective customs tariff. There may be cases in which a new industry is penalized because for fiscal reasons, a raw material or an intermediary product necessary for its operation is subject to a high revenue duty, whilst the product manufactured by that industry is not so highly taxed. That new industry enjoys what may be called a negative protection; in other words, the effect of the tariff is to subsidize the import of the foreign product.

38. One of the results of the setting up of new industries whose production takes the place of important products is a consequential decline in the revenue derived from the customs. As soon as domestic products are substituted for imported goods, on which a revenue duty is levied, the income derived from that duty diminishes. Sooner or later, the government will have to tap other sources of revenue, either by the institution of direct taxes, or by the introduction of excise duties or of consumption or turnover taxes. It would seem in the interest of economic development that this process of substitution should be expedited and that as soon as possible, the tariff should be confined to its normal function of protecting the industries. If this process is unduly delayed, domestic industry may enjoy in fact a protection which was not deliberately contemplated by the government; the foreign product will lose its normal competitive advantage so long as the domestic product is not subjected to a similar internal tax. Whether the duty is styled revenue or protective duty, its effect is clearly protective.
When the government decides to introduce a tax on the domestic product in order to replace the income derived from the revenue duty on the imported product which is imported in smaller quantities, it will be more difficult for the domestic producer to adjust himself to the situation than if the internal tax had been introduced and a protective duty had been established in conformity with the normal procedures in force.

39. In most of the countries of the ECAFE region, the change-over from a fiscal to a protective customs tariff has not yet advanced very far, but in a number of countries a distinction is already made between fiscal and protective motives and an independent machinery has been set up to deal with problems relating to the introduction of protective tariffs. The level of protection which is appropriate in the case of an industry or of branch of production and consistent with the interests of the community at large, varies from country to country, from industry to industry, and from time to time, and there is a growing recognition of the fact that it would not be in the interest of economic development to grant such protection indiscriminately or without regard to the competitiveness of the industry requiring such protection. For these reasons some governments, such as India and Pakistan, whose policy is to rely on tariffs for protective purposes, have set up a Tariff Commission which consists of independent members and has at its disposal a staff (including a cost-accounting department) which is separate from the other departments of civil service. The task of that Commission is to consider applications for protection in the light of an objective appraisal of the facts and, if necessary, to recommend changes in the level of that protection. There are no scientific criteria which may determine automatically whether an industry or branch of production is eligible for protection or what is the appropriate level of protection for a given industry. In the terms of reference of the Tariff Commissions, there is usually a clear indication that, in making their findings and their recommendations, they should take into account the interests of the consumers and of the community at large. It may be suggested that the interests of economic development would best be served if, particular attention were paid to the following factors. It would appear appropriate to examine more particularly whether the activity of the industry asking for protection would result in a net saving of foreign exchange for the country and would not lead to any substantial inflationary pressure. Economic development requires capital and foreign exchange, which are both scarce in under-developed countries and any mal-distribution of these scarce resources will retard or jeopardize economic progress. While governments, in taking their decisions on development projects, are not entirely moved by economic considerations, since they have to take into account other factors such as the need to procure employment to their people, it seems that economic development would be facilitated if, as a rule, the protection granted would not go against these two important principles. In assessing the saving in foreign exchange which a new project may bring about, it would be in order to set against the saving made by the substitution of domestically manufactured products for imported products, the outlays in foreign exchange necessary to service the loans, to pay the instalments relating to the purchase of equipment
and machinery, as well as the outlays in foreign exchange required for the import of raw material or intermediate products or spare parts, for the payment of salaries of foreign technical staff, etc. It should also be necessary to take into account any loss in foreign exchange which may result from the consumption by the industry of raw materials which would otherwise be exported. Different factors would be taken into consideration when the product of the industry is used for further processing or is used otherwise and where the product is sold directly to consumers. In the first case, it would seem normal to assess the impact of the price differential between the domestic and the imported product on the cost of production of the other industries and to take into account the cumulative effect of this factor on the cost of living. In the case of consumer goods, the direct impact of the price differential on the cost of living should be taken into account; it may be useful also to consider the impact of the price differential on sensitive items which may influence the standard of living of the working classes and be determinant for the presentation of wage claims.

40. So much for the eligibility of the industry for protection. There remains the question of the level of protection which may at the same time afford reasonable safeguards for the industry and for the consumers. There would be an advantage for an optimum allocation of resources for economic development if the level of protection in each case were fixed in such a way as to let foreign competition exercise a certain influence on the domestic market; this would induce the domestic producer to increase its efficiency and would protect the consumer against any unjustifiably high price for the domestic product. In this connexion, the obligation made on the Tariff Commissions to keep the situation under periodic review and to make recommendations in the light of changed circumstances appears to be eminently wise. If it is assumed that the level of protection is based on an estimate of the actual cost of production of a normally efficient domestic producer plus a reasonable profit margin, substantial changes may occur rapidly in the elements of this calculation in a country which is engaged actively in a programme of economic development. During the first stages of development, it may be, for instance, necessary to allow for a comparatively high margin of profit in order to attract men and capital from the trading community, to build up an entrepreneur class. After a while, the margin of profit which may have been considered necessary during the initial stages could have to be revised downwards. In the same way, the remuneration of capital or of short-term bank loans may be very high during the early stages of development but this situation may improve as soon as the country develops a commercial banking system and a capital market. On the other hand, labour costs may be particularly low in the beginning but, when industrialization has made progress, conditions may change and wages may rise. It is true that this increased cost element would be made up to a certain extent by improved productivity.
41. Even if the setting up of an independent Tariff Commission may introduce a certain element of rigidity and give less scope to international trade considerations than if these functions were left in the hands of governmental departments, it seems, on balance, that the setting up of Tariff Commissions whose members and staff are really independent from governmental or sectional influence has so many advantages that it would commend itself to the majority of governments which consider the revising of their customs policies. In order, however, to enable such a Commission to work with success, it might be appropriate to consider whether its activities should be limited to private industry or whether a similar procedure should not be applied in the case of industries owned or supported by the state. Although such extension of the jurisdiction of the Commission to state-owned or sponsored industries may give rise to administrative or political difficulties, there would be clear advantages in enabling an impersonal body to submit these industries to the same test as those financed by private means. Moreover, the influence of such a Commission would be substantially limited so long as protective tariffs do not represent the only source of protection. So long as industries may rely on the incidental protection derived from the continuance of revenue duties or the maintenance of balance-of-payments quantitative restrictions, it will be difficult for the Tariff Commission to determine the real level of protection enjoyed by a given industry. There is no doubt that, if an industry can rely on revenue duties or balance-of-payments quantitative restrictions for its protection, there will be no strong inducement for it to apply for a protective tariff or, if it does so, it will usually consider the protective tariff granted to it as a line of retreat to be used when the other forms of protection disappear. The co-existence of various forms of protection may also have the disadvantage of limiting the freedom of action of the Tariff Commission when it considers an application in the case of an industry which has been operating under the shelter of fiscal duties or quantitative restrictions. Even if the Tariff Commission is satisfied that the continuation of such an industry is not economically justifiable, it might be politically extremely difficult for it to refuse the granting of protection which may lead to unemployment or a drastic writing off of substantial capital investments. If the policy of a government is to resort eventually to the tariff as the normal means of protection for its industries, it would be in the interest of the economic development of the country as a whole if the recommendations of the Tariff Commission were made more effective in eliminating as rapidly as possible the other forms of incidental protection.

42. Whilst most governments have accepted the view that the tariff is the most appropriate means of protecting their new industries, there are still a number of cases in which quantitative import restrictions are used for the promotion of a new industry. In order to attract capital, domestic or foreign, a government may have decided to limit the import of the product to be manufactured by a new industry to the share of the market which is not going to be supplied by that industry. If, for instance, that industry is able, in a given year, to supply 80 per cent of the market, only 20 per cent will
be made available for imports. When it is able to satisfy the entire demand of the market, imports may be entirely prohibited. If this system may contribute to overcome the hesitations of the entrepreneurs or the financial backers, it may have serious disadvantages for the community at large. By earmarking in such a manner a large part of the market for the domestic producer, the government gives in effect a monopoly to the domestic producer for that share of the market. Moreover, the monopoly profit which that producer may derive from that situation might serve a more useful purpose if it were levied by the government in the form of a tariff the proceeds of which might be used to finance economic development. As the foreign competitors cannot influence the price level in the domestic market, or increase their share of the market by lowering their prices, they will naturally adjust their selling price to that of the domestic producer. If such a practice were to become permanent or to be extended to many industries, it would influence substantially the general level of prices. It will also bring about distortions in the price system and therefore in the structure of the economy. This would lead to a mal-distribution of the limited resources in capital and in foreign exchange which are available for the financing of economic development.

43. For these reasons, resort to quantitative restrictions for protective reasons is now considered to be rather the exception than the rule. There are cases where, during its first stage of operation, an industry may not be sufficiently protected by tariff measures while it appears reasonable for that industry to enjoy protection. There would be advantages if such cases were submitted for consideration to the body which has to recommend on the introduction of protective tariffs. Such a body would seem to be the best qualified to make recommendations in such cases since it has gained experience in deciding when and to what extent protection is necessary in the case of industries applying for tariff protection. There would also be advantages if the decision for the granting of protection through quantitative restrictions on imports could be valid only for a very short period, and if it were clearly provided in that decision that tariff protection would be substituted for the restriction as soon as the special circumstances justifying the adoption of that method cease to exist. The Tariff Commission might be instructed to review the situation at very short intervals and to recommend, as soon as practicable, a change in the form of protection,
V. TRADE POLICY AS A MEANS OF COMBATING INFLATION

44. The Economic Commission for Latin America, in its surveys, has shown with admirable clarity the influence which inflationary pressures may have on the rate of economic progress, and it is generally recognized today that inflation is probably one of the worst enemies of economic development. Trade policy may contribute substantially to the prevention of inflation in a number of ways. It may, for instance, prevent increases of prices on world markets from affecting the level of internal prices. The government may introduce export duties which would deprive the producers of the windfall profits which might thus accrue to them and encourage them to drive up prices in the absence of an elastic domestic supply of consumer goods. These profits may serve later to supplement prices obtained on world markets when those prices fall below the average. The government may even go further and introduce a stabilization or equalization fund which would guarantee to its domestic producers a certain level of prices, irrespective of the fluctuations which may take place on world markets. This system, if it does not replace stabilization schemes applied by international co-operation, may at least avoid some of the worst effects of fluctuating world prices for primary products on the internal stability of the primary producing countries. By adopting a reasonable attitude and adopting definite criteria for the granting of tariff protection, the government may, by its commercial policy measures, ensure that the setting up of a new industry does not drive up the general level of prices or the cost of living. By improving its methods of import control for the protection of their balance of payments, governments may also neutralize the inflationary effect of a restriction of the supply of consumer goods at a time when economic development measures lead to an increase in the purchasing power of the population. Apart from the measures which have been described in the preceding paragraphs, other possibilities are open to the governments. For instance, the drastic curtailment of the imports of non-essential or luxury goods which may be required to give the necessary priorities to essential economic development projects may induce entrepreneurs and domestic capitalists to invest money in the production of these goods in the country itself. This venture, although very profitable to those engaged in it, would be less valuable to those engaged in the development of the economy at large. Such a diversion of resources may have an inflationary effect which the government might counteract by imposing on such luxury goods an internal tax applied both on imported and domestic goods. Another method which governments have often used in order to combat inflationary pressure is to increase foreign competition by relaxing import controls or suspending customs duties on essential goods. This method has been applied in a number of cases with respect to essential food-stuffs, consumer goods, or raw materials. A more spectacular measure in the same direction has been introduced lately by the Government of the Federal Republic of Germany, which has decided to combat inflation by scaling down its customs duties for the entire industrial sector. It may be said that only industrial countries with abundant foreign exchange resources
can afford to resort to such a drastic measure and that most of the countries in the ECAFE region would not be able to take a risk of spending a large part of their scanty reserves in order to achieve such a result, even if it were highly desirable. It is nevertheless true that some governments of the region have already resorted to measures of this kind, even though these measures were of a limited scope. India, for instance, has suspended its duties on steel in order to avoid an increase of prices of steel products in the country. There may be other cases in which the governments may wish to resort to such measures in order to prevent or correct inflationary pressures which may retard or jeopardize their economic development.

CONCLUSION

The Working Party on economic development and planning of the Economic Commission for Asia and the Far East has been invited to consider the major policy questions connected with economic development and, in particular, the contribution which foreign trade policy may make in promoting economic development, and may be an integral part of such a policy. The objective of trade policy is clearly the same as that of economic development and there seems to be no reason to fear that there should be a conflict between the two. There is no lack of economic development projects in any of the countries of the ECAFE region; there is, however, a lack of capital and foreign exchange resources. Trade policy may be of particular assistance in selecting those projects which are the most profitable for the economic development in relation to the availabilities of capital and foreign exchange. The value of that contribution, however, may depend to a large extent on the practical arrangements adopted for associating those responsible for trade policy in the formation of development policy. This contribution may be comparatively small if the departments responsible for trade policy are brought in after the decisions on development projects are taken; it may be substantially greater if the advice of those departments is sought before these decisions are hammered out.