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Briefing Paper

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PROTECTIONISM IN THE WEST – THE THIRD WORLD LINK

There is currently a spate of cries for protection from a wide range of industries. In the past year the General Agreement on Tariffs and Trade (GATT) and the International Monetary Fund (IMF) have warned of an accelerating slide into protectionism in Europe and North America. In September 1977 a GATT report criticised the growing use of 'orderly marketing arrangements' which circumscribe the GATT rules and which, being 'voluntary', are hard for GATT to oppose. It is estimated that the new restrictions have affected up to 5% ($50bn)† of world trade in the past 2 years. GATT argues that protectionism is undesirable because it ties resources to less productive uses and so slows down the expansion of more dynamic industries; and also it creates uncertainty about the international economic system by threatening the system of agreed trade rules, and thereby jeopardises new investment.

Despite such words of caution, it is clear that governments are responding to protectionist pressure. 'Fair trade' is replacing 'free trade' as a slogan: in September 1977 the French Prime Minister, Raymond Barre, advocated a system of 'organised free trade', and a wide range of trade restrictions have been threatened or imposed in America and Europe.

The main reasons for this upsurge are:

- the current high level of unemployment in the Organization for Economic Co-operation and Development (OECD) countries;
- rapid increases in the level of imports in certain sectors, with the less developed countries (ldcs) featuring as an important source of imports in some but not all cases;
- a belief that some ldcs are moving away from labour intensive to more capital intensive products, which has produced a possibly unreasonable but psychologically powerful fear that the developed world is facing strong competition on all fronts.

The fear of unemployment undoubtedly explains trade union interest in protection. The Trades Union Congress (TUC) was in the forefront of bodies demanding a more restrictive Multi-Fibre Agreement (MFA). In the USA, the AFL-CIO has taken a firm stand in favour of import controls as well as restriction on the export of capital, and in February 1978 its Council adopted a 15 point programme calling for much tougher controls than those currently contemplated by the Carter Administration. Those who benefit from cheap imports are less vocal and organised than those who stand to lose. This applies not only to consumers but also to those producers whose input costs are raised by protection. In Britain the Department of Prices and Consumer Protection is widely considered to be less powerful than the Departments of Trade and Industry. The same is true at the European level. In November 1977, in a letter to *The Times*, the ex-Chairman of the Consumer Consultative Committee to the European Economic Community (EEC) complained that 'the present Commission certainly speaks in support of a much greater participation by consumers in decisions affecting their welfare..... But although the words have been fine, deeds have not matched them'.

Whatever the reasons, the British government is responding to these pressures. In January 1978 Edmund Dell said that the government wanted to amend Article 19 of GATT** as part of the Tokyo Round negotiations in order to allow selective import controls 'against countries which are disrupting our markets with their imports'. There is a case that selectivity will favour ldcs, but past experience does not lend this view much support. Both Edmund Dell and David Owen have gone on record as favouring 'organised trade' from ldcs and Mr. Dell has spoken sardonically of a New International Economic Order for the developed world.

The third world is involved in at least three ways:

(1) most directly, it is the main source of imports in some industries;

(2) with other products, the ldcs supply only a small proportion of total imports but will suffer as well as major suppliers from any blanket trade restrictions;

(3) besides these two obvious categories there is a third. Growing import substitution in ldcs since the

† Throughout this paper 'billion' (bn) represents thousand million.

* The Institute is limited by guarantee.

** See ODI Tokyo Round Briefing Paper (September 1977).

1950s has cut off some developed country (dc) export markets. In some cases, such as India and Brazil, this import substitution has developed far enough for the ldcs to compete with dc exporters in third markets.

This paper is a progress report which examines the present situation in a number of industries affecting the ldcs. It draws upon a current ODI research project on protectionism and low-cost imports in Britain. The main focus of the paper is therefore on Britain, but the wider context is also considered.

Textiles

The situation in the textile industry has been described in a previous Briefing Paper.* Since it was written negotiations with the main exporters have been concluded largely on terms very close to the EEC's original demand for much stricter control over imports which have been growing rapidly. The share of imports in domestic supply rose between 1970 and 1975 from 9% to 19% for clothing (which includes a rise of 26% to 60% for shirts) and 40% to 69% for woven cotton and allied textile products. The negotiations were conducted on two levels: in Geneva over the principles of the MFA renegotiation, and with individual suppliers over specific ceilings under a renewed agreement. In practice the bilateral negotiations, notably those with the EEC, were decisive. The British and French held out for a substantial toughening of terms and India, Brazil, Egypt, and Pakistan resisted longest. In the event they settled partly because some concessions were made, notably to India, and partly because the United States strongly urged the EEC not to press its demands to the point of breaking off negotiations, but mainly because the exporters were willing to accept severe 'voluntary' cutbacks as the price for preventing unilateral import controls by the developed countries, and in order to keep licensing procedures in their own hands. Although the full implications of the other agreements are not yet known, the USA and Scandinavia have also settled with their suppliers on terms which are generally harsher than before.

The main feature of the EEC's agreements are:

(1) Textile products are no longer treated uniformly. Under the 1974 MFA, import growth in real terms was restricted to 6% per annum for any product subject to control under a bilateral agreement. Under the new agreement products are divided into groups (five groups containing 133 categories in all) subject to different levels of permitted growth. Eight 'super sensitive' products (cotton yarn and fabrics, synthetic fabrics, knitted shirts, T-shirts, jerseys and pullovers, trousers, woven shirts, and blouses) are permitted import growth well below 6% – for example 0.25% per annum for cotton fabrics.

(2) Action has been taken to prevent new sources (ie ldcs) expanding at the expense either of Europe or, in most cases, of other ldcs, by establishing global as well as country quotas for sensitive items and by 'trigger clauses' which will automatically involve restraint when a new supplier achieves a certain share of the market (0.3% for Group I 'super sensitive' items, 1% to 1.5% for Group II 'sensitive' and 3% to 5% for the others).

(3) For the major suppliers, base level quotas for 1978 have been fixed below the 1977 level. India was exempted from this additional restriction which has mainly affected Far East producers.

(4) Flexibility provisions have been considerably tightened, reducing the scope for transferring quotas from year to year and product to product.

In redefining the MFA in this more restrictive way, not only the spirit but also the letter of the original agreement has been ignored. The Community has merely promised that 'reasonable departures' will be 'temporary and the EEC shall return in the shortest possible time to the framework of the MFA'. The Community has also refused to accept that the Textile Surveillance Board should arbitrate on matters under dispute; rather, it has stated that the Board should be no more than an 'organ of conciliation'.

The ultimate impact of the renegotiation on the suppliers cannot yet be fully assessed. A good deal depends on how successful the suppliers are in obtaining higher unit values for the exports within the agreed quotas, and exploiting what opportunities to diversify remain despite the 'trigger' clauses. At present, however, the renewed MFA may be judged a total success for protectionist elements in the European textile industry.

Shoes

Like textiles, shoe making is a classic example of the type of industry in which ldcs ought to have a comparative advantage at the lower end of the market. In recent months Britain, the USA, and Australia have all imposed restrictions on imports of ldc shoes. In the British case, volume quotas have been imposed on non-leather footwear from Taiwan and a countervailing duty was imposed on men's leather shoes from Brazil. In 1975 the TUC asked the government for a 20% across-the-board cut in textile and clothing imports and similar measures in footwear. All this comes on top of the government's temporary employment subsidy which is supporting 64,000 jobs in the shoe and clothing industries. The USA has imposed quotas on imports from South Korea and Taiwan, in a move which according to Robert Strauss, the American chief trade negotiator, has 'dampened the raging fires of protectionism' and thus, paradoxically, contributed to 'fair trade'. In November 1977 the Australian government also imposed quotas on a wide range of footwear and other items of clothing which compete with domestic production.

The volume of British imports has risen from 31% of total consumption in 1971 to 41% in 1976. Import competition varies widely between different types of footwear: in 1976, foreign manufacturers supplied 87% by volume of the UK market for textile shoes, and 40% for plastic shoes, but only 16% for slippers, and 32% for leather shoes. The ldcs have an important share in textile, plastic, and rubber shoe imports (74% of volume in 1976), but are much less important for leather footwear, supplying only 7% of the 1976 import volume. Indeed,

* The Textile Trade, Developing Countries and the Multi-Fibre Agreement (November 1976).

during the period 1970-76, the ldcs share in the volume of UK imports fell from 61% to 53%. Because of this concentration on the cheap end of the market, their share of imports by value is lower than their share by volume, and stood at 24% in 1976. The major source of import growth in the UK is undoubtedly Italy, which increased its share of UK imports over the period 1970-76 from 10% to 18% in volume terms and from 24% to 32% in value. Since both countries are members of the EEC, it will be difficult to protect the British industry from Italian competition. One prescription for the survival of the industry is concentration on up-market footwear, chiefly leather shoes, where competition is more on the basis of quality than on price. On this reckoning, it is possible that the sales policy of the main shoe retailers, which are alleged to have emphasised low-priced shoes, has more responsibility for the industry's difficulties than do ldc exports. Paradoxically, some protectionist measures may also be undermining the long-term viability of the industry. Because of the quota placed on its exports, Taiwan is now beginning to export shoes with a higher unit value to compensate for the volume loss and is thus moving up-market.

Cutlery

Cutlery is another example of labour intensive manufacturing, but one that is linked to heavy industry because of its reliance on steel. British cutlery manufacturers have submitted proposals to the Department of Trade for quota restrictions on imports. Cutlery importers are, not surprisingly, opposed to this and a committee established by the British Importers Confederation has submitted counter proposals. In September 1977 it was announced that South Korean cutlery manufacturers had agreed to cut exports of stainless steel ware to Britain following two days of talks with the Cutlery and Silverware Association. Similar calls for protection are being voiced elsewhere in Europe, and after its talks in Britain, the Korean delegation visited Germany and Brussels for trade talks. However, the UK's efforts to get EEC protection are being hampered by the French and Italians who have restrictions of long standing and see no need to replace them with a new set of EEC controls.

The Sheffield industry has been in decline for the past 25 years, but a small number of strong, modern companies have now emerged. The cutlery market has three main sub-sectors: industrial cutlery; domestic tableware; high quality specialist goods. Import competition is severe in only one of these – domestic tableware. Indeed, Britain has an overall trade surplus as a result of substantial exports of industrial cutlery which more than compensate for a deficit on tableware. In 1976, total exports of cutlery reached almost £39m, compared with imports of only £26m, although the latter figure is a significant increase over the £19m recorded for 1975. In 1976, ldcs as a group supplied only 18% by value of total cutlery imports. The only ldcs with an important share of imports are Hong Kong and South Korea, although Taiwan's exports are growing and India is just starting. Hong Kong's exports are extremely volatile. Table 1 shows the volume and value of imports from the two countries for 1975-76 in the sub-sectors for which they are most competitive: stainless steel knives, and spoons, forks, and tableware. A Korean canteen of cutlery can sell for £5.00, compared with £30.00 for a British one, and dumping is impossible to prove because there is no home market for comparison. The table indicates that, as with textiles, the two countries are concentrating on the cheaper end of the market as their volume shares are higher than their value shares.

Wood

The most vocal section of the British wood industry appears to be the manufacturers of chipboard who claimed in October 1977 that unless imports were restricted their industry would be on the verge of collapse within 6–12 months. The main competition comes from other European suppliers, and the trade's problems are also attributable to the recession in the furniture and construction industries. Another section of the wood industry that has suffered from the recession, and has been in decline since 1973, is wooden doors. At present imports are taking some 40% of current sales volume. Again, the main source of competition is Europe, but Taiwan has also achieved a significant stake in the market. Door production in Taiwan is heavily automated, and it is believed that much of the capital investment has come from Japan. Imports from Taiwan have risen from just under 5,000 tonnes worth £1.7m in 1974 to 7,442 tonnes valued at £3.8m in 1976, which accounted for one-quarter of total imports and some 15% of UK production. The goods in question are very low value

Table 1. Volume and value of imports from Hong Kong and South Korea, 1975-76

		% of total imports			
		1975		*1976*	
		Volume	*Value*	*Volume*	*Value*
Hong Kong	Knives	14	10	17	12
Hong Kong	Spoons etc.	19	18	23	22
South Korea	Knives	38	21	34	16
South Korea	Spoons etc.	43	32	37	28

louvre and ornamental doors, sold at prices considerably below those attainable by European suppliers; a panelled door from Taiwan, for example, retails at £30.00 – half the British price. They are popular in the do-it-yourself market which because of the depressed state of new building is contributing a higher proportion of total demand than is usual. The British industry is protected to some extent by an anti-dumping levy; but this applies only to louvred doors. In addition, British interests are organising a European lobby since Taiwan is also exporting to the Netherlands, Germany, Belgium, France, Ireland, and Denmark. The British Woodworking Federation is petitioning the Department of Trade for protection and also, with its European counterparts, the EEC, despite the fact that the UK still runs an overall trade surplus on wooden doors: in 1976 exports at just under £30m were almost double the value of imports. Exports have grown significantly since 1974, largely because the Saudi-Arabian market has expanded very rapidly.

Steel

Import substitution abroad rather than import penetration at home is the main although not the sole cause for the British steel industry's concern with the third world. Steel has been in recession for four years and since it is difficult and expensive to shut down production in existing plants there has been a spate of dumping allegations and anti-dumping devices. These are mainly directed at other developed countries but in November 1977 the European Commission imposed a 'penalty duty' on steel nuts from Taiwan on the grounds that the exporter had not kept its promise made in 1976 to raise prices, and the previous month US steel manufacturers filed a dumping complaint against two Indian steel manufacturers. The USA has its Solomon Report with a recommendation of trigger prices, while Europe has the Davignon plan.* The stated aim of these measures is to allow obsolete plant to be run down at a socially acceptable rate. The European steel industry is particularly vulnerable to the recession because it exports about one-quarter of its output, while imports satisfy a significant proportion of the domestic market. Those countries in Europe keenest on protection are Britain, France, Belgium, and Luxembourg. Import substitution by ldcs – which are expected to produce 8% of total world output by the mid 1980s – has been a significant but still minor factor. The producing ldcs are Brazil, India, South Korea, Taiwan, and the Philippines. Latin American production rose by 12% between 1976 and 1977, largely due to an expansion in Brazil, while crude steel output in South Korea has doubled in the past two years, and exceeded 4m tons in 1977. It is important to note that this import-substitution also provides export opportunities for other sectors of industry. In January 1978, Davy-Loewy announced that it had won an £88m order to supply Brazil with a steel billet rolling mill for the Minas Gerais steel complex, bringing the total value of British orders for the complex to £235m. Although import-substitution is the main problem, some ldcs are also exporting direct to the dcs, and Brazil and South Korea are among the countries with which the EEC is negotiating bilateral self-restraint agreements under the Davignon Plan. The agreements seek to stabilise imports at 1976 levels, initially for 12–15 months.

Shipbuilding

Shipbuilding has a similar problem of global overcapacity, due largely to past dc policies, which is likely to get worse in the near future. It is estimated that even in 1980 the world's shipbuilding capacity will continue to be at least 30% in excess of demand. The ldcs are currently contributing to this overcapacity, building 16% of world tonnage in 1976 and with as much as 30% of the world order book by June 1977. The leading ldc shipbuilders are India, South Korea, Brazil, and Taiwan. Brazil currently has 8% of world orders, while South Korea was the only country to increase the length of its order book during 1977, thus giving it 3% of world orders. Much of the controversy in the West concerns the apportioning of responsibility for cut-backs. Until recently the Japanese have refused to accept a planned cut-back and, by a combination of efficiency and price cutting, boosted their share of OECD orders to 75% in 1976, some 20% more than their average share in recent years. During 1977, however, Japan agreed to cut back to 65% of current output by 1980 and have now done so. Although most of the controversy has centred on Europe and Japan, there is one development that is particularly worrying for the ldcs. In August 1976 the Association of West European Shipbuilders presented a report to the OECD shipbuilding working party which argued that dcs should unite against the third world and 'rethink' their aid programmes and 'should refrain from giving support to third world countries which could lead to an expansion of capacity'. The OECD appears not to have acted on the proposal, and it is not clear what precisely is intended or whether ldc shipbuilding capacity is dependent on aid, but the emphasis is significant particularly when viewed against the more liberal situation in 1975 when European shipbuilders sought to parcel out world trade and allocated the ldcs a fairly generous share of the assumed 1980 market (4–5m tons each for both Europe and Japan, and 3–4m tons for the ldcs).

Cars

Temporary shortages rather than an excess of capacity characterises the UK's car problem, although Britain is not the only country in difficulties. A succession of booms and slumps has meant that at certain times, particularly since 1974, the demand for cars in Europe has temporarily exceeded domestic supply, thus providing a bridgehead for imports. The main sources of imports are Japan and also American-owned companies with their new sub-compact, transnationally assembled models.

Much of the verbal pressure for protection in Britain is directed specifically at the Japanese, and import restrictions are a possibility. However, the third world is also involved to a limited extent. There is already a well-established practice for heavy trucks to be exported as chassis/cab only and for the bodies to be built locally in ldcs. Since the 1950s, a number of the richer or larger ldcs, such as Iran, Argentina, Nigeria, and India, have established local assembly/production plants to replace imports of complete vehicles. Even where these plants are run by dc companies, they tend to be less profitable for the parent firm than export of complete vehicles. Brazil and South Korea have gone

* The US proposal was made to President Carter by a special inter-agency task force under Anthony Solomon, Under-Secretary of the Treasury for Monetary Affairs. The Davignon Plan, named after the EEC Industry Commissioner, was introduced in January 1978 and, for an interim period of 3 months, requires imports from third countries to be traded close to Community ruling prices; this arrangement is to be replaced by a system of prices and quantity restrictions negotiated with third country steel suppliers.

further and set up production plants for export as well as home consumption. Brazil has almost doubled its capacity since 1971 to 827,000 units, over half the level of production achieved by Italy or the UK. Since production is controlled by dc companies its output of complete vehicles is unlikely to compete directly in Europe with those of the parent companies. However, it may well compete successfully in third areas, and also export components to the dcs.

The South Korean industry is in a class of its own because it is owned largely by indigenous interests. It currently has an annual production capacity of 200,000 units, including both cars and commercial vehicles. In 1976 it exported 1,350 cars, but in the first 10 months of 1977 exports had increased to 6,000 units worth $13.7m, and there are plans to increase exports to 100,000 vehicles a year by 1981. The car industry is based on the Hyundai Pony, with present production capacity of 50,000 units a year and a strong orientation towards exports. The factory producing the Pony was established with British technical expertise. At present South Korean exports are concentrated in the Far East, and affect the European industry only indirectly. However, there are plans to develop its overseas network further, although some observers are sceptical about the Pony's competitiveness with Japanese cars.

Conclusion

The omissions from this Briefing Paper are possibly as significant as the inclusions. Only industries that are publicly complaining about import competition have been considered. However, there are other industries equally threatened by imports which are applying little visible pressure for controls, such as those parts of the electronics industry in which ldcs offer competition. One explanation is that such industries are dominated by multi-national companies which are both producers and consumers, and which have overseas production capacity. The ability of multinationals to cope with ldc competition is typified by the Zenith Corporation which, having failed to receive protection from the US government, announced plans to shift manufacturing to Mexico. Protection is demanded most strongly by nationally-based industries, like the British clothing industry, in which there is very little overseas sub-contracting or foreign investment by UK firms so that producers and importers have conflicting interests. Another example is the cutlery industry in the UK where the trade federation is split on the protection issue possibly because some firms have developed importing interests and some have not.

In some of the sectors reviewed in this paper the national problem of weakened industries does not derive from ldc imports into Britain but from import substitution and ldc exports to third areas. Import controls will do little to help this situation. However, there is evidence of pressure to stop dcs selling manufacturing plant to ldcs which, if successful, would have serious consequences for the third world and, of course, for dc exporters as well.

Even in those sectors where ldcs export directly to the UK, they often supply only a small part of total imports which also come from other dcs, and often the Comecon countries; in the case of footwear for instance, Britain's main competitor is Italy, a fellow member of the EEC. Often the industry as a whole has a trade surplus. It is reported that the UK government has established an inter-departmental committee to consider the prospects for ldc exports and the resulting adjustment problems for British industry. This opens the possibility of a constructive assessment of alternatives to protection.

It is clear from these industry briefs that a small number of middle-income countries, notably Hong Kong, Taiwan, and South Korea, are involved in most sectors and hence have borne the brunt of protectionist pressure. However, it is well to remember that many other ldcs stand to lose from protection in the developed world, either directly, as in the case of Indian textiles, or indirectly because trade patterns have been fossilised.

Except possibly in a limited number of sectors, ldcs are neither the main source of imports nor the main cause of unemployment, but they are none the less vulnerable because they are too weak to retaliate and they provide an obvious scapegoat. Politicians may therefore find it expedient to act against them. However, such action would hurt not only the developing countries but also the exporters and consumers of the developed world.

Table 2. UK Employment in affected industries

Industry	*1968*	*1973*	*1974*	*1975*	*1976*
Textiles	702	556	525	484	492
Clothing and Footwear	497	415	401	381	381
Motor Vehicles	487	510	496	443	460
Cutlery and Tableware	13	14	14	13	13
Iron and Steel	279	231	251	240	232
Shipbuilding and Marine Engineering	186*	177	177	174	171

* 1970

Source: Trades Union Congress, *Economic Review 1978*, (London, February 1978)