Trade Policies for Productive Transformation: Trade Agreements

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Outline

- productive transformation
- Industrial policy
- Trade and structural transformation nexus
- Empirical evidence
- Role of tariffs
- Impact assessments
- Other IP tools limited by trade agreements
- Some reflections on trade regimes

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Productive Transformation

- The shift from low-productivity and low-wage sectors to high-productivity and high-wage sectors. From an agriculture and a resource-based economy to an industrialized economy
- Sectoral pattern: early stages: concentration and specialization based on natural comparative advantages; intermediate stages: diversification based on comparative advantage acquired through policies and capacity building; maturity: concentration/specialization at a high technological level
- Three factors for development: increasing return to scale, technological change and synergie and cluster effects (Erik Reinert)
- Importance of structural transformation: higher income levels; sustained growth (less volatile growth and less vulnerable economies); productive jobs; and economic dynamism
- Recent ILO Global Employment Trends report chapter on structural change confirming this importance for the promotion of the decent work agenda
- Productive transformation requires domestic investment and an important role for the state: “the developmental state”
- Productive transformation requires an industrial policy

Industrial Policy

A range of policies aimed at inducing structural change/industrial development. These are necessary for take-off and long term growth, and include:

- Policies affecting “infant industry” support of various kinds
- Trade policies
- Science and technology policies
- Public procurement
- Policies affecting foreign direct investment
- Intellectual property rights
- The allocation of financial resources

What are some of the successful elements of industrial policy?

- The role of the state is key in driving the industrialization process
- Focus on high quality activities (increasing returns) characterized by dynamic imperfect competition and not on low quality activities characterized by perfect competition (see next slide for a full list)
- Risks have to be taken to be successful
- The need for investments in education and innovation (public research centers)
- Selective-targeted policies need to have some sort of control mechanism (such as export targets, local content requirements)
- Experimentation and innovation are essential
- Comparative advantages have to be created
- Access to cheap (domestic) finance for infant industries
- National ownership of the industrialization strategy is important
- Tariff policy can be a determining element when it comes to protecting a sector or industry to take off

High quality activities (Erik S. Reinert)

- New knowledge with high market value
- Steep learning curves
- High growth in output
- Rapid technological progress
- High R&D content
- Necessitates and generates learning by doing
- Imperfect information
- Investments come in large chunks (indivisible)
- Imperfect but dynamic competition
- High wage levels
- Important economies of scale and scope
- High industry concentration
- High barriers to entry and exit
- Branded products
- Produce linkages and synergies/clusters
- Product innovations

Two schools of thought on industrial policies

- "horizontal industrial policies" i.e. to provide an enabling environment for industrialization such as a favorable investment climate, attraction of FDI, linking up with global value chains, export oriented strategies following comparative advantage, promoting of education and vocational training, building appropriate and efficient infrastructure, encouraging international technology transfers, and fostering research and development (World Bank, Unido)

- "vertical industrial policies" i.e. targeted to specific sectors: important role for the state, nurturing of infant industries, it involves creating comparative advantage, focus on increasing returns activities, developing domestic markets, learning by doing, technology transfers, great role for domestic investors, domestic research, export targets, high output of engineers, relatively equal income distribution, rent-seeking, firm-level R&D, high levels of investments, re-investment of profits etc. (Ha Joon Chang, Reinert, Cimoli, Dosi, Amsden, Stiglitz etc)
- These two streams have different views on the role of trade policies

Trade and trade liberalization

- The neoliberal and still prevailing view is that trade liberalization is beneficial for economic growth and employment
- This has resulted in a focus on market access in trade agreements and promotion of exports along comparative advantage
- WTO, World Bank, IMF, and OECD promote free trade and further trade liberalization

BUT:

- The quality of the growth is entirely ignored (what kind of jobs are destroyed and created (quality)
- The contribution to productive transformation or structural change is ignored
- The distribution of costs and benefits of this growth are largely ignored: the bargaining power of governments and workers has been reduced vis-à-vis multinationals due to increased competition

Trade liberalization and development

- Trade liberalization leads to specialization
- This results in specialization in products in which the country has a comparative advantage at the moment of liberalization
- For many developing countries trade liberalization therefore has resulted in specialization in low value added products such as commodities, natural resources and low value added manufactures such as textiles and electronic components, resulting in low wage/low income levels often accompanied by poor working conditions
- Global value chains have reinforced this specialization pattern. A large chunk of FDI in developing countries is in the extractive industries.
- The focus and reliance by many countries on FDI and linking up to global value chains makes it difficult for them to “own” their development process

Trade liberalization and development

- “The most advanced sectors are the ones most subject to increasing returns and consequently the most sensitive to the drop in volume caused by sudden competition from abroad”. “Therefore, free trade between nations at very different levels of development tends to destroy the most efficient industries in the least efficient countries”: the Vanek-Reinert effect
- This means that developing countries have to be careful in liberalizing their trade, especially with more advanced economies.
- Once a country liberalizes and takes commitments in a trade agreement it might well prevent a country from protecting new sectors it wants to develop in the future.

UNCTAD and Buffie: African countries

- UNCTAD country studies (Laird, 2006) from Malawi, Zambia, Brazil, Jamaica, Bangladesh, India, the Philippines and Bulgaria examine the impact of trade liberalization.
- In particular, the rapid growth of imports of industrial products led to the closure of some local industries and to stagnation or low growth in industrial jobs.
- For example, in Zambia, tariff reductions led to job losses, due to relocations and closures. Formal employment fell from 23 per cent over the period 1981–1990 to an average of 12 per cent during 1991–2000 and to 8.1 per cent in 2003.
- Countries like Malawi and Jamaica also showed a decline in the manufacturing sector and in employment.
- The study on India showed the growth of employment in the informal economy and increased casualization of employment
- Buffie (2001) finds that trade liberalization in Africa had serious effects on employment, while Latin American liberalization in the 1990s has led to large formal job losses and increasing underemployment in Peru, Nicaragua, Ecuador and Brazil

Erik S. Reinert

- Mongolia:“Half a century of industry building in Mongolia was virtually annihilated over a period of only 4 years, from 1991-1995. In most industrial sectors, production was down by more than 90 percent in physical volume since the country had opened up to the rest of the world, almost overnight, in 1991.”
- Peru: “the inefficient industrial sector in Peru nonetheless created a wage level that was about twice as high as what today’s globalized economy is able to deliver in Peru”.
- Mexico: “Mexican real wages dropped drastically as the NAFTA agreement slowly decimated traditional “complete industries” while increasing the simple assembly (maquila) activities. The increasing return industries died out in order to give birth to constant return activities, thus primitivizing the national production system.”

Ha Joon Chang/Amsden

- *The Economist* recently lauded the success of Chile which 'moved from basic industries such as mining, forestry, fishing and agriculture to aluminium smelting, salmon farming and winemaking thanks to a number of government initiatives'. It added that this was achieved by following its comparative advantage.
- However, Ha Joon Chang describes Chile as a case that 'has lost a lot of manufacturing industries and become excessively dependent on natural resources-based exports' (Chang, Ha Joon 2007):
- Not having the technological capabilities to move into higher productivity activities, Chile faces a clear limit to the level of prosperity it can attain in the long run.
- Amsden (2007: 84) reinforces this assessment:
- Chile started the post-war period with a per capita income roughly twice that of Taiwan (same size and arability as Chile) but ended the century with a per capita income barely half Taiwan's, which in the meantime had targeted manufacturing growth.

ILO/WTO publication (2011)

- Article by Dani Rodrik and Margaret McMillan
- In both Latin America and sub-Saharan Africa, structural change has made a sizable negative contribution to overall growth, while Asia is the only region where the contribution of structural change is positive.
- Impact of trade opening on structural transformation in Latin America and sub-Saharan Africa: globalization appears not to have fostered the desirable kind of structural change. Labour has moved in the wrong direction, from more-productive to less-productive activities, including, most notably, informality.
- Minerals and natural resources do not generate much employment, unlike manufacturing industries and related services. Even though these “enclave” sectors typically operate at very high productivity, they cannot absorb the surplus labour from agriculture.

Tariff policy

- Plays an important role in industrial policymaking
- The drive for liberalization and structural adjustment programmes, as well as export led growth have reduced attention for the role of tariffs
- All successful (industrialised) economies have used tariffs to protect their industries, including countries like Korea, but also China and Vietnam.
- Tariff policy is even more important given that other industrial policies are already severely restricted in the WTO

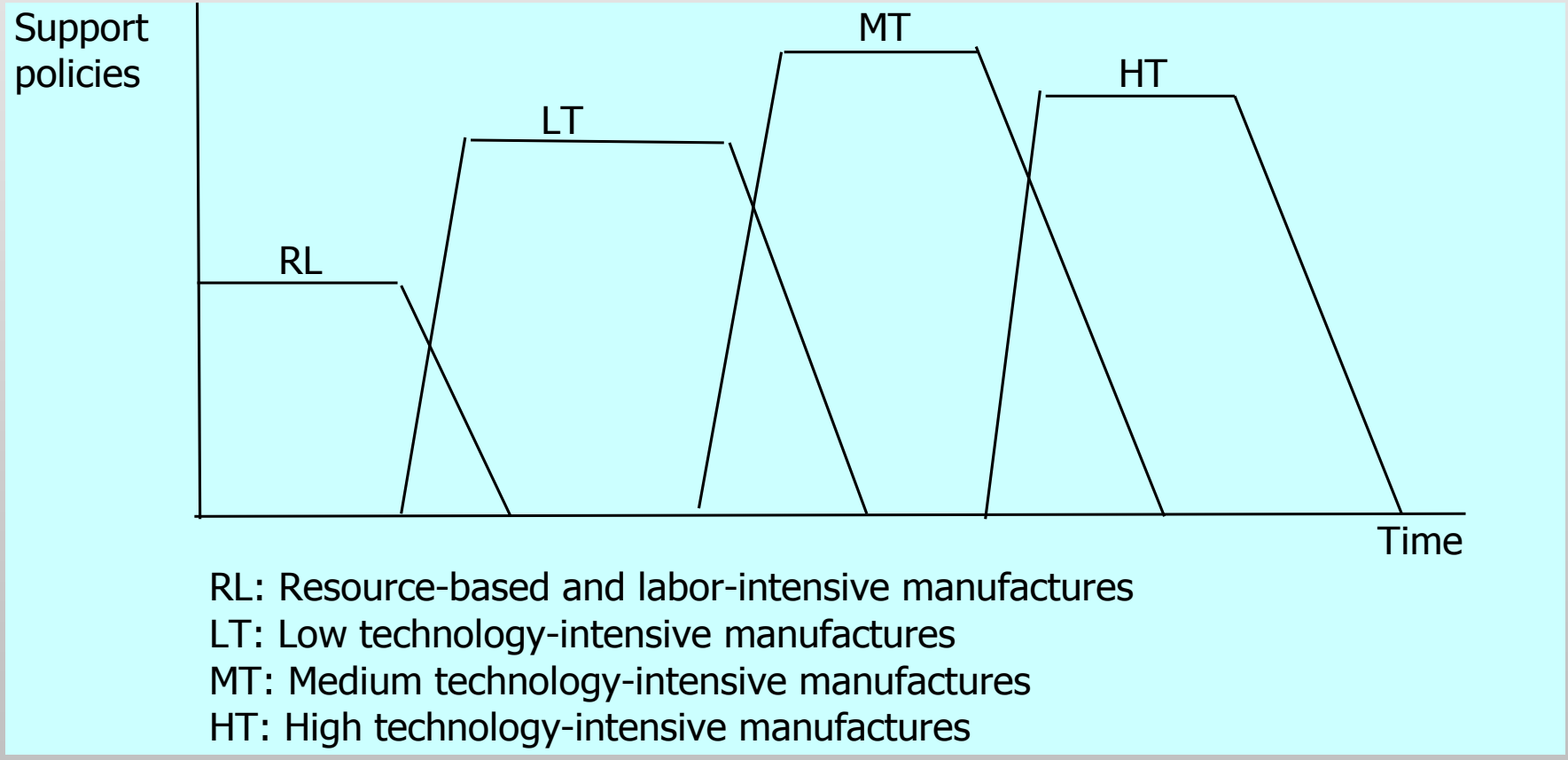
Tariffs and Industrial development

- Trade policies in developing countries are very liberal today compared to policies used by industrialized countries
- Industrialized countries had much higher tariffs at similar income levels
- Developing countries are also asked to reduce tariffs at a much faster rate and on a line by line basis
- Developing countries are asked to harmonize their tariff levels

Tariff patterns in the industrialization process

- Coexistence of very low and very high tariffs during the process
- Tariffs raised on some products and lowered on others
- Importance of tariff flexibility
- Average tariffs first rising then falling

Stylized representation of open-economy support polices (Akyüz)



RL: Resource-based and labor-intensive manufactures
LT: Low technology-intensive manufactures
MT: Medium technology-intensive manufactures
HT: High technology-intensive manufactures

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Other Industrial Policy tools limited by trade and investment agreements

- Investment requirements such as local content requirements, performance requirements, export targets and reinvestments. These are limited in WTO/TRIMS, FTAs and BITs
- Strong intellectual property protections (patent protection) especially on technology which makes processes like reverse engineering like used in the past not possible. It also restricts transfer of technology. These are limited in WTO (TRIPS) and FTAs
- Subsidies: numerous restrictions on subsidies, in FTAs and WTO (ASCM)
- National treatment principle: foreign trading partners/investors cannot be treated less favorably than local ones….but can be treated more favorably..
- “patents and their rights, creating artificial rents in order to promote new knowledge are heralded as an indispensable ingredient of world growth, while protection, creating manufacturing rents in order to spread this production to new geographical areas, is considered the greatest of all evils” (Erik S. Reinert and Jomo S)

Carnegie/ILO study on Brazil (2009)

- looking specifically at the WTO/Doha impacts on Brazil
- Under the full Doha Round scenario, for example, unskilled labor demand will increase most strongly in the sectors of cereal grains, animal products, and sugar, and it will fall in electrical and electronic manufacturing.
- Skilled labor demand (which will translate into increases or decreases in wages because of the assumption of full employment) will be strongest in cereal grains, animal products, and sugar but will fall in eleven of the twenty-seven sectors, most of which are in manufacturing.
- There will, therefore, be a shift of employment from the manufacturing sector to the agricultural sector.
- Wages and working conditions in these sectors are quite distinct.

EPA/ILO

Assessment of the EPA for West and Central Africa:

- Risk of de-industrialization
- Risk of job losses in the formal economy
- Growth of the informal economy
- Downward pressure on wages and working conditions
- Increased poverty among agriculture producers
- Increase in inequalities
- Lower competitiveness of the formal economy
- Loss of tariff revenue
- Specialization in production where the countries have a comparative advantage e.g. agriculture

ILO Employment sector 2010

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EPA/EAC (ITUC)

- Tariff liberalization: 82.5% of tariff lines to 0% in 25 years, with 80% of liberalization done by 2023
- Excluded lines are mainly agricultural products and some mainly low value added manufacturing products
- Infant industry protection only during the first 10 years of the agreement and for a period of maximum 8 years
- Safeguards (against import surges) only for current production
- Regional integration is undermined in the EPAs as the EPA groupings are different from regional groupings
- LDCs are in groups with lower middle income countries and make commitments accordingly
- All these measures ignore the impacts on structural change

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Lebanon/WTO accession (ITUC)

- An assessment of the proposed bound (maximum) tariffs in Lebanon's offer (2004) shows that the majority of bound tariffs are going to be very low (below 15 percent) in many industrial sectors including textiles and clothing, metals, metal products, tools, machinery (both electrical and non-electrical), autoparts, all sorts of vehicles, cameras, clocks, optical instruments, toys, weapons, electronical products, radio, TV, and most glassware.
- A somewhat higher protection (20-40 percent tariff) is given to a few products or product groups like freezers, refrigerators, electric lights, most furniture, mattresses, electric wires, cables, hats, leather products, perfume and make-up, tiles, building blocks, some metal products, footwear, blankets and linen, carpets, some chemical products, some paper and paper products, and construction material like windows, doors, parquet, cement and plasters.
- A high protection (more than 50 percent tariff) is given to some agricultural goods like some meat, milk, yoghurt, cheese, eggs, alcoholic drinks, beer, tobacco, seeds, honey, many fruits and vegetables, pine nuts, thyme, fresh mint, oil, bananas, fruit preparations, ice cream, olives, tomatoes, potatoes, liver preparations, corn, asparagus and cucumber.
- The high protections are used for current production in agriculture and therefore ignores the tariff needs for structural transformation.

NAMA/Doha/WTO (ITUC)

- Non Agriculture Market Access (NAMA): manufacturing, natural resources, fish, fish products and forestry products
- Tariff reductions in middle income countries bringing bound tariffs to levels of 12%-15% which would have implications for productive transformation
- In many sectors cuts in applied rates which would have implications for jobs: textiles, clothing, leather, footwear, automobile and furniture
- Limited flexibilities that cannot be changed over time
- Main problem: takes away tariff flexibility as maximum (bound) levels become low and flexibilities cannot be changed over time

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What trade regime is needed?

- Trade policy plays an important role in an industrial policy and productive transformation: the infant industry argument
- Trade liberalization impacts often adversely on productive transformation
- Trade policy space needs to be assessed and used (there is still quite some space available) and might need to be recovered in some instances especially in FTAs and BITs. This is a country specific exercise
- The existence of GVCs is used to argue for trade opening and to justify current trade regimes. However, how much do GVCs allow for value upgrading and how much do GVCs allow for productive transformation, knowing that domestic investment and the role of the state in driving the industrialization process have proven to be key elements for productive transformation

What trade regime is needed?

- Most trade agreements allow for a limited number of tariff lines to remain protected. Most countries use these for current production and therefore such protection is no longer available when countries want to defy comparative advantage
- Trade agreements therefore need to allow for much more flexibility. These needs for flexibility do change over time and trade agreements need to provide for such changes over time
- Less than full reciprocity principle is important given that trade opening in non-industrialised countries can have adverse effects on structural change
- Trade policy instruments need to be used to serve development strategies so as to create structural transformation that provides productive and decent jobs
- Regional integration and regional industrial policies (e.g. Mercosur) are important for structural transformation as many countries are faced with small domestic markets