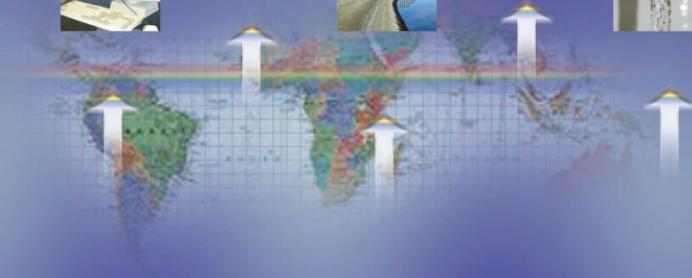


## WHY DEVELOPING COUNTRIES NEED TARIFFS

How WTO NAMA Negotiations Could Deny  
Developing Countries' Right to a Future



**WHY DEVELOPING COUNTRIES NEED TARIFFS?  
HOW WTO NAMA NEGOTIATIONS  
COULD DENY DEVELOPING COUNTRIES'  
RIGHT TO A FUTURE**

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## **ABBREVIATIONS**

BIS	Bank for International Settlements
BITs	Bilateral Investment Treaties
EBRD	European Bank for Reconstruction and Development
FTAs	Free-Trade Agreements
GATT	General Agreement on Tariffs and Trade
GATS	General Agreement on Trade in Services
ISI	Import Substitution Industrialization
LDCs	Least developed Countries
LTFR	Less than full reciprocity
MITI	Ministry of International Trade and Industry
MFA	Multi-Fibre Arrangement
NAMA	Non-Agricultural Market Access
NAFTA	North American Free Trade Agreement
QRs	quantitative restrictions
RTAs	regional trade agreements
SWW	Second-World-War
SDT	Special and differential treatment
TRIMS	Trade-Related Investment Measures
TRIPS	Trade-Related Intellectual Property Rights
VERs	Voluntary Export Restraints

### **Organizations**

ECLAC	Economic Commission for Latin America and the Caribbean
OECD	Organisation for Economic Cooperation and Development
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
WTO	World Trade Organization



## EXECUTIVE SUMMARY

The NAMA negotiations are heading towards a development disaster. If the developed countries have their way and force the developing countries to massively cut (or even altogether eliminate) industrial tariffs on a line-by-line basis in an irreversible manner, the future prospect of industrial development, and therefore economic development, in today's developing countries is truly bleak.

In debating the kind of trade agreements that would help alleviate poverty and bring about development, history is the most reliable guide. Policies that are tried and tested should be defended; those that have failed should not. In the case of NAMA, and contrary to what many developed countries would have us believe, there is a respectable historical case for tariff protection for industries that are not yet profitable, especially in developing countries. By contrast, free trade works well only in the fantasy theoretical world of perfect markets.

The historical and contemporary evidence shows that it is extremely difficult, if not totally impossible, for technologically-backward countries to develop without trade protection (of which tariffs are the main element) and subsidies. The evidence shows that trade liberalization works only when it happens gradually and selectively as part of a long-term industrial policy.

Virtually all of today's developed countries built up their economies using tariffs and subsidies (and many other measures of government intervention) throughout the 19th century and most of the 20th century (in particular, until the early 1970s). Throughout most of the period between the 1820 and 1945, the United States maintained average industrial tariffs at around 40 per cent, and never below 25 per cent except for brief periods, far higher than those it

accepts from developing countries in the NAMA negotiations today. Five of the six fastest growing developed countries in the so-called 'Golden Age' (1950-73) were high tariff countries (Japan, Italy, Austria, Finland and France).

Double standards are thus rife when these countries preach the virtues of free trade and free markets to today's developing countries, many of which in fact have tariff rates lower than those that prevailed in today's developed countries at similar levels of development.

The evidence from the developing countries also supports this view. They did very poorly when they were deprived of policy freedom (most notably tariff autonomy) until the Second World War, while their performance after they gained policy autonomy was a great deal better. With very few exceptions, the tariff cuts and other measures of trade liberalization in these countries during the last two decades or so have produced at best disappointing economic performances, and at worst economic collapse.

The numerous success stories among developing countries over the last 50 years, from the Republic of Korea and Taiwan Province of China to more recent examples in China, India and Viet Nam, show that, while some trade liberalization may be necessary and beneficial, infant industry protection is vital in the early stages, and trade should be liberalized gradually, in line with the economy's ability to upgrade its capabilities. Success stories such as the Japanese and Korean auto industries, or Korean steel conform to the historical pattern established by almost all successful industrial countries from 18th Century Britain onwards. Without protection, Japan and the Republic of Korea would still be exporting silk and wigs made with human hair respectively. Anyone who drives a Japanese or a Korean car is living proof that infant industry protection is still a very much valid argument in today's world.

More recently, China's take-off in the 1990s took place behind average tariffs of over 30 per cent, while Viet Nam has used state

trading, import monopolies, import quotas and high tariffs in generating annual growth rates of 8 per cent since the mid 1980s.

In contrast, premature liberalization in sub-Saharan Africa has been devastating. Economic growth in the continent was negative in per capita terms, while manufacturing employment collapsed. In Senegal, following trade liberalization starting in 1985, a third of all manufacturing jobs were lost. In Uganda, domestic production was swamped by imports as manufacturing capacity utilization fell to just 22 per cent. Even the relative success case of Ghana has shown mediocre growth and almost no upgrading of economic structure. Although growth has returned in the last few years, the rate is extremely low and its sustainability is questionable.

In many Latin American countries, protection and subsidies in the earlier so-called import substitution era generated higher growth than in the post-liberalization era and moreover, established the industrial capabilities that led to export increases in the latter period. Mexico, the poster child of regional integration, has grown more slowly in the liberalization period than under import substitution and lost jobs outside the export-oriented maquila sector.

Some of the principles that govern the NAMA negotiation (and the WTO as a whole) – notably the ‘level playing field’ - are profoundly flawed. Others, such as special and differential treatment, less-than-full reciprocity and flexibility, are interpreted in such a narrow way and twisted, as to rob them of their developmental content and undermine their practical value in the negotiations.

All in all, there are thus strong theoretical and empirical arguments that show that the kind of tariff cuts proposed in the current NAMA negotiations are likely to damage the future of the developing countries. It may not be too much of an exaggeration to say that the developing country trade negotiators have to fight the developed countries’ NAMA proposals as if the future of their countries depended on it.

Just as developed countries argue that they need to protect their past through agricultural protection and subsidies, the developing countries have the right to build a new future through industrial protection and subsidies. This right should be explicitly recognized. Granted, some countries have failed and will fail, in their attempt to do so, but this is not a reason to abandon industrial policy, just as the occasional failure in parenting does not justify abolishing the family. On the whole, the developing countries have been good at handling the risk involved. When they used industrial protection and subsidies more actively during the so-called ISI period, they did much better than when they were severely constrained in the use of those measures in the subsequent period of trade liberalization and other neo-liberal economic reforms.

Given this reality, the arguments deployed by the developed countries against the use of protection and subsidies by developing countries can only be understood as another effort by the rich world to “kick away the ladder” of development from developing countries.

If they are to fulfil the developmental promises made in Doha and prevent the creation of a world economy divided by a growing gulf between haves and have-nots, the powerful players in the WTO must ensure that any NAMA agreement gives developing countries the largest possible policy space so that that they can work out what is good for them and find their own ways to achieve it. An immediate suspension of the NAMA negotiations until a new and pro-development text can be agreed would be a good place to start.

## **I. INTRODUCTION: NAMA – THE UNDER-ESTIMATED DANGER**

Since the seemingly inexorable juggernaut of “Singapore Issues” was stopped at the Cancún ministerial meeting of the WTO in 2003, many developing country trade negotiators and development campaigners, both from the North and the South, have focused their attention on reducing agricultural protection and subsidies in the North.<sup>1</sup>

At first glance, this makes sense. They believe that most poor people in the world are farmers living in developing countries, so making it easier for them to export to the developed countries by reducing the latter’s agricultural tariffs and subsidies is an obvious way to help the poor and to promote economic development.

However, there is another issue that in the longer run may well have a much bigger impact than agricultural trade on the developing countries but, has only recently started getting attention – the NAMA (Non-Agricultural Market Access) negotiations.

Although overshadowed by other issues – such as the Singapore Issues, reform of TRIPS (trade-related intellectual property rights), and the liberalization of agricultural trade – the NAMA negotiations have been moving steadily, if slowly, ahead. After their launch at the Doha ministerial meeting of the WTO in 2001, they received a critical impetus from the December 2002 United States proposal to radically cut all industrial tariffs by 2010 and then to eliminate them altogether by 2015.<sup>2</sup> Since the Singapore Issues were

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<sup>1</sup> On the collapse of the Cancún talks, see Chang (2003).

<sup>2</sup> For the details of the United States proposal, see the Communication from the United States, TN/MA/W/18, issued on 5 December 2002 through the Negotiating Group on Market Access at the WTO.

put on ice after the 2003 Cancún ministerial meeting, NAMA has become, along with services, the main focus of developed country trade negotiators and, they have moved it to a point where an agreement may be reached fairly swiftly, if a deal can be struck on agriculture.

Unfortunately, developing country negotiators have not until recently given NAMA the attention it deserves, although many of them are now fully aware of the potential danger that it poses for their countries' future development. Some developing country negotiators, especially those from the least-developed countries, may still tend to think that NAMA is not relevant to them, as they have few industries to protect at present. And in so far as the developing country negotiators are worried about NAMA, their main concern is often more about which formula – US, EC, Korean, Indian, Chinese, and more recently ABI (Argentina-Brazil-India), the Caribbean, Pakistani, and Mexican – to use in cutting the tariffs. At least so far, the developing country negotiators have barely tried to utilize the statement in Annex B of the so-called “July 2004 package” that “additional negotiations are required to reach agreement” in order to question some of the basic premises of NAMA (TWN, 2005).

However, the importance of the NAMA negotiations cannot be over-emphasised, for the result of this negotiation can make or break the future of economic development in dozens of developing countries around the world.

At one level, there is not much that is new about NAMA. Lowering of industrial tariffs, which is the central element of NAMA (there are other issues like non-tariff barriers [NTBs]), has always been the key goal of the GATT (General Agreement on Tariffs and Trade) and its current re-incarnation, the WTO. However, the current round of NAMA negotiations is like nothing we have seen before.

First of all, in contrast to previous rounds of industrial tariff reduction negotiations, *the main cuts will eventually be made by the developing countries*, especially the middle-income ones. Before the Uruguay Round, industrial tariff cuts mostly applied to the developed

countries while the developing countries were allowed to make less cuts.

Second, the context in which the tariff cuts are to be made magnifies their potential impacts. As we shall see in greater detail in Part III, the range of policy tools available to the developing countries has shrunk sharply in the last two decades.<sup>3</sup> Subsidies, quantitative restrictions, foreign investment regulations (such as local content requirements), directed credit programmes, foreign exchange rationing, and many other tools of industrial promotion have become either impossible to use or very circumscribed. Given this shrinkage in policy space in other areas, *the relative importance of tariffs as a policy tool has increased significantly in the recent period* (on the question of policy space, see Chang, 2005, and Gallagher (ed.), 2005). This in turn means that the impact of any NAMA tariff cut is going to be much bigger than if it was done in a context where tariffs were relatively less important, as in the early post-Second-World-War (henceforth post-SWW) period.

Third, the tariff cuts are certain to be made in a manner that is much more stringent than before. For example, in the Uruguay Round, tariff cuts involved only cuts in average tariffs. This time, a “Swiss” formula, which requires that higher tariffs be cut most steeply, and that tariffs are cut *line-by-line*, is to be employed. This means that the developing countries are not even going to have the freedom to protect some key sectors while cutting tariffs in others. In contrast, in agriculture, where they are largely on the defensive, the developed countries advocate a much less draconian tariff reduction formula and are refusing to put caps on agricultural tariffs.

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<sup>3</sup> Such changes were brought about by liberalization and privatization that followed the SAP (structural adjustment programme) and its many subsequent re-incarnations, the Uruguay Round and the consequent launch of the WTO, the RTAs (regional trade agreements), the BITs (bilateral investment treaties, and, the increasing openness of developing country capital markets that punish countries that do not follow the international policy “norms”.

Fourth, the tariff cuts proposed by the developed countries in the NAMA negotiations are on a *historically unprecedented scale*. Even though the “zero-tariff” proposal from the United States is considered to be a deliberately radical opening gambit, the core United States proposal is to bring average industrial tariffs in developing countries down to 5-7 per cent by 2010,<sup>4</sup> the lowest level since the days of colonialism and unequal treaties, when the weaker countries were deprived of policy autonomy, especially the right to set tariffs (see section III.3).<sup>5</sup> With very few exceptions, they will be also lower than the rates that prevailed in today’s developed countries until the early 1970s (see sections III.1 and III.2).<sup>6</sup>

Given the above considerations, it is critical that we clearly understand what is at stake in the NAMA negotiations and, it is towards the enhancement of such understanding that this paper seeks to make a contribution. In doing so, it does *not* enter into the minutiae of the various competing NAMA proposals. Instead, it steps back and shows how economic theory, historical evidence, and contemporary experiences all suggest that the kind of drastic line-by-line industrial tariff cuts proposed by the developed countries in NAMA are certain to condemn the developing countries to eternal underdevelopment and poverty.<sup>7</sup> By doing so, it hopes to inform the debate around a critical aspect of the Doha Round and help to prevent the

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<sup>4</sup> See also Switzerland, whose delegation argued for a five-year timeframe for the NAMA tariff cuts.

<sup>5</sup> The EC proposal will bring average industrial tariffs down to 5-15 per cent. The Republic of Korea’s and the Indian proposals will bring them down to 10-25 per cent and to 10-50 per cent respectively.

<sup>6</sup> The exceptions are the United Kingdom and the Netherlands between the late- 19th and the early 20th centuries, Germany briefly in the late 19th century, and Denmark after the Second World War. See tables 3 and 5 for further information.

<sup>7</sup> This will be an outcome that is inconsistent not only with the professed “development” orientation of the Doha Round but also with other promises made by the rich countries through the Millennium Development Goals, G8, and other initiatives.

signature of an agreement in Hong Kong that will come to be seen as a historic catastrophe for development.

This paper is organized in the following way. The next, theoretical part of the paper (Part II) examines some critical but often neglected aspects of the theoretical case for and against industrial tariffs. It is followed by Part III, which examines in great detail historical and contemporary evidence on the relationship between trade policy (especially tariffs) and economic development. Part IV critically examines some key principles underlying the NAMA negotiations – and the WTO in general – and questions the whole premises upon which the current NAMA negotiations are conducted. The last part (Part V) summarizes the argument and draws policy conclusions.



## II. TARIFF AND ECONOMIC DEVELOPMENT THEORY

When hearing about the first attempt by the American colonists to engage in manufacturing, the then British Prime Minister Pitt the Elder declared that the colonists should “not be permitted to manufacture so much as a horseshoe nail” (cited in List, 1885 [1841], p. 95). This remark epitomizes the attitude of the economically more advanced countries towards the attempt by the economically less advanced countries to industrialize.

Such attempts to prevent industrial development in the poorer countries have often been pursued through the most blatant power politics. Colonies were banned from pursuing high-value-added activities (typically in manufacturing), while being forced to practice free trade. Weaker countries were usually forced into unequal treaties that deprived them of the right to set tariff rates and imposed low flat-rate tariffs (3-5 per cent, depending on the treaty) for revenue purpose only (see section III.3 for further details).

Interestingly, such intervention has frequently been presented as friendly and impartial advice. In his famous *Wealth of Nations*, Adam Smith kindly advised the Americans not to artificially promote manufacturing industry and argued that any attempt to “stop the importation of European manufactures” would “obstruct instead of promoting the progress of their country towards real wealth and greatness”.<sup>8</sup> Today we often hear the developed countries arguing, once again with the help of famous economists, that the developing countries should open up their international trade because it is good for them. NAMA is the most recent episode of such “friendly advice” against industrial development in the poorer countries.

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<sup>8</sup> The full quote is given in section III.1.2.

Yet, it is precisely the countries that ignored such “friendly” advice from the more advanced countries that have succeeded in developing their economies. The United States, the country pushing the hardest to lower tariffs in the NAMA negotiations, is the best example of this.

Against the urgings of Adam Smith, the first United States Treasury Secretary Alexander Hamilton, proposed a policy package in his *Report on Manufactures* to the Congress in 1791 that would provide tariff protection and government subsidies to the country’s nascent manufacturing industries. Poignantly, “Nails & Spikes” (which Pitt the Elder had thought was too good for the Americans) was one of the industries that Hamilton wanted to promote (Hamilton, 1791 [2001], p. 712).

Hamilton’s idea was simple but powerful. Given that most American industries were “in their infancy”, he argued that they could not be expected to compete against the mature industries in the more advanced economies without an initial period of deliberate government “promotion”. He proposed a series of measures including tariff protection, subsidies, tariff rebates (for manufacturing inputs, especially those used for producing export goods), and public investment in transport, to encourage the infant industries.<sup>9</sup>

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<sup>9</sup> Hamilton (1791 [2001]) proposed eleven categories of “the principal of the means by which the growth of manufactures is ordinarily promoted” (p. 709). They were [translation into modern terms are provided in square brackets]: (I) “protecting duties” (p.698) [i.e., tariffs]; (II) “prohibitions of rival articles or duties equivalent to prohibitions” (pp. 698-9); (III) “prohibitions of the exportation of the materials of manufactures” (p. 698); (IV) “pecuniary bounties” (pp. 688-703) [i.e. subsidies]; (V) “premiums” (p. 703) [i.e., cash prizes for worthy innovations]; (VI) “the exemption of the materials of the materials of manufactures from duty” (pp. 703-4) [i.e. tariff rebates on inputs for export]; (VII) “drawbacks of the duties which are imposed on the materials of manufactures” (pp. 704-5); (VIII) “the encouragement of new inventions and discoveries at home and, of the introduction into the United States of such as may have been made in other countries, particularly those which are related to machinery” (pp. 705-6) [i.e., technology policies]; (IX) “judicious regulations for the inspection of manufactured

What would have happened if the Americans had listened to Adam Smith, then the world's greatest ever economist, rather than their up-start 35-year-old finance minister, with only an undergraduate degree in liberal arts that included little training in economics, from what then was a second-rate college (Columbia, which was called King's College in the colonial days)?<sup>10</sup> Would the United States have achieved "real wealth and greatness", as Adam Smith had said it would if it followed his advice? It is highly unlikely.

All Americans who are old enough to use money have seen Hamilton countless times on the face of the ten-dollar bill, but few of them know that they owe their high living standard and international political influence to that intellectual father of protectionism, and not to free-market economists like Adam Smith.

Not just the United States but most of today's developed countries – including the United Kingdom, the supposed home of free trade and free markets – have used an industrial development strategy in which tariff protection was a key, if not necessarily the most important component, especially (but not exclusively) in the earlier days of their economic development, as it will be shown later in this paper. In contrast, it will also be shown, that countries that could not use policies, including tariffs, that fit their conditions, have been mostly condemned to low growth and under-development, whether it was because of the unequal treaties, the conditions on aid and debt relief or, the restrictions introduced by the WTO and regional trade agreements.

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commodities" (pp. 706-7) [i.e. product standards]; (X) "the facilitating of pecuniary remittances from place to place" (p. 707) [i.e. financial development and current account liberalization]; (XI) "the facilitating of the transportation of commodities" (pp. 707-8).

<sup>10</sup> In his recent biography of Hamilton, Chernow (2004) describes King's College's education in the following way: "Though not an outstanding school, King's offered a solid classic curriculum of Greek and Latin literature, rhetoric, geography, history, philosophy, math and science" (p. 52). According to Chernow, Hamilton first wanted to be a medical doctor and mainly studied anatomy, but later mainly studied political philosophy and law (pp. 51-2).

## **II.1 Why Protection?**

Trade protection can be given for many different reasons. For example, one argument behind the strong protection of agriculture in countries like Switzerland and Japan is that they want to preserve rural communities in order to maintain their “national identities”. Food security concerns, especially in the early post-Second-World-War period, have also been important in introducing high agricultural tariffs in many countries. For another example, tariff protection can be provided to sustain employment, especially the employment of those who are less privileged (e.g. industries that mainly employ poor people, industries located in poor regions and, industries that are for historical reasons confined to certain socially underprivileged groups).

However, the most important reason for the developing countries to provide tariff protection is the promotion of infant industries, along the lines suggested by Alexander Hamilton.

In technical terms, infant industry protection can be understood as a solution to the problems of knowledge transfer and learning. In the standard economic literature, transfer of production technology (and other pieces of knowledge) is assumed to be costless and instantaneous, as technologies are seen as “blueprints” that can be taken “off-the-shelf” and applied at no cost. However, in the real world, it takes time and, more importantly investment in technological capabilities, for firms in technologically-backward countries to absorb advanced technologies. This means that without an initial period of protection they are not going to survive international competition. Given this problem, infant industry protection is meant to provide the relevant firms the time and the resources (by giving them, through trade protection and subsidies, “artificial” profits, or “rents”, which can be re-invested) that are necessary for their knowledge-upgrading process.

To use the parenting analogy, which is natural given the very notion of “infancy”, it may be stated that, in the same way that we

protect our children until they “grow up” and are able to compete with adults in the labour market, developing country governments need to protect their newly-emerging industries until they go through a period of “learning” and become able to compete with the producers from the more advanced countries.

To put it more concretely, if I drove my five-year-old son into the labour market on the ground that he is able to earn his living (as five-year olds unfortunately are forced to in many developing countries), he may become a very savvy shoeshine boy or even a competent unskilled worker, but there is virtually no chance that he will become a nuclear physicist or a chartered accountant, as those jobs would require at least another dozen years of parental protection and investment in education and training. Likewise, if a developing country commits itself to free trade before it develops its technological capabilities, it may become the best producer of coffee or cheap garments in the world, but the chance of it becoming a world-class producer of cars or electronics will be extremely low.

As happens with parental protection for children, infant industry protection can go wrong. In the same way some children may remain dependent on their parents for too long because the parents are over-protective, governments can continue infant industry protection for too long, making the industries concerned fail to stand on their own feet. Just as some children do not work hard to prepare themselves for adult life, so infant industry protection can be wasted on some industries. In the same way that some children can manipulate their parents and live off them well into their adulthoods, some industries may be able to secure government protection well beyond the necessary point. Just as some families will be more successful with their children than others, even with similar conditions, so some countries are going to be more successful than others in promoting infant industries. In the same way that even the most “successful” family may have one or two “black sheep”, even the most successful countries will have some failures in infant industry protection.

However, just as failures in the world of parental protection are hardly an argument against parenting itself, so cases of failures in

infant industry protection do not constitute an argument against infant industry protection *per se* – especially when history shows that with startlingly few exceptions, successful countries in the past and in the present have used infant industry protection (see Part III). The “bad” examples of infant industry protection merely tell us that protection needs to be used wisely if it is to be fruitful.

Indeed, recent debates, mainly those surrounding East Asia, have highlighted what needs to be done to increase the chance of success with infant industry protection (see Chang, 1994, ch. 3; Stiglitz, 1996; Lall, 2004; Chang, 2006, forthcoming).

First, the choice of “target” infant industries should be realistic. Of course, the difficult is that people have different views on what is “realistic”. In the 1970s, not many people thought it “realistic” for the Republic of Korea to enter the steel and the automobile industries, using tariffs and subsidies, yet the country now possesses world-class firms in exactly those industries (see section III.4.4. (a) for the details). However, this does not change the fact that a successful infant industry promotion requires realistic assessments of the country’s and the relevant firms’ current technological and managerial capabilities, and the prospects for their development, as well as the conditions in the international market.

Second, infant industry protection needs to be combined with an export strategy. Above all, export earning is critical in allowing the less developed country to upgrade its economic activities, including especially the infant industries, as it provides the means to purchase advanced technologies and machinery. In addition, export market performance can provide not only some degree of market discipline to the protected firms but also an “objective” criterion by which policy-makers can judge the performance of the enterprises receiving infant industry protection (something that is otherwise difficult, as market prices have been deliberately “distorted”). In the case of smaller countries, economies of scale cannot be achieved without entering the export market early on and, if one gets the

production scale wrong, the unit production cost can easily double or treble.<sup>11</sup>

Third, the success of infant industry promotion depends critically on the government's readiness to discipline the recipients of the rents that it creates through various policy means (tariffs, subsidies, entry barriers). The great success of the East Asian countries in their industrial policies is often attributed to the ability of their states to discipline the firms receiving state supports (see III.2.2 on Japan and III.4.4.(a) on the Republic of Korea and Taiwan Province of China). The point is that the suspension of market discipline that is inevitable in the promotion of infant industry, requires that the government play the disciplinarian role for the promotion to succeed.

Fourth, the competence and political insulation of the bureaucracy that implements the infant industry programme is an important factor in determining its success. In saying this, I am not trying to push the familiar point that countries that do not already have a good bureaucracy should never try infant industry promotion and other "difficult" policies (World Bank, 1993, is a well-known example of such an argument).<sup>12</sup> While it is necessary to calibrate

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<sup>11</sup> Economists usually estimate the allocative efficiency losses from monopoly to be at most a few per cent of total output of an industry. This means that even the most stringent anti-monopoly measures will increase efficiency in the industry concerned by a few per cent, whereas government intervention to get the production scale right can easily double efficiency in the industry.

<sup>12</sup> The experiences of the East Asian countries, whose policies other developing countries are advised not to imitate because they lack good bureaucracies of the East Asian kind, illustrates my point beautifully. Contrary to popular perception, these countries did not start with a high level of bureaucratic competence, but built it up through bureaucratic reform and "learning-by-doing" in policy implementation. Especially the bureaucracies of Taiwan Province of and the Republic of Korea were widely considered corrupt and incompetent until the 1960s – after all, the Republic of Korea was sending its bureaucrats to Pakistan and the Philippines (at the encouragement of the World Bank) for extra training until the late 1960s!

policies according to bureaucratic capabilities in the short run, in the long run conscious efforts have to be made to improve those capabilities. Such improvement cannot be achieved only through improvement in formal training. It also requires the accumulation of policy design and implementation experiences by actually trying out – and some times failing – with some of those “difficult” policies, first on a smaller scale and then expanding as capabilities develop. “Learning by doing” inevitably involves some degree of “learning by failing”. As a popular saying goes, “if you are not failing, you are not trying hard enough”.

Fifth, how closely the government interacts with the private sector while not becoming its hostage, is very important in determining the success or otherwise of an infant industry programme. In his study of industrial policy in the Republic of Korea and Taiwan Province of China, Peter Evans (1995) has captured this beautifully in his notion of “embedded autonomy”, which argues that, in order to be effective in its intervention, a government needs to have close ties with societal actors, including the private sector firms (“embeddedness”) but, also has to have its own will and power (“autonomy”). Autonomy without embeddedness can become dangerous, while embeddedness without autonomy means that the state is turned into Marx’s “executive committee of the bourgeoisie”.

## **II.2 Tariff vs. Subsidies**

When faced with the argument for infant industry protection, mainstream economists often respond that even if there is a case for infant industry promotion, tariffs are not the best way to achieve it. In order to avoid the distortionary effects of tariffs, they argue that direct subsidies should be used. For example, the World Bank (1987) categorically states that “[i]f an industry really is essential, the question is how best to preserve it. The orthodox economic answer is through

subsidies, not tariffs or import controls. Subsidies do not raise prices, hurt customers, or raise costs to users” (p. 144).<sup>13</sup>

However, if tariffs are such a poor policy tool, why have they been the most popular tool of industrial promotion throughout history? The answer is that whatever academic economists may think, the policy-makers usually know what they are doing. They know that there are other, and possibly more effective means to promote an industry, and they frequently use them – direct subsidies, subsidized credits, subsidized rates for government-supplied utilities, and many other forms of direct and indirect subsidies. However, they also know that the subsidies so beloved of academic economists have one critical problem – they require revenue that they do not have!

An obvious solution to this problem is to collect more taxes. However, in reality, tax is not something that can be so readily collected, especially in developing countries where there are serious problems with tax collection capability (e.g. not enough information on personal incomes, under-paid and over-worked tax officials, etc.) and sometimes even with state legitimacy (e.g. some governments do not even effectively control all parts of their official territories). On the political economy of taxation in developing countries, see Toye, 2000 and John, 2005.

In the context of limited fiscal capability, tariffs are even more attractive, because they are the easiest tax to collect, providing revenues, as well as an industrial policy tool. This is why the poorer the country, the higher the share of tariff revenue in total (fiscal) revenue tends to be. Even after two decades of trade liberalization, tariffs still accounts for 15 per cent on average of government revenue in

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<sup>13</sup> In his classic textbook on international economics, John Williamson makes the same point, although in a more sophisticated manner. He argues that “in principle it is better to protect with subsidies and then to finance those with tariffs and export taxes specifically chosen to minimize distortions, rather than relying on one set of tariffs to both protect and raise revenue” (Williamson, 1983, p. 84).

developing countries (South Centre, 2004, p. 5).<sup>14</sup> As can be seen from table 1, in the case of some poor economies, the share can be as high as half (54.7 per cent for Swaziland, 53.5 per cent for Madagascar, 50.3 per cent for Uganda, and 49.8 per cent for Sierra Leone).

Some argue that loss of tariff revenue is not a serious issue on the grounds that many of the countries whose reliance is strongest in the table are least developed countries (LDCs) that are not going to be required to cut industrial tariffs in the near future in the current NAMA negotiations. However, this is not a reason to be complacent. These countries may not be necessarily required to cut industrial tariffs in the current round of NAMA negotiation, but, they are expected to substantially increase the proportion of tariffs that are bound, a process that is likely to involve at least some tariff cuts and, that will leave them vulnerable to pressure for further cuts in subsequent rounds.

Moreover, for several other developing countries that will have to make tariff cuts through the formula, a seemingly low reliance on tariffs as a source of government revenue may in reality turn out to be crucially important in relative terms. In other words, a 5 per cent or 8 per cent share of tariffs in government revenue may correspond to total government spending on specific public policies, such as housing or the promotion of family farming. In addition, since some of these countries have already undergone trade reforms to reach their current levels of dependence on tariffs, they are likely to face serious difficulties in undertaking further reforms and finding supplementary sources of revenue.

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<sup>14</sup> The fiscal adjustment that had to be made to reach even this level was large – for example, the share of tariffs in total government revenue in Pakistan came down from 29 per cent in 1992 to 15 per cent in 2001 (South Centre, 2004, p. 6). Even a recent IMF study shows that less than 30 per cent of the revenue lost due to trade liberalization over the last 25 years in low-income countries has been recovered through other means (Baunsgaard & Keen, 2005).

**Table 1**  
**Import Duties as a Share of Total Tax Revenue**  
**in Selected Developing Countries in 2001**

Country	Share	Country	Share
Algeria	12.1%	Morocco	18.8%
Bangladesh	30.0%	Nepal	30.9%
Burundi	16.4%	Oman	10.3%
Cameroon	31.6%	Pakistan	15.4%
Congo, D.R.	33.7%	Papua New Guinea	24.2%
Congo	23.2%	Paraguay	17.5%
Cote d'Ivoire	27.6%	Peru	10.5%
Dominican R.	44.1%	Philippines	19.6%
Ethiopia	26.3%	Sierra Leone	49.8%
Guinea	42.9%	Sri Lanka	27.4%
India	24.1%	Swaziland	54.7%
Iran	14.4%	Syria	11.7%
Jordan	20.4%	Thailand	12.3%
Lebanon	39.0%	Tunisia	12.5%
Madagascar	53.5%	Uganda	50.3%
Mauritius	29.3%	Venezuela	12.1%

Source: South Centre (2004), table 1.

Last not but least, the mainstream economists' recommendation for subsidies rings hollow when the WTO has done the exact opposite of what they recommend and banned almost all subsidies! First best or not, following the launch of the WTO, the use of subsidies has become highly circumscribed, except in areas where the developed countries actively use them (e.g. agriculture, R&D, regional development).

### **II.3 The Increased Importance of Tariffs**

In today's developed countries, tariffs used to be an important tool for promoting economic development, at least up until the Second World War, and especially until the 1920s. This is because other tools of state intervention were under-developed until then.

First of all, subsidies could not be used widely because governments had limited budgetary resources (see table 2). Tax collection was hampered by lack of information, poor administrative capabilities, and political resistance. Political resistance was particularly serious in the case of income tax. It was only from the 1930s that income tax became widespread.<sup>15</sup> As a result, like today's developing countries, the governments of today's developed countries at that time relied rather heavily on tariffs for their revenues. In addition, until the 1930s, the balanced budget doctrine dominated, so governments were in general very reluctant to commit themselves to budget outlays such as subsidies.

Second, these governments also had limited influence over investment decisions. They owned few financial institutions and industrial enterprises, with some notable exceptions in Prussia in the 18th century (e.g. steel, linen) and Japan in the late 19th century (e.g. shipbuilding, textiles) (see pp. 33-4 on Prussia and pp. 46-7 on Japan in Chang, 2002, for further details).

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<sup>15</sup> In 1842 the United Kingdom was the first country to introduce a permanent income tax. Denmark introduced income tax in 1903. In the United States, the income tax law of 1894 was overturned as "unconstitutional" by the Supreme Court. The Sixteenth Amendment allowing federal income tax was adopted only in 1913. In Belgium, income tax was introduced only in 1919. In Portugal, income tax was first introduced in 1922, but was abolished in 1928, and re-instated only in 1933. In Sweden, despite its later fame for high income tax rates, income tax was first introduced only in 1932. See Chang (2002, p. 101) for further details.

**Table 2**  
**Percentage share of government expenditure in GNP**  
**or GDP in the developed countries, 1880-1985**

	<b>France</b>	<b>Germany</b>	<b>Japan</b>	<b>Sweden</b>	<b>United Kingdom</b>	<b>United States</b>
1880 <sup>a</sup>	15	10	11	6	10	8
1929 <sup>a</sup>	19	31	19	8	24	10
1960 <sup>b</sup>	35	32	18	31	32	28
1985 <sup>b</sup>	32	47	33	65	48	37

Source: World Bank (1991), p. 139, table 7.4

a. GNP; b. GDP

Third, industrial regulation was virtually unheard of. For example, even the most basic industrial regulation (competition law) did not exist until the early 20th century in any of today's developed countries.<sup>16</sup> Even financial regulation, which was more developed than industrial regulation, remained primitive.<sup>17</sup>

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<sup>16</sup> The 1890 Sherman Act is commonly regarded as the world's first competition law. However, this Act was mainly used against trade unions until President Theodore Roosevelt used it against J.P. Morgan's railway cartel in 1902. The first "real" competition law was the 1914 Clayton Act of the United States, which exempted trade unions. In Europe, the first competition law was introduced in Germany in 1933. See Chang (2002), pp. 91-2 for further details.

<sup>17</sup> Until the Great Depression, unregulated "wildcat banks" were an important feature of the United States banking industry. Banking regulation was introduced only in 1934 in Germany and in 1935 in Belgium. See Chang (2002, pp. 93-4) for further details. In terms of securities regulation, the first country to introduce comprehensive regulation was the United States, which did so in 1933. Even the United Kingdom, with its long history of financial markets, introduced comprehensive financial regulation as late as in 1988. See Chang (2002, pp. 98-9) for further details.

Fourth, these governments could not even use monetary policy in order to encourage investment in general, because they did not have a central bank.<sup>18</sup> The Gold Standard further restricted their monetary policies. Open capital markets meant that governments could not use foreign exchange rationing for the purpose of influencing industrial investment patterns (by affecting the pattern of imports of machinery and intermediate inputs), as was the case during the early post-SWW years in most countries, developed and developing (see sections III.2 and III.4).

The unequal treaties that today's developed countries imposed on the weaker countries in the 19th and the early 20th centuries demonstrate the importance of tariffs at the time (see section III.3). The two pillars of any unequal treaty were extraterritoriality for the citizens of the stronger countries (so that they would not be subject to the local justice system) and the deprivation of tariff autonomy from the weaker country's government. In other words, these treaties clearly show that tariffs were seen as "the" economic policy instruments at that time.

Tariffs became less important in relative terms after the Second World War until the 1970s. This was *not* because tariffs were used less. Although there was a significant fall in industrial tariffs in

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<sup>18</sup> The Swedish Riksbank was nominally the first official central bank in the world (established in 1688), but until the mid-19th century, it could not function as a proper central bank because it did not have monopoly over note issue, which it acquired only in 1904. The first "real" central bank was the Bank of England, which was established in 1694 but became a full central bank in 1844. By the end of the 19th century, the central banks of France (1848), Belgium (1851), Spain (1874), and Portugal (1891) gained note issue monopoly, but it was only in the 20th century that the central banks of Germany (1905), Switzerland (1907), and Italy (1926) gained it. The Swiss National Bank was formed only in 1907 by merging the four note-issue banks. The United States Federal Reserve System came into being only in 1913. Until 1915, however, only 30 per cent of the banks (with 50 per cent of all banking assets) were in the system, and even as late as 1929, 65 per cent of the banks were still outside the system, although by this time they accounted for only 20 per cent of total banking assets.

the developed countries, many developing countries used tariffs quite heavily during this period.

However, during this period, tariffs were less important in relative terms, because a much wider range of policy tools became available and, because there was greater “policy space” to use them, compared to the periods before and after.

Especially in the developed countries, subsidies could be used much more widely, because the fiscal capabilities of the government expanded with the strengthening of the income tax system (see table 2). The retreat of the *laissez-faire* ideology during the period also made it politically more acceptable to use subsidies.

In addition to the standard NTBs like quota, new NTB measures were developed during this period. The most notorious example is the so-called voluntary export restraints (VERs) imposed on Japanese exports, which were anything but voluntary, but there were many more measures developed during the period (more on this in section III.2.1).

With the old ideology against state ownership gone and the impressive performance of the Soviet Union until the 1950s, many governments nationalized industrial enterprises or set up new industrial enterprises, especially in key industries such as steel (e.g. Italy, the Republic of Korea, India), shipbuilding (e.g. Singapore), automobiles (e.g. France), and chemicals (e.g. Italy, Taiwan Province of China, the Republic of Korea). Industrial regulations also became more comprehensive and complex. In many countries, licensing was required to set up enterprises above a certain size, investments above certain levels had to be approved by the government, restrictions were put on foreign investments and, technology imports in key industries had to be approved by the government.

During this period, in many countries banks were frequently owned by the government and were heavily regulated. They were often instructed to make loans to particular industries or, even par-

ticular individual firms that were deemed important by the government (known as “policy loans” or “directed credit programmes” in the East Asian countries during the post-SWW period). Development banks were set up in many countries in order to provide long-term finance for industry.

Now that most countries could have a central bank (previously prohibited in many former colonies), monetary policy could be used in order to encourage industrial development (see Epstein, 2005, on the developmental role of the central bank).

Capital controls, which most countries introduced following the Second World War,<sup>19</sup> enabled their governments to influence investment flows by controlling the imports of capital goods and key intermediate inputs through foreign exchange rationing.

The success of socialism until then (especially when the true human costs were still unknown) and, more importantly the success of wartime planning in the developed capitalist economies, prompted many countries to introduce planning in various areas, such as indicative investment planning (especially France, Japan, and the Republic of Korea) and manpower planning.

All these changes introduced new policy tools and strengthened some of the old ones, making tariffs much less important in relative terms between 1945 and 1980 (roughly).

By the 1980s, industrial tariffs had become unimportant in the developed countries, as they were cut to generally low levels through the early GATT Rounds (see section III.2.1). This is not to say that these countries stopped protecting their industries altogether. Some of the weakest industrial sectors have been protected through quantitative restrictions – the MFA (Multi-Fibre Arrangement) in the case of textiles and clothing, and the VERs in the case of Japanese passenger cars. There was also widespread use of tariff escalations (escalating with the degree of value-added) and tariff peaks (tariff rates

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<sup>19</sup> The few exceptions included the United States and Mexico.

more than three times the national average), especially in labour-intensive products such as textiles and clothing, leather, rubber, footwear and fish products (for further details, see ActionAid, 2005, pp. 12-3). Non-tariff barriers, such as sanitary and phytosanitary standards, and anti-dumping measures have also been used for protective reasons (ActionAid, 2005, p. 13). However, it is true that in general by the 1980s industrial tariffs had become relatively unimportant for the developed countries.

In contrast, since the 1980's industrial tariffs have become more important in relative terms for the developing countries, despite the fact that tariff rates in general were reduced during this period. This was due to the declining availability and scope of other measures of industrial promotion.

Since the introduction of the SAPs by the World Bank and the IMF in the 1980s, many developing country governments have been forced to cut subsidies to their industries. SAPs also have privatized their industrial enterprises, making it impossible for them to give "hidden" subsidies by supplying certain key inputs at below-market prices.

Since the 1980s, thanks to the rise of monetarist ideology and pressure from the IMF, central banks have become almost exclusively focused on inflation and in the process have often become anti-developmental. The introduction of the BIS (Bank for International Settlements) capital adequacy standard has made investments more difficult in developing countries, as their banks are required to be run with the same level of "prudence" as those in the developed countries, even when they need to lend more aggressively.<sup>20</sup> Development banks, seen as relics of the "bad old days" of import substitution, have been curtailed in their scope. Many banks and other state-owned financial firms have been privatized and there has been financial deregulation, reducing the government's ability to influence the

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<sup>20</sup> The BIS capital adequacy standard, first introduced by the BIS, the club of the key central banks, in 1988 requires that banks do not lend more than certain multiples of their capital (currently the ratio is set at 12.5).

flows of investment. Open capital markets mean that foreign exchange rationing is not a tool of industrial policy any more.

Thanks especially (if not exclusively) to the WTO and other international agreements – such as regional trade agreements (RTAs) and bilateral investment treaties (BITs) – the use of non-tariff policy tools has become highly circumscribed. The use of quantitative restrictions has been restricted, forcing countries to “tariffy” most quotas. The use of subsidies is now severely constrained by the WTO, except in areas where the developed countries actively use subsidies (e.g. agriculture, R&D, regional development). The TRIMS (Trade-related Investment Measures) agreement and the GATS (General Agreement on Trade in Services) have made regulation of foreign investment much more difficult by banning performance requirements (e.g. local content requirements). Strengthening of intellectual property rights protection through TRIPS and BITs has made the acquisition of technology much more expensive.

Given the above, tariffs are now about the only major tool of industrial promotion remaining to the developing countries, although many are not free to fully use even this degree of “policy space” due to aid and loan conditions from donor governments and the IMF-World Bank. Depriving the developing countries of this last tool is tantamount to forcing them to accept international market forces blindly, something that no successful country had done in the past, as we shall see in Part III.

## **II.4 Tariff Reduction: Theory and Practice**

The basic premise of the NAMA negotiations is that free trade, or at least “freer” trade (lower tariffs, lower NTBs) always brings welfare gains. However, this premise is based on trade theory largely built upon unrealistic assumptions about perfect markets and perfect knowledge.

All other things being equal, lowering the tariffs for a particular product will indeed make its import cheaper, benefiting its consumers. However, the overall result of the exercise depends on what happens to the producers newly exposed to import competition.

Increased import competition may make the domestic producers more efficient. In this case, everyone is better off, and the only possible loser from the process will be the workers sacked in the process of raising efficiency. However, in the standard trade theory models that underlie the NAMA proposals for tariff cuts, not even this is considered a problem because perfect resource mobility is assumed and therefore, the displaced worker is bound to find an alternative employment, which is at least as well-paying as his/her current job.

In reality however, what happens following the tariff cut very much depends on where and how it is done. If the magnitude of the tariff cut is large, as it is likely to be if the developed countries get their way in the current NAMA negotiations, and therefore if the domestic producers need to increase their efficiency very quickly in order to survive, the result may be the closure of the relevant producers, destroying income and jobs, rather than a rise in their efficiencies. Whether the local firms can survive depends on their ability to raise productivity (which will depend not only on their own managerial competence and skill base but also on national capabilities in terms of R&D, technology absorption and modification, and skills). Given the current state of industry in developing countries and the scale of tariff cuts proposed, NAMA is likely to result in the widespread closure of manufacturing firms in the developing countries, as surges of cheap imports wipe out local producers.

Given that resource mobility is not perfect in the real world, the resources (including the workers) released by bankrupt enterprises may not find alternative employment opportunities that will allow them to make contributions to the national economy as large as they were before. For example, if a reduction in steel tariff results in the closure of steel mills, the blast furnaces are likely to be sold as scrap metal and the laid-off steel workers are likely to end up unem-

ployed or working in unskilled jobs like security guards or janitors. The displaced workers may find alternative employment more easily, if there are good re-training schemes, whether provided by the firms (as in Japan) or the government (as in many European countries) but, these schemes are not “naturally” provided by the market.

Even if tariff cuts lead to the destruction of domestic producers and the resulting waste of resources, the whole society may be said to gain, if the costs from the destruction of income and jobs are lower than the benefits to the consumers from cheaper imports.<sup>21</sup>

However, even in this case, the distributional question still remains, as there is no automatic “trickle-down” from the gainers to the losers from trade liberalization. For example, how do car buyers, who now benefit from cheaper imported cars, compensate the automobile workers who lost their jobs thanks to trade liberalization?

In the developed countries, this compensation is relatively easy because there are rather well-established mechanisms to re-distribute wealth – the welfare state, regional development subsidies, worker re-training, and re-location schemes and so on. However, in the developing countries, such mechanisms are at best weak and often non-existent. Moreover, the already meagre abilities of their governments to make fiscal transfers to the losers in the process of structural change that follows trade liberalization will be further impaired by the consequent fall in government revenue. If such a fall in revenue occurs, as is often the case when a country is at the same time forced to reduce government deficits, or even generate a surplus under an IMF-World Bank programme, its ability to “compensate the losers” will be even more impaired.

Most importantly, tariff cuts may damage long-term economic development. In the short run, it may indeed be more efficient for developing countries to get rid of those industries that cannot survive without tariffs and other protective measures and rely on agriculture

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<sup>21</sup> In making this statement, we are momentarily putting aside the difficult methodological problem of interpersonal utility comparison.

and some labour-intensive industries (although the question of protection of these sectors by the developed countries still remains). However, in the long run, it is extremely unlikely that the countries can develop on that basis, as economic development requires industrial diversification and upgrading, which is nearly impossible to achieve without protection and subsidies, as historical and contemporary evidence shows (see Part III).

Thus seen, the theoretical model underlying proposals for tariff cuts and other trade liberalization measures are based on highly unrealistic assumptions about resource mobility, technological learning, and the mechanisms of income re-distribution.

One important thing to note at this point is that despite highly unrealistic assumptions that are biased towards free trade, mainstream models that estimate the benefits of trade liberalization are able to come up with only modest sums (for an excellent critical review of these estimates, see Ackerman, 2005).

The estimates vary widely, depending on the methodology and the data used but, even the most optimistic estimate by an OECD study (OECD, 2003, as cited in HM Treasury/DTI, 2004) puts the global welfare benefits from complete merchandise (agriculture and manufacturing) trade liberalization at US\$1,212 billion. A more cautious World Bank study (World Bank, 2003b, as cited in HM Treasury/DTI, 2004) estimates the benefits at US\$518 billion. However, other studies suggest much more modest figures. For example two World-Bank-sponsored studies put the figures at US\$287 billion (Anderson et al., 2005) or even US\$84 billion (Hertel and Keeney, 2005), which is less than 7 per cent of the above-cited OECD estimate.

These sums, especially at the higher end of the estimates, look impressive. HM Treasury/DTI (2004) describes the numbers it cites (which happen to be all in the higher end of the estimates) as “compelling” (p. 53). However, while these numbers look large in absolute terms, their relative magnitudes are actually quite small.

In 2003, the world's total income was US\$34,491 billion (World Bank, 2005, p. 257, table 1), so even the US\$1,212 billion estimate by OECD (2003) represents only around 3.5 per cent of world income. When it comes to the conservative estimates, we are talking about 0.83 per cent (Anderson et al.) or even 0.24 per cent (Hertel & Keeney) of world income.

More specifically in relation to NAMA, according to the comprehensive and meticulous review by Ackerman (2005), existing studies estimate that around 2/3 of the above-mentioned benefits would come from agricultural liberalization. This means that the benefits from industrial trade liberalization are in the region of US\$28 billion to US\$404 billion, or 0.08-1.17 per cent of world income.

How much of these benefits would go to the developing countries? Take the middle two among the four estimates cited above. The World Bank (2003b) estimates that the benefits from industrial trade liberalization for the developing countries will be about US\$109 billion. Anderson et al. (2005) estimates the benefits at around US\$34 billion. Given that the developing countries' collective income in 2003 was US\$6,762 billion (World Bank, 2005, p. 257, table 1), these are equivalent to 0.50 per cent to 1.61 per cent of their income – hardly “compelling” figures.

Given the above, we can say that even under “best-case” (in other words, unrealistic) scenarios, NAMA is likely to bring only very small benefits, possibly as small as the equivalent of 0.1 per cent of world income and definitely not more than equivalent to around 1 per cent of world income. The benefits for the developing countries are estimated to be bigger in proportional terms (as they account for less than 20 per cent of world income), but even then they are not likely to be more than around 1.5 per cent of their income.

## **II. 5 Summary and Conclusions**

In this part (Part II), we have shown that there are robust arguments for the protection of infant industries. In the same way children need parental protection and financial supports while they are being educated and preparing for the future, new industries in the developing countries require government protection and subsidies at the initial stages of their development, so that they can absorb new technologies and learn to compete in the world market. Examples of failed infant industry promotion exist, but they should not be used as an argument against the exercise as a whole but, only as reminders that infant industry programmes need to be designed and administered well – in the same way that the existence of bad parenting does not negate the necessity of parenting itself, but only tells us to be more conscientious as parents.

We have also shown that contrary to conventional wisdom, tariffs are not necessarily an inferior way of promoting infant industries. Especially in the developing countries, there are practical considerations, especially fiscal implications, which make tariffs a better policy tool than subsidies, which are supposed to be better according to standard economic theory. In addition, tariffs have become more important recently, not least because the WTO has made most subsidies and other tools of industrial policy intervention illegal (or “actionable” in the technical jargon).

We have argued that trade liberalization always brings net benefit only in the fantasy world of perfect markets and instantaneous adjustments. In reality, the outcome of trade liberalization depends on a number of factors.

First of all, it depends on whether the firms in the liberalizing industries can raise productivity fast enough, which in turn depends on things like the scale and the speed of trade liberalization, the gap in productivity with the more advanced countries and, the technological capabilities of the firms and the country in question.

Second, even if the firms in the liberalized industries make quick enough adjustments, and therefore the economy as a whole benefits from tariff cuts (an unlikely outcome given the scale of tariff cuts proposed by the developed countries in the NAMA negotiations), the net benefits are likely to be very small, even according to the estimates by free-trade economists employing assumptions that are inherently biased towards free trade. Even the most optimistic estimates of the benefits of total industrial trade liberalization have come up with figures that may look “compelling” in absolute terms but are insignificant in relative terms – at most 1 per cent of world income.

Third, whatever the net benefits, there will be gainers and losers from the liberalization process. Whether the resulting distribution of gains and losses is socially acceptable will depend on whether and how much the government can re-distribute the gains to compensate the losers, which in turn depends on the existence and the effectiveness of the welfare state and other income transfer mechanisms (e.g. subsidies to depressed regions).

Our discussion in this Part shows that the standard trade theory that forms the basis of the argument for NAMA is based on highly unrealistic and simplistic assumptions, which are inherently biased towards free trade. If we tweak even one or two of these assumptions, the whole edifice of free trade falls apart. As we shall show in the next Part (Part III) of the paper, the argument for free trade is not supported by historical and contemporary evidence either.

### **III. TARIFF AND ECONOMIC DEVELOPMENT – EVIDENCE**

To the supporters of indiscriminate trade liberalization, the move towards free trade is the inevitable destiny of human civilization. To be sure, there are constant siren calls from protectionist lobbies and misleading ideologues, who tempt the policy-makers to deviate from the narrow and straight path of free trade but, the historical trend has been unmistakably in the direction of freer, if not totally free, trade.

According to what I call the “official history of capitalism”, represented by works like Bhagwati (1985, 1998) and Sachs & Warner (1995) in the area of economics, the world economy has moved towards free trade ever since the United Kingdom, starting in the 18th century, proved the virtues of freetrade and free-market capitalism over protectionist and interventionist mercantilism.

Initially, most countries were reluctant to adopt free trade but, when British economic success became so obvious, one by one they fell into line. Major changes came with the repeal of the Corn Laws (protecting grain producers) in the United Kingdom in 1846 and the Anglo-French free trade agreement (the so-called Cobden-Chevalier Treaty) in 1860. Other bilateral free-trade agreements followed, and by the late 19th century, free trade became dominant.

Unfortunately, runs the “official history”, the historical march towards free trade was reversed after the Great Depression. A beggar-thy-neighbour policy of tariff wars was triggered by the notoriously populist and protectionist Smoot-Hawley Tariff of the United States in 1930, which the free-trade economist Jagdish Bhagwati described as “the most visible and dramatic act of anti-trade folly” (Bhagwati, 1985, p. 22, f.n. 10).

After the Second World War, the developed countries learned their lesson and moved to free trade through a series of multilateral tariff reduction agreements in the GATT.

However, in the immediate post-SWW years, the developing countries strayed from the path of economic virtue, raising their trade barriers to new heights. According to Sachs & Warner (1995), the developing country policy-makers at the time had political motives in adopting the protectionist policies, such as the need for nation building and the need to “buy off” certain interest groups. However, more importantly, they were influenced by “wrong” theories, such as the infant industry argument, the “big push” theory, Latin American structuralism, and various Marxist theories. In this context Sachs & Warner (1995) are worth citing at length.

“Export pessimism combined with the idea of the big push to produce the highly influential view that open trade would condemn developing countries to long-term subservience in the international system as raw materials exporters and manufactured goods importers. Comparative advantage, it was argued by the Economic Commission of [*sic*] Latin America (ECLA) and others, was driven by short-term considerations that would prevent raw materials exporting nations from ever building up an industrial base. The protection of infant industries was therefore vital if the developing countries were to escape from their over dependence on raw materials production. These views spread within the United Nations system (to regional offices of the United Nations Economic Commission), and were adopted largely by the United Nations Conference on Trade and Development (UNCTAD). In 1964 they found international legal sanction in a new part IV of the General Agreement on Tariffs and Trade (GATT), which established that developing countries should enjoy the right to asymmetric trade policies. While the developed countries should open their markets, the developing countries could continue to protect their own markets. Of course, this

“right” was the proverbial rope on which to hang one’s own economy! [italics added]” (p. 17).

Fortunately, the official history continues, interventionist and protectionist policies have been largely abandoned across the world since the 1980s with the rise of neo-liberalism, which emphasizes the virtues of small government, *laissez faire* policies and, international openness. Especially in the developing world economic growth had begun to falter in the 1970s in most countries outside East and Southeast Asia, which were already pursuing “good” policies, especially open (if not completely free) trade policy. This growth failure, which often manifested itself in the economic crises of the early 1980s, exposed the limitations of old-style interventionism and protectionism.

As a result, the story goes, most developing countries have come to embrace “policy reform” in the neo-liberal direction. The most symbolic of these conversions, according to Bhagwati (1998), are: Brazil’s embrace of neo-liberal doctrine under the presidency of Fernando Henrique Cardoso, a leading dependency theorist until the 1980s; the entry of traditionally anti-United States Mexico into the NAFTA (North American Free Trade Agreement); and the move towards an open, liberal economy by India, once the bastion of protectionism and regulation (p. 37). The crowning glory of this trend towards liberalization and opening up, was the fall of Communism in 1989, which finally ended the “historical anomaly” (Sachs & Warner, 1995, p. 3) of protectionism and interventionism that had prevailed in the early postwar years.

When combined with the establishment of new global governance institutions such as the WTO, it is argued that these policy changes at the national level have created a new global economic system, comparable in its (at least potential) prosperity to the earlier “golden age” of Liberalism (1870-1914).<sup>22</sup> Renato Ruggiero, the first Director-General of the WTO, argues that thanks to this new world

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<sup>22</sup> Sachs & Warner (1995) date this “golden age” as 1850-1914.

order we now have “the potential for eradicating global poverty in the early part of the next [21st] century – a utopian notion even a few decades ago, but a real possibility today” (Ruggiero, 1998, p. 131).

In summary, the “official history” tells us that protectionism is bad but, that it gets adopted because of ideological propaganda and interest-group politics. History shows, it is argued, that countries that have resisted such temptation and stuck to free (at least freer) trade, starting with 18th-century Britain, have performed better. Given that industrial tariffs are the main trade barriers in the developing countries, the case for radical cuts, if not total abolition, of such tariffs is evident to those who believe the official history.

Plausible and influential it may be, but this official history is wrong on numerous counts. The role and the impact of trade protectionism, especially tariffs, in the history of economic development, both in today’s developed and the developing worlds, has been very different from what the official historians would have us believe, and show the real dangers of radical industrial tariff cuts proposed by the developed countries in the current NAMA negotiations.

### **III.1 Developed Countries: Historical Experience**

*In this section, we look at the industrialization experiences of today’s developed countries, showing that they never practiced what they now preach to the developing countries in terms of trade policy. In the early days of their industrialization, these countries used numerous protectionist and interventionist measures (especially tariffs) to promote their industries (further details can be found in Chang, 2002).*

### **III.1.1 The United Kingdom**

Contrary to the popular myth that depicts it as the first country that developed on the basis of free market and free trade, the United Kingdom was an aggressive user, and in certain areas a pioneer, of interventionist policies intended to promote infant industries.

Such policies, although limited in scope, date back to the 14th century (Edward III) and the 15th century (Henry VII) in relation to woollen manufacturing, the “high-tech” industry of the time. In the 14th and the 15th centuries, England was an exporter of raw wool to the Low Countries (what are now Belgium and the Netherlands). Consequently, various British monarchs tried to change this by, among other things, protecting the domestic woollen manufacturers through tariffs, taxing raw wool exports, and poaching skilled workers from the Low Countries.<sup>23</sup>

Especially between the 1721 trade policy reform of Robert Walpole, the United Kingdom’s first Prime Minister, and the repeal of the Corn Laws in 1846, the United Kingdom implemented a most aggressive industrial promotion policy. During this period, it actively used policies such as tariff protection, export subsidies, import tariff rebates on inputs used for exporting, and export quality control by the state – policies that are these days typically associated with Japan and other East Asian countries (see Brisco, 1907, on the details of Walpole’s trade policy). As we can see from table 3, the United Kingdom had very high tariffs on manufacturing products (in fact the highest among the countries for which average tariffs can be calculated) even as late as the 1820s, some two generations after the start

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<sup>23</sup> In a now-almost-forgotten book, *A Plan of the English Commerce* (1728), the famous 18th century merchant, politician, and the author of the novel, *Robinson Crusoe*, Daniel Defoe, describes how the Tudor monarchs, especially Henry VII (1485 – 1509) and Elizabeth I (1558 – 1603), transformed England from a country heavily relying on raw wool export to the Low Countries into the most formidable woollen manufacturing nation in the world through deliberate state intervention.

of its Industrial Revolution, when it was significantly ahead of its competitor nations in technological terms.

**Table 3**  
**Average Tariff Rates on Manufactured Products For Selected**  
**Developed Countries In Their Early Stages Of Development**  
 ( weighted average; in percentages of value)<sup>1</sup>

	1820 <sup>2</sup>	1875 <sup>2</sup>	1913	1925	1931	1950
Austria <sup>3</sup>	R	15-20	18	16	24	18
Belgium <sup>4</sup>	6-8	9-10	9	15	14	11
Canada <sup>5</sup>	5	15	n.a.	23	28	17
Denmark	25-35	15-20	14	10	n.a.	3
France	R	12-15	20	21	30	18
Germany <sup>6</sup>	8-12	4-6	13	20	21	26
Italy	n.a.	8-10	18	22	46	25
Japan <sup>7</sup>	R	5	30	n.a.	n.a.	n.a.
Netherlands <sup>4</sup>	6-8	3-5	4	6	n.a.	11
Russia	R	15-20	84	R	R	R
Spain	R	15-20	41	41	63	n.a.
Sweden	R	3-5	20	16	21	9
Switzerland	8-12	4-6	9	14	19	n.a.
United Kingdom	45-55	0	0	5	n.a.	23
United States	35-45	40-50	44	37	48	14

Source: Chang (2002), p. 17, table 2.1, largely based on Bairoch (1993), p. 40, table 3.3.

Notes:

R= Numerous and important restrictions on manufactured imports existed and therefore average tariff rates are not meaningful.

1. World Bank (1991, p. 97, Box table 5.2) provides a similar table, partly drawing on Bairoch's own studies that form the basis of the above table. However, the World Bank figures, although in most cases very

similar to Bairoch's figures, are *unweighted* averages, which are obviously less preferable to *weighted* average figures that Bairoch provides.

2. These are very approximate rates, and give range of average rates, not extremes.
3. Austria-Hungary before 1925.
4. In 1820, Belgium was united with the Netherlands.
5. Source: K. W. TAYLOR, "Tariffs", in W. Stewart WALLACE, ed., *The Encyclopedia of Canada*, Vol. VI, Toronto, University Associates of Canada, 1948, 398p., pp. 102-108.
6. The 1820 figure is for Prussia only.
7. Before 1911, Japan was obliged to keep low tariff rates (up to 5 per cent) through a series of "unequal treaties" with the European countries and the United States. The World Bank table cited in note 1 above gives Japan's *unweighted* average tariff rate for *all goods* (and not just manufactured goods) for the years 1925, 1930, 1950 as 13 per cent, 19 per cent, 4 per cent.

The United Kingdom moved significantly, although not completely, to free trade with the repeal of the Corn Laws in 1846. Today, the repeal of the Corn Laws is commonly regarded as the ultimate victory of the classical liberal economic doctrine over wrong-headed mercantilism.<sup>24</sup> However, many historians familiar with the period see it as an act of "free trade imperialism" intended to "halt the move to industrialization on the Continent by enlarging the market for agricultural produce and primary materials" (Kindleberger, 1978, p. 196).

Indeed, this is exactly how many key leaders of the campaign to repeal the Corn Laws, such as the politician Richard Cobden and John Bowring of the Board of Trade, saw their campaign. Cobden argued:

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<sup>24</sup> For example, Bhagwati uses a political cartoon about the repeal of the Corn Laws from the *Punch* magazine of the time for the cover of his famous 1985 book, *Protectionism*.

“The factory system would, in all probability, not have taken place in America and Germany. It most certainly could not have flourished, as it has done, both in these states, and in France, Belgium, and Switzerland, through the fostering bounties which the high-priced food of the British artisan has offered to the cheaper fed manufacturer of those countries” (*The Political Writings of Richard Cobden*, 1868, William Ridgeway, London, vol. 1, p. 150; as cited in Reinert, 1998, p. 292).

In summary, contrary to popular belief, the United Kingdom’s technological lead that enabled this shift to a free trade regime was achieved “behind high and long-lasting tariff barriers”, as the eminent economic historian Paul Bairoch once put it (Bairoch, 1993, p. 46). It should also be pointed out that the United Kingdom “adopted Free Trade painfully slowly: eighty-four years from *The Wealth of Nations* to Gladstone’s 1860 budget; thirty-one from Waterloo to the ritual victory of 1846” (Fielden, 1969, p. 82).

It is for this reason that Friedrich List, the 19th-century German economist who, instead of Hamilton, is often mistakenly known as the father of modern “infant industry” theory, argued that the United Kingdom preaching free trade was equivalent to someone who has already climbed to the top “kicking away the ladder” with which he/she had climbed. He is worth quoting at length on this point.

“It is a very common clever device that when anyone has attained the summit of greatness, he *kicks away the ladder* by which he has climbed up, in order to deprive others of the means of climbing up after him. In this lies the secret of the cosmopolitical doctrine of Adam Smith, and of the cosmopolitical tendencies of his great contemporary William Pitt, and of all his successors in the British Government administrations.

Any nation which by means of protective duties and restrictions on navigation has raised her manufacturing power and her navigation to such a degree of development that no other nation can sustain free competition with her, can do nothing wiser than *to throw away these ladders* of her greatness, to preach to other nations the benefits of free trade, and to declare in penitent tones that she has hitherto wandered in the paths of error, and has now for the first time succeeded in discovering the truth [italics added]" (List, 1885, pp. 295-6).

It should also be noted that the United Kingdom's free trade regime did not last long. Already by the 1880s, some hard-pressed British manufacturers were asking for protection. By the early 20th century, the re-introduction of protectionism was one of the hottest issues in British politics, as the country was rapidly losing its manufacturing advantage to the United States and Germany. The influence of the Tariff Reform League, formed in 1903 under the leadership of the charismatic politician Joseph Chamberlain, is a good testimony to this (see Clarke, 1999, on the rise and fall of the Tariff Reform League and Chamberlain's role in it). The era of free trade ended when the United Kingdom finally acknowledged that it had lost its manufacturing eminence and re-introduced tariffs on a large scale in 1932 (Bairoch, 1993, pp. 27-8).

### ***III.1.2 The United States***

If the United Kingdom was the first country successfully to launch a large-scale infant industry promotion strategy, its most ardent user was the United States – Paul Bairoch once called it “the mother country and bastion of modern protectionism” (Bairoch, 1993, p. 30).

As mentioned above (Part II), the first systematic argument for infant industry promotion was developed by Alexander Hamilton, the first Treasury Secretary of the United States. In fact, Friedrich List, the 19th-century German economist who is the supposed intel-

lectual father of infant industry protection, first learned about the argument during his exile in the United States during the 1820s (Henderson, 1983; Reinert, 1998).

Many United States intellectuals and politicians during the country's catch-up period clearly understood that the free trade theory advocated by the British Classical economists was unsuited to their country. Indeed, as we mentioned earlier, it was against the advice of great economists like Adam Smith and Jean Baptiste Say that the Americans protected their industries. In his *Wealth of Nations*, Adam Smith wrote:

“Were the Americans, either by combination or by any other sort of violence, to stop the importation of European manufactures, and, by thus giving a monopoly to such of their own countrymen as could manufacture the like goods, divert any considerable part of their capital into this employment, they would retard instead of accelerating the further increase in the value of their annual produce, and would obstruct instead of promoting the progress of their country towards real wealth and greatness” (Smith, 1937 [1776], pp. 347-8).

Between 1816, when it first put up high industrial tariff rates, and the end of the Second World War, the United States had one of the highest average tariff rates on manufacturing imports in the world – usually at around 40 per cent and rarely falling below 25 per cent (for further details, see Chang, 2002, pp. 26-29). Given that the country enjoyed an exceptionally high degree of “natural” protection due to high transportation costs at least until the 1870s, when steamships became common, we can say that the United States industries were the most protected in the world for over a century until the Second World War.

Even the Smoot-Hawley Tariff of 1930, which Bhagwati (1985) and other free-trade economists like to portray as a radical departure from the country's historic free-trade stance, only margin-

ally (if at all) increased the degree of protectionism in the United States economy. As table 3 shows, the average tariff rate for manufactured goods that resulted from this bill was 48 per cent, and it still falls within the range of the average rates that had prevailed in the United States since the Civil War, albeit in the upper region of this range. It is only in relation to the brief “liberal” interlude of 1913-1929 that the 1930 tariff bill can be interpreted as increasing protectionism, although even then it was not by very much (from 37 per cent in 1925 to 48 per cent in 1931 – see table 3).

In this context, it is also important to note that the American Civil War was fought on the issue of tariffs as much as, if not more than, on the issue of slavery. Of the two major issues that divided the North and the South, the South had actually more to fear on the tariff front than on the slavery front. Abraham Lincoln was a well-known protectionist who had cut his political teeth under the charismatic politician Henry Clay in the Whig Party, which advocated the “American System” based on infrastructural development and protectionism – thus named in recognition that free trade was in the “British” interest. Moreover, Lincoln thought the blacks were racially inferior and that slave emancipation was an idealistic proposal with no prospect of immediate implementation (Garraty & Carnes, 2000, pp. 391-2; Foner, 1998, p. 92). He is said to have emancipated the slaves in 1862 as a strategic move to win the War rather than out of moral conviction (Garraty & Carnes, 2000, p. 405).<sup>25</sup>

It was only after the Second World War, with its industrial supremacy unchallenged, that the United States liberalized its trade (although not as unequivocally as the United Kingdom did in the mid-19th century) and started championing the cause of free trade – once again proving List right in his “ladder-kicking” metaphor. The following quote from Ulysses Grant, the Civil War hero and the

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<sup>25</sup> In response to a newspaper editorial urging immediate slave emancipation, Lincoln wrote: “If I could save the Union without freeing any slave, I would do it; and if I could save it by freeing all the slaves, I would do it; and if I could do it by freeing some and leaving others alone, I would also do that” (Garraty & Carnes, 2000, p. 405).

President of the United States during the period 1868-1876 clearly shows how the Americans had no illusions about ladder-kicking on the British side and on their side.

“For centuries England has relied on protection, has carried it to extremes and has obtained satisfactory results from it. There is no doubt that it is to this system that it owes its present strength. After two centuries, England has found it convenient to adopt free trade because it thinks that protection can no longer offer it anything. Very well then, Gentlemen, my knowledge of our country leads me to believe that within 200 years, when America has gotten out of protection all that it can offer, it too will adopt free trade.” (Ulysses S. Grant, the President of the United States, 1868-76, cited in Frank, 1967, p. 164).<sup>26</sup>

### ***III.1.3. Other Countries***

Similar pictures emerge in relation to the history of economic development of others among today’s rich countries. When they were catching up with the more advanced countries, almost all of them used some form of infant industry promotion strategy, in which tariffs were a key (if not the only nor necessarily the most important) component.

It is noteworthy that it is the United Kingdom and the United States – the supposed homes of free trade – and not countries like France, Germany, or Japan – countries usually associated with protectionism – that used *tariff* protection most aggressively.

France, usually portrayed as the interventionist counterpoint to freetrade United Kingdom, actually had lower tariff protection than the United Kingdom during the first three quarters of the 19th century (see table 4). Tariff protection was relatively low in Germany,

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<sup>26</sup> I am grateful to Duncan Green for drawing my attention to this quote.

**Table 4**  
**Protectionism in the United Kingdom and France, 1821-1913**  
(measured by net customs revenue as a percentage  
of net import values)

<b>Years</b>	<b>United Kingdom</b>	<b>France</b>
1821-1825	53.1	20.3
1826-1830	47.2	22.6
1831-1835	40.5	21.5
1836-1840	30.9	18.0
1841-1845	32.2	17.9
1846-1850	25.3	17.2
1851-1855	19.5	13.2
1856-1860	15.0	10.0
1861-1865	11.5	5.9
1866-1870	8.9	3.8
1871-1875	6.7	5.3
1876-1880	6.1	6.6
1881-1885	5.9	7.5
1886-1890	6.1	8.3
1891-1895	5.5	10.6
1896-1900	5.3	10.2
1901-1905	7.0	8.8
1906-1910	5.9	8.0
1911-1913	5.4	8.8

Source: Nye (1991), p. 26, Table 1.

and Japan's tariff was bound below 5 per cent until 1911 due to a series of unequal treaties that it was forced to sign upon opening up to the outside world in 1853 (see table 3). These countries did, however, more actively use other means of state intervention than did the United Kingdom or the United States (e.g. government investment in industry or infrastructure projects).

*Average* tariff figures do not give the full picture of industrial promotion efforts. For example, during the late 19th and the early 20th century, while maintaining a relatively low *average* tariff rate, Germany and Sweden accorded strong tariff protection to strategic industries such as steel and engineering.

Moreover, there were many measures other than tariffs that today's rich countries used in order to develop, although some of these (e.g., state-owned enterprises) were not widely used until the Second World War for one reason or another (see section II.3). These measures included quantitative trade restrictions (quotas), export subsidies, tariff rebates on inputs used for exports, establishment of state-owned enterprises (or public-private joint-ventures), conferring of monopoly rights, cartel arrangements, directed credits, R&D support, regulation of foreign investments, regulation of technology imports and, the promotion of institutions that allow public-private cooperation.

The exceptions to this historical pattern are Switzerland and the Netherlands. However, these were countries that were already on the frontier of technological development by the 18th century and therefore did not need much infant industry protection. It should also be noted that the Netherlands had deployed an impressive range of interventionist measures up until the 17th century in order to build up its maritime and commercial supremacy (Boxer, 1965).<sup>27</sup> While hav-

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<sup>27</sup> Moreover, these two countries did not protect patents until late in their stages of development, flying directly against the emphasis that today's orthodoxy puts on the protection of intellectual property rights (Schiff, 1971). Switzerland did not have any patent law until 1888, when they introduced a patent law that protected only mechanical inventions ("inventions

ing relatively low tariffs, Switzerland has always been willing to use NTBs when necessary. According to an UNCTAD report in the mid-1980s, Switzerland applied NTBs to around one-quarter of its total imports (UNCTAD, 1984, p. 66, table 14).<sup>28</sup>

Another important point, which is particularly relevant for the NAMA debate, is that there were considerable flexibilities in the use of tariffs by today's developed countries before the Second World War.

For example, in an attempt to develop the heavy and chemical industries (such as steel and engineering) that were newly emerging in the late 19th century, countries like Germany and Sweden that had previously had relatively low industrial tariffs, raised their tariffs for the new infant industries. In the case of Germany, the 1879 tariff increase for the iron and steel industry did not lead to a large increase in average tariffs but, in the case of Sweden, a similar move concerning the engineering industry after 1892 significantly raised its average tariff. As we can see from table 3, by 1913 its average tariff rate on manufactured products was among the highest in Europe. Indeed, according to one study conducted in the 1930s, Sweden ranked second, after Russia, among the 14 European countries studied in terms of its degree of manufacturing protection.<sup>29</sup>

For another example, the dramatic fall in transatlantic transportation cost since the 1870s, due to the spread of the steamship and the invention of refrigerated ships, made it possible for the land-rich

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that can be represented by mechanical models"). Only in 1907 did Switzerland start to protect chemical (and pharmaceutical) inventions, but even then it did not recognize product (as opposed to process) patents in chemicals until 1978. More interestingly, the Netherlands abolished its 1817 patent law in 1869 on the ground that patents were politically-created monopolies inconsistent with its free-market principles – a position that seems to elude most of today's free-market economists – and did not re-introduce a patent law again until 1912.

<sup>28</sup> I thank Yilmaz Akyuz for drawing my attention to this information.

<sup>29</sup> The information is from H. Liepmann, *Tariff Levels and the Economic Unity of Europe*, London, 1938, as cited in Bairoch (1993), p. 26, table 2.3.

countries of the Americas (the United States, Canada, Argentina, and Uruguay in particular) to export temperate-zone agricultural products (such as wheat, beef, lamb, and dairy products) to Europe. As a result, many European countries, including Sweden and Germany, increased their agricultural tariffs from the 1870s.

Such policy reversals were possible not least because many tariff cuts at the time were based on bilateral free-trade agreements (FTAs) with a limited lifetime (usually 20 years). Many of the FTAs signed in the 1860s and the 1870s were not renewed after their expiry. Most notably, Sweden moved to protectionism in 1892, because that was when most of its FTAs expired. This is a marked contrast to the tariff cuts currently proposed in the NAMA negotiations, which are supposed to be permanent, and suggest that there may be a case for introducing time limits on the WTO agreements.

These historical examples show that it is absolutely necessary for countries to be able to raise and lower tariffs according to changing circumstances, an avenue which will be closed to the developing countries if industrial tariffs are reduced and bound at low levels (or even totally abolished forever) through the NAMA negotiations (not to speak of when the zero industrial tariff of the United States is realized in 2015). This issue of flexibility will be reviewed in section IV.II (also see Akyuz, 2005).

### ***III.1.4 Comparison with Today's Developing Countries***

Those few free-trade economists who are aware of the records of protectionism in today's developed countries have tried to avoid the obvious conclusion – that is, protectionism can be very useful for economic development – by arguing that while some (minimal) tariff protection may be necessary, most developing countries have tariffs rates that are much higher than those used by today's developed countries in the past.

Little et al. (1970) is a classic example. It argues that “[a] part from Russia, the United States, Spain, and Portugal, it does not ap-

pear that tariff levels in the first quarter of the twentieth century, when they were certainly higher for most countries than in the nineteenth century, usually afforded degrees of protection that were much higher than the sort of degrees of promotion for industry which we have seen, in the previous chapter, to be possibly justifiable for developing countries today [which they argue to be at most 20 per cent even for the poorest countries and virtually zero for the more advanced developing countries]” (pp.163-4). Similarly, the World Bank (1991) argues that “[a]lthough industrial countries did benefit from higher natural protection before transport costs declined, the average tariff for twelve industrial countries<sup>30</sup> ranged from 11 to 32 per cent from 1820 to 1980 ... In contrast, the average tariff on manufactures in developing countries is 34 per cent” (p. 97, Box 5.2).

This argument sounds reasonable enough, but is actually highly misleading in one important sense. The problem with it is that the productivity gap between today’s developed countries and the developing countries is much greater than that existing between the more developed of today’s developed countries and the less developed among them in earlier times.

Throughout the 19th century, the ratio of per capita income in PPP terms between the poorest of today’s developed countries (say, Japan and Finland) and the richest among them (say, the Netherlands and the United Kingdom) ranged between 2 and 4 to 1.<sup>31</sup> Today, the gap in per capita income in PPP terms between the most developed countries (e.g., Switzerland, Japan, the United States) and the least developed ones (e.g. Ethiopia, Malawi, Tanzania) is typically in the region of 50 or 60 to 1. Middle-level developing countries such as Nicaragua (US\$2,060), India (US\$2,230), and Zimbabwe (US\$2,690) have to contend with productivity gaps in the region of 10 or 15 to 1. Even for quite advanced developing countries such as

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<sup>30</sup> They are Austria, Belgium, Denmark, France, Germany, Italy, the Netherlands, Spain, Sweden, Switzerland, the United Kingdom, and the United States.

<sup>31</sup> The GDP estimates here and in the rest of this section are from Maddison (1995).

Brazil (US\$6,840) or Colombia (US\$5,580), the productivity gap with the top industrial countries is about 5 to 1.

This means that developing countries need to impose much higher rates of tariffs than those used by today's developed countries in earlier times, if they are to provide the same degree of actual protection to their industries as the ones accorded to the industries in today's developed countries in the past.<sup>32</sup>

For example, when the United States accorded over 40 per cent average tariff protection to its industries in the late 19th century, its per capita income in PPP terms was already about 3/4 that of the United Kingdom. And this was when the "natural protection" accorded by distance, which was especially important for the United States, was considerably higher than today. Compared to this, the 71 per cent trade-weighted average tariff rate that India used to have just before the WTO agreement, despite the fact that its per capita income in PPP terms is only about 1/15 that of the United States, makes the country look like a champion of free trade. Following the Uruguay Round, India cut its trade-weighted average tariff to 32 per cent, bringing it below the United States average tariff rate between the end of the Civil War and World War II.

To take a less extreme example, in 1875 Denmark had an average tariff rate of around 15-20 per cent, when its income was slightly less than 60 per cent of that of the United Kingdom. Following the

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This is not to say that all industries in the same country should get the same degree of protection, determined by the national productivity gap with the advanced countries. To begin with, some industries will have smaller productivity gaps with their advanced country competitors than others. Furthermore, even with similar productivity gaps, different industries are likely to have different capabilities to close the gaps, depending on their human and organizational capabilities. Moreover, for political and other reasons, the country's government may have differential abilities to "discipline" firms that fail to raise productivity despite protection. In the end, the desirable pattern of protection will be one where different industries receive different degrees of protection, depending on their respective productivity gaps, learning capabilities, and political situations.

Uruguay Round, Brazil cut its trade-weighted average tariff from 41 per cent to 27 per cent, a level that is not far above the Danish level, but its income in PPP terms is barely a fifth of that of the United States.

Thus seen, *given the productivity gap*, even the relatively high levels of protection that prevailed in the developing countries until the 1980s do not seem excessive by the historical standards of today's developed countries. When it comes to the substantially lower levels that have come to prevail after two decades of extensive trade liberalization in these countries, it may even be argued that today's developing countries look much less protectionist than today's developed countries in earlier times.

If the developed countries have their way in the NAMA negotiations, the developing countries are going to end up with industrial tariffs rates that are *lower* than what could be found in the developed countries until the Second World War, only with a few exceptions (the United Kingdom and the Netherlands between the late-19th and the early 20th centuries, and Germany briefly in the late 19th century – see table 3).

### ***III.1.5 Trade Policy and Economic Performance***

It is clear from the discussion above that virtually all of today's developed countries, when they were catching up with the more advanced countries, did not conduct free trade but used tariffs and other measures of protection in order to promote their industries. However, can we conclude from this that such measures played a positive role in the development of these countries?

Such causality is not easy to establish but, there is an increasing amount of evidence that lets us make such an inference.

At the country level, Bairoch (1993) points out that throughout the 19th century and right up to the 1920s, the United States was the fastest growing economy in the world, despite being the most protec-

tionist during almost all of this period (pp. 51-2). According to Bairoch, there is also no evidence that the only significant reduction of protectionism in the United States economy (between 1846 and 1861) had any noticeable positive impact on the country's development. Most interestingly, the two best 20-year GDP per capita growth performances during the 1830-1910 period were 1870-1890 (2.1 per cent) and 1890-1910 (2 per cent) – both periods of particularly high protectionism (pp. 52-3).<sup>33</sup> It is hard to believe that this association between the degree of protectionism and overall growth is purely coincidental.

Many economic historians also agree that the selective protection of heavy and chemical industries in Germany and Sweden in the late 19th century and the early 20th century helped these countries catch up with the more advanced countries at the time (for further details, see Chang, 2002).

There is also an increasing number of cross-section econometric studies that show that there was no negative relationship between tariff levels and growth rates among today's developed countries before the SWW, in contrast to today's conventional wisdom. Indeed many of these studies show that higher tariff rates were in fact associated with *faster* economic growth among these countries during the period.

Through regression analysis of statistical evidence from ten of today's developed countries from 1875 to 1914, O'Rourke (2000) shows that protection (measured by average tariff rates) was *posi-*

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<sup>33</sup> According to Bairoch, the third fastest-growing 20-year period was that of 1850-70 (1.8 per cent). However, the record for this period is more difficult to assess than those of the other two periods. First of all, 1850-61 was a period of relatively (but then only relatively) low protectionism, while 1862-70 witnessed a marked increase in protection. Moreover, this period contains the periods of the Civil War (1861-5) and the postwar reconstruction, and thus cannot be treated in the same way as other periods.

tively related to growth.<sup>34</sup> Looking at the historical data from 35 developed and developing countries, Clemens & Williamson (2001) also show that there was a *positive* correlation between average tariff rates and economic growth for the periods 1875-1908 and 1924-34.<sup>35</sup> Looking at the historical data from 22 developed and developing countries, Vamvakidis (2002) could not find any correlation between tariff rates and growth rates between 1870 and 1910, but found *positive* correlation for the 1920-40 period.<sup>36, 37</sup>

It is not easy to draw straightforward conclusions from cross-section econometric studies, especially when they use historical data that involve both developed and developing countries. However, whichever study one believes in, it seems clear that there is *no* statistical evidence that higher tariffs were associated with lower growth

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<sup>34</sup> The 10 countries are Austria, Canada, Denmark, France, Germany, Italy, Norway, Sweden, the United Kingdom, and the United States.

<sup>35</sup> The 35 countries included are Argentina, Australia, Austria, Brazil, Burma, Canada, Ceylon, Chile, China, Colombia, Cuba, Denmark, Egypt, France, Germany, Greece, India, Indonesia, Italy, Japan, Mexico, New Zealand, Norway, Peru, the Philippines, Portugal, Russia, Serbia, Spain, Sweden, Thailand, Turkey, the United Kingdom, the United States and Uruguay. See Data Appendixes A-1 to A-7 for further details.

<sup>36</sup> The 22 countries included are Argentina, Australia, Austria, Belgium, Brazil, Canada, Chile, Colombia, Finland, France, Germany, India, Italy, Japan, Mexico, the Netherlands, Portugal, Spain, Sweden, Switzerland, the United Kingdom, and the United States. See p. 73, Appendix 1.

<sup>37</sup> Looking at 28 developed and developing countries during the 1870-1913 period, Irwin (2002) casts some doubt on the positive relationship between tariff rates and growth rates. He points out that the positive correlation that he finds between the two during 1870-1914 is largely driven by the United States, Canada, and Argentina. He argues that the positive correlation between the two almost disappears if he takes these three countries out. However, it is not clear to me whether the United States, the most industrially successful country at the time, should be put in the same basket as Canada and Argentina which, Irwin rightly points out, grew largely on the basis of agricultural exports while raising government revenue through imposing high tariffs on industrial imports. It should also be noted that even after this somewhat questionable adjustment, it is not as if Irwin can find a negative relationship between tariff levels and growth.

before the SWW among today's developed countries. If anything, countries with higher tariffs seem to have grown faster, although we are *not* suggesting that therefore high tariffs are necessarily good for growth. As any policy instrument, tariffs can be beneficial or harmful, depending on the purpose for which they are deployed, the intensity and the timeframe of their use and, other instruments that are used in combination.

However, we can confidently say that the statistical studies of the developed countries before the SWW do *not* support the current orthodoxy that higher tariffs lead to lower growth.

### **III.2 Developed Countries: Contemporary Evidence**

#### ***III.2.. Industrial Tariffs in the early post-SWW Period***

Surprisingly, the data on the tariffs of the developed countries in the earlier post-SWW years are not readily available, either from the WTO or the OECD.<sup>38</sup> In table 5 below, we have compiled what data we can on industrial tariffs in the developed countries in the early post-SWW years from publicly available sources.

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<sup>38</sup> When one of my research assistants contacted the WTO, she was told that the data before 1996 are not available and that even the latter are available only to government officials. For another example, when asked to provide the historical data on tariffs of the developed countries that he used in one of his papers, a researcher told me that he was given the data by the WTO for the late 1970s on the condition that they will remain confidential. Another point to note in analysing the post-SWW tariff data of the developed countries is that the individual country data for the member countries of the European Economic Community (now the European Union) have *not* been available since the 1960s. This means that the EEC (or EU) figures obscure the fact that the countries like France and Italy had high tariffs while countries like Germany and the Netherlands had low tariffs at least until the 1960s.

The table shows that many developed countries maintained quite high levels of industrial tariffs at least until the early-1960s, compared to even many of today's developing countries at similar or lower levels of development.

For example, in 1959, France was at a similar level of development as Malaysia today,<sup>39</sup> but its average industrial tariff rate (30 per cent) was nearly four times that of Malaysia's level today (8.6 per cent).<sup>40</sup> Table 5 shows that the average industrial tariff levels in Austria (20 per cent) and Finland (20 per cent-plus) in 1962 were similar to what Pakistan has today (20.2 per cent),<sup>41</sup> but that their 1962 incomes were around 3.5 times that of Pakistan today.<sup>42</sup>

Even after four smaller Rounds of industrial tariff reductions in the 1940s and the 1950s – the Geneva Round (1947), the Annecy Round (1949), the Torquay Round (1951), and the second Geneva Round (1956) – and two major Rounds of industrial tariff reduction in the 1960s – the Dillon Round (1960-1) and the Kennedy Round (1964-7) – industrial tariffs in the developed countries were still significant in the early 1970s. At 6-13 per cent, average industrial tariffs in the developed countries in the early 1970s were similar to or even higher than the levels that will prevail in the developing countries after the current round of NAMA negotiations if the developed coun-

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<sup>39</sup> In 1959, France's per capita income was US\$7,116 in 1990 international dollars (Maddison, 2001, p. 276, table C1-c). In 1999, Malaysia's per capita income in 1990 international dollars was US\$7,328 (Maddison, 2001, p. 305, table C3-c).

<sup>40</sup> The Malaysian tariff rate is the applied rate from WTO (2005), table 3. Malaysia has bound 81.2 per cent of its tariff lines and the average *bound* rate is 14.9 per cent.

<sup>41</sup> Pakistan's tariff rate is the applied rate from the WTO (2005), table 3. Pakistan has bound 37 per cent of tariff lines and the average *bound* rate is 35.3 per cent.

<sup>42</sup> In 1962, Finland's per capita income was US\$6,820 and that of Austria US\$6,950 in 1990 international dollars (p. 276, table C1-c). In 1999, Pakistan's per capita income in 1990 international dollars was US\$1,952 (p. 305, table C3-c).

tries have their way (5-15 per cent according to the EC proposal and 5-7 per cent according to the United States proposal).

**Table 5**  
**Average Tariff Rates (%) on Manufactured Products**  
**for Selected Developed Countries in the early**  
**post-Second-World-War Period**

	1950	1959	1962	1973	1979
Europe					
Belgium	11	14			
France	18	30			
Germany	26	7			
Italy	25	18			
Netherlands	11	7			
E.E.C. Average <sup>1</sup>		15	13	8	6
Austria	18		20 <sup>2</sup>	11	8
Denmark	3				
Finland			20-plus <sup>3</sup>	13	11
Sweden	9		8	6	5
Japan	n.a.		18	10	6
United Kingdom	23		16		
United States	14		13	12	7

Sources: 1950 data are from Bairoch (1993, p. 40, table 3.3). 1959 data are from Grubel & Johnson (1967, pp. 766-7, table 1). 1962 data are unweighted average calculated from the data on 36 2-digit SITC industries in Balassa (1965, p. 580, table 1). The figure for 1960 Austria is from Katzenstein (1985, p. 112). The data for 1973 and 1979 are from the data on the results of the Tokyo Round (1973-79), reported in Greenaway (1983, p. 95, table 5.3).

Notes:

1. EEC average after 1973 includes Denmark and the United Kingdom.
2. 1960

3. Estimate by the author. The data on Finland's tariff rates are not readily available but, according to the data reported in table 8.2 of Panić (1988, p. 151), in 1965 tariff revenue as a percentage of all imports in Finland was 9.97 per cent, which was considerably higher than that of Japan (7.55 per cent), which had 18 per cent average industrial tariff rate, or that of Austria (8.57 per cent), which had a 20 per cent average industrial tariff rate. Given this data, it would not be unreasonable to estimate that Finland's average industrial tariff rate in the mid-1960s was well over 20 per cent.

Moreover, the tariff figures during this period quite significantly under-state the extent of protectionism in these countries compared to the pre-SWW period.

First of all, between the end of the SWW and the late 1970s (and into the 1980s in some countries), most developed countries, with the notable exception of the United States, had significant capital controls (which were absent during most of the period before the SWW). The resulting foreign exchange rationing meant that the government could control what was imported, regardless of the tariff levels, although there were differences in the degrees to which the government used it as a tool for industrial development (e.g. France and Japan did so more than the United Kingdom). In addition, many imports were subject to formal quotas and import licensing.

Second, as mentioned earlier (section II.3), this period also saw the development of various NTBs. One important such example is the textile import quota system imposed through the MFA. Another example is the VERs imposed most notably on Japanese cars, which were "voluntary" only in the Orwellian sense. Many developing countries complain about the abuse of anti-dumping measures or the sanitary and phytosanitary standards by the developed countries. These were arrangements not available before the SWW.

Given these, a 20 per cent average tariff in the 1950s and the 1960s may signify a much more protectionist trade regime than what

prevailed under say, a 30 per cent or even a 40 per cent average tariff before the SWW.

### ***III.2.2 Trade Policy and Economic Performances***

Five of the six fastest-growing developed countries during the so-called “Golden Age of Capitalism” (1950-73), shown in table 6, were high-tariff countries in table 5 – Japan (ranked 1st with a per capita income growth rate of 8.05 per cent), Italy (3rd at 4.95 per cent), Austria (4th at 4.94 per cent), Finland (5th at 4.25 per cent), and France (6th at 4.05 per cent).

The exception and second-fastest growing economy in the group, the Federal Republic of Germany, achieved its “miracle on the Rhine” with relatively low tariffs, so we are not suggesting that there is a simple correspondence between a country’s tariff level and its growth rate. However, it is undeniable that the fast-growing developed countries during the Golden Age were high-tariff countries.

In terms of particular industries, the best example of the success of protectionist policy during this period is Japan’s automobile industry. Today, many people would consider Japanese cars as “natural” as French wine or Scottish smoked salmon. However, in the early post-SWW years, there was nothing “natural” about this industry to many people, including many Japanese themselves.

After the end of the SWW, the Japanese automobile industry was in a dire state. The free-market-oriented central bank, the Bank of Japan, was opposed to the development of the industry behind protective tariff walls – not an unreasonable position given that the country’s largest automobile producer, Toyota, had to be bailed out by its intervention in 1949 (Magaziner & Hout, 1980, p. 55). However, the interventionist MITI (Ministry of International Trade and Industry) prevailed, and the industry was kept alive through protection and subsidies.

**Table 6**  
**GDP per capita Growth for Today's Developed Countries**  
**in Different Phases of Their Development**  
 (Annual Average Compound Growth Rates)

	1870-1913	1913-1950	1950-73	1973-98
Austria	1.45	0.18	4.94	2.10
Belgium	1.05	0.70	3.55	1.89
Denmark	1.57	1.56	3.08	1.86
Finland	1.44	1.91	4.25	2.03
France	1.45	1.12	4.05	1.61
Germany	1.63	0.17	5.02	1.60
Italy	1.26	0.85	4.95	2.07
Netherlands	0.90	1.07	3.45	1.76
Norway	1.30	2.13	3.19	3.02
Sweden	1.46	2.12	3.07	1.31
Switzerland	1.55	2.06	3.08	0.64
United Kingdom	1.01	0.92	2.44	1.79
European-12 Average	1.33	0.83	3.93	1.75
Japan	1.48	0.89	8.05	2.34
United States of America	1.82	1.61	2.45	1.99

Source: Maddison (2001), p. 265, table B-22.

Then in the late 1950s came another challenge. When the first Japanese attempt to export passenger cars to the United States market spectacularly failed in the late 1950s (Toyota's sub-compact car, Toyopet), the debate on the future of the Japanese automobile industry flared up again, with free-market economists arguing that this is what happens when a country, whose biggest export item is silk, tries to defy the law of comparative advantage and export things like automobiles. They argued that the automobile industry should be

liberalized by lowering tariff barriers and removing government subsidies.

Luckily for Japan (and for the rest of the world, which has eventually benefited from better cars), the MITI prevailed again and the Japanese Government continued with its support for the industry. Until as late as 1962, Japan's nominal tariff rate on automobile imports was 35.9 per cent. It was not only the highest among the developed countries – the corresponding figures were 23.1 per cent in the United Kingdom, 19.5 per cent in the European Community, 14.7 per cent in Sweden and 6.8 per cent in the United States – but also the highest for any Japanese industry, at about double the national average (18 per cent) (Balassa, 1965, p. 580, table 1). The automobile industry was excluded from the liberalization package for FDI in 1969, hardly surprising when the total output of the Japanese automobile industry was still less than half that of General Motors (for further details, see Chang & Green, 2003, p. 24). In addition to tariffs and restrictions on FDI, a host of other measures were used in order to promote the industry throughout the 1960s and the 1970s – direct subsidies, accelerated depreciation, import quotas, and “rationalization” through government-mediated mergers and acquisitions (Magaziner & Hout, 1980, pp. 55-57).

By the 1970s, the Japanese automobile industry became so successful that a host of VERs was imposed by other developed countries. However, when the Japanese car-makers subsequently tried to enter the luxury end of the market in the mid-1980s, many were sceptical about their prospect of competing with European luxury cars. In 1986, when Honda launched its luxury brand, the Acura, and Toyota was preparing for the launch of its own, the Lexus, the *New York Times* reported that “[a]nalysts say it is uncertain at this point whether the new upscale Japanese cars will actually take sales away from high-priced European models”.<sup>43</sup> Even until 1989, when Lexus was launched, the marketing vice-president of BMW of North America, Inc., categorically stated that “[w]e don't fear the Japa-

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<sup>43</sup> “Japan's Push into Upscale Car Market” by John Holusha, *New York Times*, 3 March, 1986.

nese”, before adding rather condescendingly that “we do respect them”.<sup>44</sup>

However, by the end of the 1990s, Lexus became the best-selling luxury car in the United States market, beating Mercedes-Benz and BMW. Now GM executives are openly admitting that their company will soon hand over the position of world’s no. 1 car-maker to Toyota.

If the Japanese Government and Toyota had listened to the free-trade economists and given up on the automobile industry, Japan would still be exporting clothing and cheap electronics, while drivers the world over would not have benefited from the efficiency and the beauty of Japanese cars. The next time free-trade advocates buy a Japanese car, they would do well to reflect on the gulf between their theory and personal practice!

### **III.3 Developing Countries: Historical Evidence**

In the “official history of capitalism”, it is rarely mentioned that before the SWW, many countries – most of them still developing countries – were drawn into the globalization process through forceful means and on highly unjust terms (colonization, gun-boat diplomacy, unequal treaties, etc.).

Many countries were colonies, often for centuries, without any freedom to control even what went on inside their borders, not to speak of cross-border flows of resources, including international trade. The weaker countries that were somewhat more fortunate and escaped the fate of colonial occupation were forced into “unequal treaties” that deprived them of policy autonomy, especially over tariffs.

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<sup>44</sup> “Japan’s New Luxury Cars Drive Head-on at Europeans” by Warren Brown, *Washington Post*, 6 January, 1989.

### ***III.3.1 Colonies***

Until the Second World War, vast tracts of the world, including most of today's developing countries, were under colonial rule. Typical measures taken by the imperialist countries in relation to industrial development or rather, the prevention of it, included the following:

- High value-added manufacturing activities were outlawed in the colonies. For example, under Robert Walpole, the British prime minister, Robert Walpole, the father of British protectionist policy, the construction of new rolling and slitting steel mills in America was outlawed, which forced the Americans to specialize in low value-added pig and bar iron, rather than high value-added steel products.
- Exports from the colonies that competed with the colonizer's products were banned. For example, the cotton textile industry of India was dealt a heavy blow in the 18th century by the British ban on cotton textile imports from India ("calicoes"), which were superior to the British ones. In 1699 Britain banned the export of woollen cloth from its colonies to other countries (the Wool Act), essentially destroying the Irish woollen industry. This Act also stifled the emergence of the woollen manufacturing industry in the American colonies.
- Policies were deployed to encourage primary production in the colonies. For example, in the 1720s, Walpole provided export subsidies ("bounties") and abolished import duties on raw materials produced in the American colonies (such as hemp, wood, and timber). This was done in the belief that encouraging the production of raw material would "divert them from carrying on manufactures which interfered with those of England" (Brisco, 1907, p. 157).
- The use of tariffs by colonial authorities was banned or, if they were considered necessary for revenue reasons, countered in a number of ways. When in 1859 the British colonial government in India imposed small import duties on textile goods (3-10 per cent) for purely fiscal reasons, the local producers were taxed to the same magnitude in order

to provide a “level playing field” (Bairoch, 1993, p. 89). Even with this “compensation”, the British cotton manufacturers put constant pressure on the government for the repeal of the duties, which they finally got in 1882. In the 1890s, when the colonial government in India once again tried to impose tariffs on cotton products – this time in order to protect the Indian cotton industry, rather than for revenue reasons – the cotton textile pressure groups thwarted the attempt. Until 1917, there was no tariff on cotton goods imports into India.

### ***III.3.2 Semi-Colonies***

Semi-colonies that were subject to unequal treaties were deprived of tariff autonomy and were not allowed to impose more than a nominal, flat rate tariff, typically 3-5 per cent, for purely revenue purposes.

Britain first used unequal treaties in Latin America, starting with Brazil in 1810, as the countries in the continent acquired political independence. Starting with the Nanking Treaty (1842), which followed the Opium War (1839-42), China was forced to sign a series of unequal treaties over the next couple of decades. These eventually resulted in a complete loss of tariff autonomy and, very symbolically, a Briton being the head of customs for 45 years – from 1863 to 1908. From 1824 onwards, Thailand (then Siam) signed various unequal treaties, the most comprehensive being in 1855. Persia signed unequal treaties in 1836 and 1857, and the Ottoman Empire in 1838 and 1861.<sup>45</sup>

Even Japan lost its tariff autonomy following the unequal treaties signed after its opening up in 1853 (see table 3). It was only able to end the unequal treaties in 1911 (Johnson, 1982, p. 25). In this context, it is also interesting to note that when Japan forcefully

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<sup>45</sup> The 1838 Convention of Balta Liman with Turkey (then the Ottoman empire) bound Turkish import duties at 3 per cent (Fielden, 1969, p. 91).

opened up Korea in 1876 it exactly imitated the “Western” countries and forced Korea to sign an unequal treaty that deprived the latter of its tariff autonomy – despite the fact that it still did not have tariff autonomy itself. Japan and the Republic of Korea’s recent role in pushing investment and NAMA within the WTO replicates this “poacher turned gamekeeper” phenomenon, a disappointing combination of self interest and historical amnesia that deprives the debate of those who should be the most convincing advocates of policy space.

The larger Latin American countries were able to re-gain tariff autonomy from the 1880s. Many others achieved it only after the First World War, while Turkey and China had to wait until 1929.

It is extremely disconcerting to note that binding tariffs at a low, uniform rate (although not necessarily below 5 per cent) is exactly what modern day free trade economists recommend to developing countries. The classic work by Little et al. (1970) argues that the appropriate level of protection is at most 20 per cent for the poorest countries and virtually zero for the more industrialized developing countries (pp. 163-4). The World Bank (1991) argues that “[e]vidence suggests the merits of phasing out quantitative restrictions rapidly, and reducing tariffs to reasonably *low and uniform* levels, such as a range of 15-25 per cent [emphasis added]” (p. 102). Most disturbing of all, industrial tariffs of developing countries will fall to 5-7 per cent (the United States proposal) or to 5-15 per cent (the EU proposal), if the proposals from the developed countries are adopted at the NAMA negotiations. In the name of development, the WTO is in danger of re-introducing precisely the trade rules employed by the imperial powers to stifle the development of poor countries.

### ***III.3.3 Economic Performances under Forced Free Trade***

How did today’s developing countries, as colonies and semi-colonies, fare under the condition of forced free trade? This question can be answered by comparing the imperialist period with subse-

quent periods, when they acquired tariff (and other policy) autonomy.

According to table 7, per capita GDP growth accelerated in Latin America after the 1870s, from 0.1 per cent during the period 1820-70 to 1.8 per cent during the period 1870-1913, when most countries in the region acquired tariff autonomy with the expiry of the unequal treaties. In Asia excluding Japan, economic performance vastly improved from virtually no growth (or even slight decline) in per capita income during various periods before 1950 to 2.9 per cent in the period 1950-73, when most of the region's countries gained independence. In Africa, per capita GDP growth accelerated from around 0.5 per cent during the period 1820-1950 to 2.1 per cent during the period 1950-73, when most of the countries in the continent became independent.

**Table 7**  
**Historical Rates of Economic Growth by Major Regions**  
**during and after the Age of Imperialism (1820-1950)**  
 (annual per capita GDP growth rate, %)

<b>Regions</b>	<b>1820-70</b>	<b>1870-1913</b>	<b>1913-50</b>	<b>1950-73</b>
Western Europe	0.95	1.32	0.76	4.08
Western Offshoots*	1.42	1.81	1.55	2.44
Japan	0.19	1.48	0.89	8.05
Asia excluding Japan	-0.11	0.38	-0.02	2.92
Latin America	0.10	1.81	1.42	2.52
Eastern Europe and the former USSR	0.64	1.15	1.50	3.49
Africa	0.12	0.64	1.02	2.07
World	0.53	1.30	0.91	2.93

\*Australia, Canada, New Zealand, and the United States.

Source: Maddison (2001), p. 126, table 3-1a.

Of course, nothing definite can be “proven” by continent-wide average statistics spanning one-and-a-half centuries, because many things are going on at the individual country level. However, the pattern is striking. In *all* parts of the developing world, economic growth accelerated dramatically after the end of imperialism.

The pattern is indeed confirmed even at the country level, according to the detailed individual country data that are available from Maddison (2001).

As table 8 shows, in the 1913-50 period, during most of which they were colonies or subject to unequal treaties, the growth rates of the Asian countries, even in those countries that have later become known as “miracle economies”, were very poor. During the 1913-50 period, only four out of 13 Asian countries for which data are available recorded positive growth in per capita income (Taiwan Province of China, Sri Lanka, and Malaysia and Singapore, which then together formed British Malaya). Only in Malaysia and Singapore (1.5 per cent) was the growth rate substantial – those for Taiwan Province of China and Sri Lanka were 0.6 per cent and 0.3 per cent respectively. In the remaining nine countries, which accounted for the vast bulk of the region’s population, per capita income actually declined during this period.

In contrast, during the post-imperialist period, all 15 countries in the table recorded positive growth – even the slowest-growing economy, Bangladesh, recorded a 0.9 per cent growth in per capita income, which would have been the second highest in Asia (after British Malaya) had it occurred in the imperialist period. Indeed, during this period, only Bangladesh and Nepal (1.4 per cent) recorded lower growth rates than the best performer in the imperialist period (British Malaya at 1.5 per cent). Even the supposed “failure” cases of the post-imperialist period, such as the Philippines (1.6 per cent) and Pakistan (2.3 per cent), did better than British Malaya during the imperialist period.

**Table 8**  
**Growth Rates of per capita GDP in Selected Asian countries**  
**during the Age of Imperialism**

	1913-50 (%)	1950-99 (%)	Growth acceleration (percentage points)
Bangladesh	-0.2	0.9	1.1
Burma	-1.5	2.0	3.5
China	-0.6	4.2	4.8
Hong Kong, China	n.a.	4.6	n.a.
India	-0.2	2.2	2.4
Indonesia	-0.2	2.7	2.9
Rep. of Korea	-0.4	6.0	6.4
Malaysia	1.5	3.2	1.7
Nepal	n.a.	1.4	n.a.
Pakistan	-0.2	2.3	2.5
Philippines	0.0	1.6	1.6
Singapore	1.5	4.9	3.4
Sri Lanka	0.3	2.6	2.9
Taiwan Province of China	0.6	5.9	5.3
Thailand	-0.1	4.3	4.4

Source: Maddison (2001), p. 143, table 3-14.

More importantly, growth rates accelerated in all 13 countries after the end of imperialism, with Taiwan Province of China (5.3 per cent) and the Republic of Korea (6.4 per cent) showing particularly rapid accelerations.

Our discussion in this section shows that during the Age of Imperialism (1820-1950), when most of today's developing countries did not have any policy autonomy (symbolized by the deprivation of tariff autonomy), they did much worse than during the early post-SWW period (1945-80), when they acquired policy autonomy and had considerable policy space.

Section III.4 shows that the reverse has happened since the 1980s. During this period, the developing countries have lost policy space and autonomy, especially in the area of trade policy, through the WTO and through loan and aid conditionalities. Most of these countries ended up doing much worse than in the 1950s-70s, which the free-trade economists love to portray as the "bad old days" of inefficiency and sluggish growth behind the walls of protectionism.

### **III.4 Developing Countries: Contemporary Experience**

#### ***III.4.1 The Evolution of Trade Policy in the post-SWW Period***

Until the Second World War, most developing countries outside Latin America were still colonized. With the end of the War came the independence of countries such as the Republic of Korea and Taiwan Province of China, soon followed by India, Indonesia, and other Asian countries. Africa followed mainly in the late 1950s and the 1960s.

Independence allowed these countries to pursue independent policies, the most important element of which was state-promoted industrial development through the use of trade protection and government subsidies, commonly (and somewhat misleadingly) known as import substitution industrialization (ISI). ISI policies are often said to have been pioneered by the Latin American countries in the interwar years, but their pedigree goes back centuries in countries like the United Kingdom and the United States, as shown in section III.1.

Despite the obvious differences between countries, ISI policies were pursued between the end of the Second World War (the Great Depression in the case of Latin America) until the debt crisis of 1982.

The international environment during this period was conducive to such policies. The World Bank and the IMF operated with fairly restricted mandates – financing infrastructure development and providing liquidity in times of short-term balance-of-payments crises, respectively – and, attached few loan conditionalities on policies outside their narrow areas of responsibility. While the developed countries were whittling down their industrial tariffs at the GATT, the developing countries were usually granted flexibilities that enabled them to safeguard tariffs and other trade policy matters. There was no “single undertaking” in the GATT, as is the case with the WTO, so countries could even opt out of some agreements that they were not happy with.

Then came a turning point in the early-1980s. The 1982 debt crisis vastly expanded the scope of intervention by the IMF and the World Bank through ever-expanding and ever-more intrusive conditionalities on their loans and debt rescheduling agreements. Trade liberalization has been one of the most important elements of these conditionalities. The year 1986 saw the launch of the Uruguay Round negotiations in the GATT, which aimed for an unprecedented degree of trade liberalization and an expansion of the mandate of the GATT to include new areas such as intellectual property rights.

Then came the collapse of Communism after 1989, which subjected a vast new area of the world to the SAP-style programmes of liberalization and privatization. This also meant the end of the Cold War, which made the developed countries more aggressive in demanding from the developing countries policies that suited their own interests.

Trade liberalization reached its peak in 1995, when the conclusion of the Uruguay Round in 1994 led to the transformation of the GATT into the more powerful and wide-ranging WTO. In 1994, the

NAFTA was signed between the United States, Canada, and Mexico, to be followed by a host of bilateral and regional FTAs, often involving the developing countries.

### ***III.4.2 Trade Policy and Economic Performance I – Cross-Section Evidence***

The conventional wisdom in the debate on trade policy today is that there is indisputable and strong statistical evidence that countries with more open trade regimes have grown faster. Those who promote this view like to present it as a “professional consensus” that should not be disputed, on the ground that there are a large number of economists who support it.

However, first of all, the fact that there is a “professional consensus” around the result should not keep us from questioning it. If the number of supporters necessarily determined the true value of a statement, the world would be flat and the sun would go around the earth, in line with the “professional consensus” established centuries ago in medieval Europe.<sup>46</sup>

Second, the evidence underlying the orthodox position on trade and growth is largely based on cross-section econometric studies. However, cross-section econometric studies that include every coun-

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<sup>46</sup> Rodriguez and Rodrik (1999) have the following take on this issue. “[I]n view of the voluminous research on the subject, a natural question that arises is whether we shouldn’t take comfort from the fact that so many authors, using various methods, have all arrived at the same conclusion. Do we not learn sometime from the cumulative evidence, even if individual papers have shortcomings?... [However, h]ad the negative relationship between trade restrictions and economic growth been convincingly demonstrated, we doubt that the issue would continue to generate so much empirical research. We interpret the persistent interest in this area as reflecting the worry that the existing approaches have not got it ‘quite right’. One indication of this is that the newer papers are habitually motivated by exegeses on the methodological shortcomings of prior work” (p. 60).

try from Switzerland to Swaziland have a fundamental problem. This is because the relationship between trade policy and growth may be and, is likely to be *structurally* different for countries at different levels of development and therefore, the statistical results may not be reliable.<sup>47</sup>

Third, not all statistical studies show a positive correlation between trade openness (however measured – see below) and economic growth. There is increasing evidence that the supposed positive relationship between trade openness and growth is probably unique to the post-SWW period (see section III.1.5). A recent study by an IMF economist claims that the relationship is unique to the 1970-90 period only. Vamvakidis, (2002), Rodrik and Rodriguez (1999) deny even that. They show that there is no statistically significant correlation between trade barriers, whether measured by import duties as a percentage of imports or by NTBs, and economic growth for the 1975-94 period (Figures I.1 and I.2). In their cross-section regression covering 84 countries between 1960 and 2000, Bosworth & Collins (2004) also found little evidence that trade openness is positively correlated with growth. UNDP (2003) goes even further and points out that there was a *positive* correlation between a country's average tariff rate and its growth rate in the 1990s (p. 29).

Last but not least, there is no agreed way to correctly measure “trade openness” (Pritchett, 1996, and Rodriguez & Rodrik, 1999).

Many of the earlier studies used *the share of trade in a country's GDP* as the measure of its trade openness (in other words, trade policy). However, this measure is largely discredited now, as trade share is only partly driven by trade policy.

*Average nominal tariff* is the most obvious and easily acquired (and therefore most frequently used) measure of trade policy orientation, but it has a number of problems. To begin with, there is the

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<sup>47</sup> In technical terms, we would say that the crucial “homogeneity condition” is violated, producing unstable parameters, which makes the outcome extremely sensitive to the sample. See Pesaran et al. (2000).

problem of calculating the average. Ideally, the average should be a weighted average, reflecting each industry's importance in the economy in some sense.

However, there is no obvious way to decide on the weights for each product. Should we use the share in GDP? Should we use the share in imports? What about the fact that very high (prohibitive) tariffs will prevent the import altogether, thus leaving the weight of the product in total imports very small?

Whatever weights one uses in calculating the average, nominal tariff rates may not correctly represent the protection (positive or negative) that each industry is getting. This is because, if there are tariffs on inputs, they make the nominal tariff rate of the final product over-state the degree of protection. This consideration has prompted some people to come up with the concept of effective rate of protection (ERP), which takes into account the negative protective impacts that tariffs on inputs have for final products, as an alternative measure. However, this is very difficult to calculate, as it has to be based on comprehensive information on input-output relationships between industries, which means that they are seldom calculated.<sup>48</sup>

Moreover, whether nominal or effective, tariff rates do not correctly represent the degree of protectionism. There are non-tariff trade barriers such as quantitative restrictions (quotas), import licensing, foreign exchange rationing, subsidies and other restrictions. All of these may have to be "translated" into their tariff equivalents, if we are to know the "true" tariff rates.

For this reason, some have tried to measure trade openness by measuring the gap between domestic prices and world market prices (which, they reasoned, sum up all visible and invisible trade restric-

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<sup>48</sup> Indeed, Westphal's calculation of the Republic of Korea's ERP in 1968 was still being cited by the author himself in 1990, even knowing that, for a country like the Republic of Korea, which experienced an enormous structural change during the intervening period, using such old measure can be misleading (Westphal, 1990).

tions), by using things like black market premiums for foreign exchange rates. The problem with this measure is that it is not just trade restrictions that determine foreign exchange rates. Macroeconomic policies, rather than trade policy, are often much more important in determining these measures.

So which measure of openness should we use? All measures have their merits and shortcomings, so there is no obvious answer to this question, although Rodriguez & Rodrik (1999) suggest that relatively simple measures (e.g. average tariffs, NTB coverage) “do a decent job of rank-ordering countries according to the restrictiveness of their trade regimes”(p. 60).

But more importantly, Pritchett (1996) has quite convincingly shown that there is little correlation between openness rankings produced by different measures of trade openness, casting the whole statistical exercise into question. What is the point of having a robust correlation between openness and growth, if which country is more open is different every time you change the measure of openness?

### ***III.4.3 Trade Policy and Economic Performance II – Time-Series Evidence***

One fact that should strike any impartial observer as strange is that, despite adopting freetrade and other “good” policies, the developing countries have been doing much worse in the last 20-25 years than they used to in the “bad old days” of supposedly disastrous ISI during the 1960s and the 1970s.

It may not be surprising that the pro-market policies implemented since the 1980s have increased income inequality and poverty in many developing countries. However, if those policies have not even generated improved economic growth, then they have a serious problem, for they were supposed to usher in a period of accelerated growth, even at the cost of some “soft” things like inequality and poverty.

As we can see from tables 9 and 10, the exact opposite of this initial claim has happened. Since the 1980s, the developing world has experienced a fall in economic growth rates. During this period, per capita income in the developing countries has been growing at around half the rate that used to prevail in those countries in the 1960s and the 1970s (3 per cent vs. 1.7 per cent).

In particular, Latin America, the most diligent student of the Washington institutions since the 1980s, used to grow at 3.1 per cent in per capita terms in the “bad old days” of ISI (1960-80), but it grew at only 0.7 per cent between 1980-2000. Even if we disregard the 1980s as the decade of adjustment, the growth record of the 1990s (1.7 per cent) is much poorer compared to those of the 1960s and the 1970s.

Even more worryingly, in the new century Latin America has not even kept up the growth rate of the 1990s. Between 2000 and 2005, the continent’s economies virtually stood still, heralding another “lost decade”. During this fiveyear period, per capita income Latin America grew only by 3 per cent (Weisbrot et al., 2005, p. 8) – or at an annual growth rate of 0.6 per cent.

Per capita income actually shrunk in the Sub-Saharan African countries in the 1980s (-1.2 per cent per annum) and the 1990s (0.2 per cent per annum). Between 2000 and 2003, growth has returned to the region, but at a very low rate of around 0.5 per cent (Mkandawire, 2005, p. 9, figure 1). This means that, even if the region continues to grow at the current rate for another 15 years, its per capita income in 2020 will be still lower than it was in 1980.

**Table 9**  
**Per capita GNP Growth Performance of the**  
**Developing Countries, 1960-80**

	<b>1960-70</b> (%)	<b>1970-80</b> (%)	<b>1960-80</b> (%)
<b>Low-income countries</b>	<b>1.8</b>	<b>1.7</b>	<b>1.8</b>
Sub-Saharan Africa	1.7	0.2	1.0
Asia	1.8	2.0	1.9
<b>Middle-income countries</b>	<b>3.5</b>	<b>3.1</b>	<b>3.3</b>
East Asia and Pacific	4.9	5.7	5.3
Latin America and the Caribbean	2.9	3.2	3.1
Middle East and North Africa	1.1	3.8	2.5
Sub-Saharan Africa	2.3	1.6	2.0
Southern Europe	5.6	3.2	4.4
<b>All developing Countries</b>	<b>3.1</b>	<b>2.8</b>	<b>3.0</b>
<b>Industrialized Countries</b>	<b>3.9</b>	<b>2.4</b>	<b>3.2</b>

Source: World Bank (1980), Appendix Table to Part I.

Note: The 1979 and 1980 figures used are not final, but World Bank estimates. Given that the estimates were supposed to be on the optimistic side, the actual growth figures for 1970-80 and 1960-80 would have been slightly lower than reported in this table.

Obviously, trade liberalization and other neo-liberal policies may not be totally responsible for poor growth performance in the developing countries during the post-1980s period. However, at the least we can say that those policies have spectacularly failed to deliver their central promise of accelerated growth. Whatever the cross-section statistical studies may say on the relationship between trade openness and growth (and we have discussed various reasons why their results may not be as robust as often thought to be), there seems to be negative correlation, if anything, between trade liberalization and growth, if we compare the record of the bad-old days of protectionism and the more recent period of freer trade.

**Table 10**  
**Per capita GDP Growth Rates of the Developing Countries,**  
**1980-2000**

	<b>1980-90</b> (%)	<b>1990-20</b> (%)	<b>1980-2000</b> (%)
<b>Developing Countries</b>	<b>1.4</b>	<b>2.0</b>	<b>1.7</b>
East Asia and Pacific	6.4	6.0	6.2
Europe and Central Asia	1.5	-1.8	-0.2
Latin America and the Caribbean	-0.3	1.7	0.7
Middle East and North Africa	-1.1	1.2	-0.1
South Asia	3.5	3.7	3.6
Sub-Saharan Africa	-1.2	-0.2	-0.7
<b>Developed Countries</b>	<b>2.5</b>	<b>1.7</b>	<b>2.1</b>

Source: World Bank (2002), table 1 (p. 233) for the population growth figures and table 3 (p. 237) for the GDP growth figures

Notes: The figures are only approximate, as they were constructed by subtracting the population growth rates from GDP growth rates. This had to be done because the World Bank stopped publishing decade-wise per capita GDP growth rates from its 1998 *World Development Report*. For country classification, see the table in p. 334 of World Bank (2000/1).

### ***III.4.4 Trade Policy and Economic Performance III – Case Studies***

#### ***(a) The Republic of Korea and Taiwan Province of China***

In the second half of the 20th century, together with Japan, the Republic of Korea and Taiwan Province of China achieved the most rapid sustained economic growth in human history. Both of the latter achieved it through state-led development similar to that used by Japan.

What was the role of tariffs in their development? While they have reduced their tariffs substantially recently, they had high tariffs

until the 1980s. As shown in table 11, until the 1970s, their average tariff rates were in the region of 30–40 per cent, incidentally the rates that many of today’s developed countries had until the 1950s.

**Table 11**  
**Tariff Rates in the Republic of Korea and Taiwan Province of China**

	<b>1955</b>	<b>1959</b>	<b>1965</b>	<b>1971</b>	<b>1974</b>	<b>1980</b>	<b>1990</b>
Taiwan Province	47%	39%	35%	39%	n.a.	31%	5%
Republic of Korea	n.a.	n.a.	40% <sup>1</sup>	n.a.	n.a.	21% <sup>2</sup>	12% <sup>3</sup>

Sources: Glick & Moreno (1997) and Wu (1998).

1 = mid-1960s. 2= early-1980s. 3= early-1990s

Although their average tariffs were lower than those of countries like India, they were notorious for having selective trade policies that had a high variation in tariff rates across industries (see Chang, 1993, for the Republic of Korea, and Wade, 1990, for Taiwan Province of China).

Moreover, during this period, quantitative restrictions (QRs) on trade were still prevalent in these countries, so tariffs understate the degree of protection. Glick and Moreno (1998) say that in the Republic of Korea 40 per cent and 25 per cent of imports were prohibited or restricted in 1973 and 1981, respectively.

But formal import quotas were only one of the many restrictions that imports faced in these countries. In the Republic of Korea, there were many domestic regulations that mandated government permission for imports of machinery and other inputs, even if the items concerned were technically freely importable (Luedde-

Neurath, 1988, pp. 78-9). The government of Taiwan Province of China actively discouraged imports of goods that competed with domestic products, through the so-called “agency restriction”, which means that importers needed government licences to operate (Wade, 1990, pp. 128-131).

All in all, these meant that the extent of QRs was much wider than the official data on import quotas suggest. According to a calculation by Luedde-Neurath (1986), as late as 1982, 93 per cent of *actually imported* items (in valued terms) were still subject to QRs of one kind or another (e.g. import quotas, industry-specific laws, import area diversification laws<sup>49</sup>) (p. 156, table 14.4). A similar calculation for Taiwan Province of China revealed that over half of imports (in value terms) faced QRs in 1984 (Wade, 1990, p. 131).

However, even these figures understate the extent of import restrictions in the two countries, as there was strict foreign exchange rationing by the government, where priority was given to the importation of capital goods and intermediate inputs, especially for the sectors promoted by the government. This meant that very often even many of the “freely-importable” items could not be imported if they had low priority in the foreign exchange rationing exercise (Chang, 1993, p. 132, on the Republic of Korea; Wade, 1990, pp. 138-9 on Taiwan Province of China).

Particularly in the Republic of Korea, there are some dramatic examples of industries that have flourished precisely because the country did not follow free trade orthodoxy.

For example, the first attempt at an export car, the Hyundai Pony, in the late 1970s, was a laughing stock. It may have looked good – after all, it was designed by the legendary Italian car designer

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<sup>49</sup> The import area diversification regulation in the Republic of Korea required that imports from Japan, with which it had a large trade deficit, required government permission even when they involved otherwise freely importable items (Luedde-Neurath, 1988, p. 79).

Giorgetto Giugiaro.<sup>50</sup> However, just as happened earlier in Japan, the quality was hopeless. Inevitably, many people, including many Koreans, argued that this industry, which went against the hallowed principle of comparative advantage, should be abandoned. However, the government persisted with protecting the automobile industry, first through an outright ban on car imports and then through high tariffs, and provided various forms of direct and indirect subsidies.

Twenty-five years on, Hyundai, the country's biggest car manufacturer, has become one of the biggest car producers in the world. While it is still not quite at the level of Toyota or Honda, it is rapidly upgrading its products and its products are now routinely voted the best in the mid-level segment of the United States car market. Once again, this was achieved through a combination of massive government protection and subsidies, combined with the firm's dedication to investment and innovation.

Another even more striking example from the Republic Korea is the steel maker, POSCO (Pohang Steel Company) (for further details on POSCO, see Amsden, 1989, ch. 12). When the Government of the Republic of Korea decided in the late 1960s to apply to seek funding to build its first modern steel mill, the World Bank declined the application on the ground that the project was not viable – not an unreasonable decision, given that the country's biggest export items at the time were fish, cheap apparel, wigs, and plywood. The country did not even possess deposits of the key raw materials of iron ore and coking coal. These materials had to be imported from places as far away as Australia (China, the nearest source of these materials, was off limits due to the Cold War). High tariff protection was provided to ensure the survival of the new producer. To cap it all, the government proposed to run this as a state-owned enterprise (and it was run as one until a few years ago).

A perfect recipe for disaster, according to standard economic theory! Yet within ten years, the company became the most efficient

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<sup>50</sup> In 1983, Giugiaro also designed the ill-fated Marille pasta. It was supposed to hold the biggest amount of source of all pastas but never took off.

steel-producer in the world and is now the world's fifth largest steel producer.

Of course, the Republic of Korea and Taiwan Province of China had their shares of poor choices for protection and subsidies but, as argued earlier (section II.1), this is in itself, not an argument against government protection and promotion of industries. The point is that the governments of these countries made the right decisions more often than have others – a fact that is ultimately reflected in their superior economic records. To use a business analogy, we should accept that not even Bill Gates always makes the right decision. The difference between a good businessman and a poor one is not whether one always makes the right decision while the other always fails to do so, but that one makes the right decision more often than does the other. To put it in sporting terms, in sports like baseball and cricket, what counts is the batting average, and not whether someone scores a hit every time he hits, because nobody does.

***(b) Sub-Saharan Africa***

Most countries in Sub-Saharan Africa were forced to liberalize their trade, following the SAPs in the early- to mid-1980s. The results have been very disappointing, to say the least.

While its growth rate in the “bad old days” was not spectacular, economic growth collapsed since the 1980s, as can be seen from tables 7, 9, and 10 above.

Between 1950-73, the per capita income growth rate in Africa (including both Sub-Saharan Africa and North Africa) was a very respectable 2.1 per cent (table 7) – a significant improvement from the days of imperialism (0.64 per cent in 1870-1913 and 1.02 per cent in 1913-50). In the 1960s, per capita income in the low-income countries of Sub-Saharan Africa grew at 1.7 per cent per year, while that of the middle-income countries in the region grew at 2.3 per cent (table 9). In the 1970s, the former group grew at the very disappointing rate of 0.2 per cent, but the latter group was still capable of notching up a respectable 1.6 per cent growth rate (table 9).

However, the region's per capita income *shrank* at the rate of 0.7 per cent per year between 1980 and 2000, when it embarked on trade liberalization and other "reforms" (table 10). Its per capita income *shrank* at the rate of 1.2 per cent per year in the 1980s and at the rate of 0.2 per cent per year in the 1990s. As mentioned earlier (section III.4.3), it has started to grow in the last few years, but the growth rate is low (around 0.5 per cent per annum) and it is doubtful whether it can be further accelerated without a significant policy change.

While there were a few cases in Sub-Saharan Africa where easing import restrictions led to a revival in economic growth, such recoveries proved to be short-lived, because they failed to change the underlying economic structure and/or raise productivity. Ghana is an example that deserves more detailed discussion here (the following is based on Shafaeddin, 2005, ch. 2, unless otherwise specified).

Ghana embraced economic reform in the 1970s, experiencing a fall in GDP of 30 per cent during the period 1971-83. Following this, it was converted into one of the "model students" of the World Bank-IMF. Initially, its economic reforms, especially trade liberalization, seemed to produce very good results, not least because of the hefty injection of foreign exchange that the Bank and the Fund were making in an attempt to make Ghana a showcase of SAP in Sub-Saharan Africa. In the first few years of the reform (1984-87), its income grew at 5.9 per cent, which means a 2.5 per cent growth rate in per capita terms,<sup>51</sup> while manufacturing value-added (MVA) grew at a spectacular 14.5 per cent, or 11.1 per cent in per capita terms.

However, Ghana's economic reform started to run out of steam towards the end of the decade. Between 1988 and 1992, income growth slowed down, although still maintaining a decent 4.6 per cent, or around 1.3 per cent in per capita terms.<sup>52</sup> However, the

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<sup>51</sup> Ghana's population growth rate between 1984 and 1987 was 3.4 per cent (calculated from Maddison, 2001, p. 311, table C4-a).

<sup>52</sup> Ghana's population growth rate between 1988 and 1992 was 3.3 per cent (calculated from Maddison, 2001, p. 311, table C4-a).

growth of MVA dramatically slowed down to 3.2 per cent, or  $-0.1$  per cent in per capita terms, and manufacturing employment collapsed from 78,700 in 1987 to 28,000 in 1993 (Khor and Goh, 2004, p. 6). Throughout the 1990s, Ghana's per capita income grew at a reasonable rate of 1.7 per cent (1999-2000),<sup>53</sup> but MVA *shrank* at the rate of 1.2 per cent per year between 1993 and 2001.

More worrying is the fact that Ghana totally failed to upgrade its economy during the reform period. Nearly 77 per cent of the increase in exports between 1981 and 2000 was due to gold (going back to the country's colonial days when it was called the Gold Coast!). In 2000, of the top 20 export items (at the 3-digit level), only six were manufactured goods (aluminium, veneer and plywood, plastic articles, petroleum products, furniture and parts, cotton fabric). Collectively they accounted for only 18.3 per cent of Ghana's exports, and one item very close to being a raw material, aluminium (9.1 per cent), accounted for half of the country's manufactured exports. This is disturbing enough, but what is more worrying is the absence of industrial diversification. Of the six items mentioned above, only two were "new" products compared to the top 20 in the pre-liberalization period (1981) – plastic articles moved from rank 111 to 11, while cotton fabrics moved from 40 to 19. Moreover, these two items respectively accounted for only 1.5 per cent and 0.5 per cent of total exports, which means that only 2 per cent of Ghana's exports was made up of "new" industries after nearly two decades of trade liberalization (and other economic reforms).

Many other Sub-Saharan-African countries did not even experience the kind of short-lived recovery occurring in Ghana (for further country-level details, see Soludo et al. (eds.), 2004). The consequences of some of the more prominent examples of Sub-Saharan African trade liberalization since the 1980s, reported in Khor and Goh (2004, p. 6), largely based on Buffie (2001), are outlined below.

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<sup>53</sup> Between 1990 and 2000, Ghana's GDP grew at 4.3 per cent (World Bank, 2002, p. 236, table 3). During this period, its population grew at a rate of 2.6 per cent (ibid., p. 232, table 1).

- Senegal: Following trade liberalization starting in 1985, one third of all manufacturing jobs were eliminated in by the early 1990s.
- Cote d'Ivoire: Following tariff cuts of 40 per cent in 1986, the chemical, textile, shoe, and automobile industries virtually collapsed.
- Uganda: Following trade liberalization in the 1980s, the capacity utilisation rate in the industrial sector fell to 22 per cent.
- Nigeria: Following trade liberalization in the 1980s, the capacity utilisation rate in the industrial sector fell to 20-30 per cent.
- Zimbabwe: Following trade liberalisation in 1990, the unemployment rate jumped from 10 per cent to 20 per cent.

Sub-Saharan Africa's experience shows the limits of premature trade liberalization and indirectly proves the wisdom of the infant industry argument. It shows that at the earlier stage of development, tariffs and other protective measures are critical in maintaining output and employment in the manufacturing sector, and consequently in generating economic growth. Needless to say, some SSA countries did mess up their economies during the ISI period (e.g. Ghana in the 1970s), but even so, on average, the region's performance was much better during the ISI period than in the trade liberalization (or more broadly the SAP) period. Moreover, even the relative success story of Ghana shows that without some sort of infant industry protection, poor countries have no hope of diversifying their economies through industrialization and of accelerating growth on a sustainable basis.

### ***(c) Latin America***

Latin America is the part of the developing world that first started ISI (in the interwar period). Given this history, trade liberalization since

the 1980s has been politically much more controversial in Latin American countries than in other developing countries.

The popular perception is that the ISI period in Latin America was a disaster that produced huge inefficiencies and stagnant growth, which, many people assume, is why the countries in the region accepted trade liberalization with such zeal in the more recent period. Given this, it is widely assumed that economic performance in Latin America has improved following the abandonment of ISI and trade liberalization since the mid-1980s.

However, the record tells a very different story. As shown in tables 9 and 10, Latin America grew at an annual rate of 3.1 per cent in per capita terms in the ISI period (1960-80), but grew at only 1.7 per cent in the 1990s (for the benefit of the free-traders, we are discounting the 1980s as the adjustment period, when it *shrank* at the rate of 0.3 per cent per year). Even more worrying, between 2000 and 2005, Latin American countries grew at a rate of only 0.6 per cent.

Moreover, tariff protection and other ISI policies were critical in establishing the industrial capabilities that underpinned those export increases that did occur in the liberalization period in some Latin American countries. For example, EMBRAER, the Brazilian firm that is the world's leading regional-jet manufacturer, was developed under state ownership during the ISI period (it is now a private firm) through a combination of tariff protection, government procurement, and subsidies (Goldstein, 2001). Even the recent export success of Chile's natural-resource-based industries (e.g., forestry, fishing) was based on a wide range of state subsidies for marketing, research and training (Cypher, 2004; Schrank and Kurtz, forthcoming).

The case of Mexico most dramatically illustrates how trade liberalization has failed to deliver the promised outcomes, which were supposed to surpass those of the ISI period.

If any developing country can succeed with free trade, it should be Mexico. It borders on the largest market in the world, with which it has had a free trade agreement (the North American Free Trade Agreement; NAFTA) for over a decade. Due to its history, it has a large diaspora living in the United States,<sup>54</sup> who can provide informal business links – similar links provided by the Chinese diaspora proved quite important in the success of some Southeast Asian countries and of China itself more recently. It has a decent industrial base, thanks to the quite successful experience with ISI up to the 1970s. Furthermore, it has no shortage of skilled workers and competent managers, as is the case in some Sub-Saharan-African countries. Although its infrastructure has declined recently it is not a major bottleneck (at least as yet), unlike in many poorer developing countries. The country's institutions are developed enough to qualify it for OECD membership.

Despite these apparent advantages, the result of Mexican trade liberalization since 1985, and especially since the start of NAFTA in 1994, has been disappointing.

On the positive side, Mexico managed to significantly increase the share of manufacturing in its exports following trade liberalization, from about 40 per cent in 1980 to over 80 per cent in 2004 (Moreno-Brid et al., 2005, p. 1006, table 3). This happened in conjunction with the increase in its market share in the OECD countries from 1.78 per cent in 1985 to 3.62 per cent in 2001 (*ibid.*, p. 1008, table 4). The so-called *maquila* (labour-intensive assembly for exports) sector in particular saw its output grow by 16 per cent per year between 1981 and 2000 (Palma, 2003).

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<sup>54</sup> Most of them are more recent immigrants but some of them are also the descendants of the former Mexicans who became Americans due to the annexation of large swathes of Mexican territory, including all or parts of modern California, New Mexico, Arizona, Nevada, Utah, Colorado, and Wyoming, after the United States-Mexico War (1846-48) under the Treaty of Guadalupe Hidalgo (1848).

However, the positive story on the export side is overshadowed by very disappointing records on growth, productivity, and jobs.

Between 1985 and 1995, the pre-NAFTA period of liberalization in Mexico, GNP per capita grew at a dismal 0.1 per cent,<sup>55</sup> whereas it grew at over 3 per cent in the “bad old days” of ISI (1955-82).<sup>56</sup>

Under NAFTA, economic growth improved for a while, but the momentum ran out after several years. Between 1994 and 2002, Mexico’s per capita GDP growth was 1.8 per cent.<sup>57</sup> In the last few years, the Mexican economy has been doing very badly. Per capita GDP growth was negative in 2001 (-1.8 per cent), 2002 (-0.8 per cent), and 2003 (-0.1 per cent) and grew only by 2.9 per cent in 2004, which was barely enough to move the income back to the 2001 level.<sup>58</sup>

Manufacturing GDP grew at 3.7 per cent during the period of pre-NAFTA trade liberalization (1988-1994) but, its growth slowed down to 2 per cent after NAFTA (1994-2000). The average manufacturing GDP growth rate for the 1988-2000 period was 2.9 per cent, which is less than half of the growth rate of 7 per cent during the “bad old days” of ISI (1960-81) (Palma, 2003, table 3). Even the relatively successful maquila sector had grown almost entirely on the basis of employment growth, with virtually no productivity growth since the mid-1980s (Palma, 2003, p. 10).

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<sup>55</sup> World Bank (1997), p. 215, table 1.

<sup>56</sup> According to Moreno-Brid et al. (2005), per capita income during 1955-82 grew at a rate of over 6 per cent. As Mexico’s population growth rate during this period was 2.9 per cent per annum (calculated from Maddison, 2001, p. 280, table C2-a), this gives a per capita income growth rate of over 3 per cent.

<sup>57</sup> Weisbrot et al. (2004), figure 1.

<sup>58</sup> The 2001 figure is from World Bank (2003), p. 235, table 1. The 2002 figure is from World Bank (2004), p. 252, table 1. The 2003 figure is from World Bank (2005), p. 257, table 1. The 2004 figure is from World Bank (2006), p. 294, table 1.

Mexico's post-trade-liberalization performance was equally poor in terms of employment. Between 1991 and 2000, employment in the maquila industries increased 2.75-fold. However, employment in the (much bigger) non-maquila industries *declined* by 9 per cent (Palma, 2003, p. 20, table 2). Moreover, in the last few years, many maquila industries have migrated to China and the Central American countries, in search of cheaper labour. Between January 2001 and October 2002 alone, maquila employment fell by more than 20 per cent in electronics and footwear and nearly 20 per cent in apparel (Palma, 2003, p. 25, figure 15). As a result, in 2004, unemployment in Mexico reached an all-time high (Moreno-Brid et al., 2005, p. 1016).

Mexico's experience serves as a cautionary tale against premature trade liberalization, even for a middle-income country with a decent industrial base and exceptional market access. Mexico has failed to translate its obvious advantages into accelerated growth, both overall and in manufacturing, and good jobs. The growth records are so much poorer than the "bad old days" of import substitution, which the new era of liberal trade was supposed to outperform, that one begins to wonder whether the bad old days were after all so bad. In particular, the recent decline of the maquila sector shows that a sustainable export base can only be built on the basis of long-term investment in physical capital, technology, and worker skills. Low wages are not enough, because there is always some even poorer country ready to enter the market.

***(d) Success Stories of the 1990s – China, India, and Viet Nam***

The economic successes in the 1990s of the "new miracle economies" – China, Viet Nam, and to a lesser extent India – are often presented by freetrade economists as the proof that the road to economic development lies in active global integration through liberalization of international trade and investment.

While the factors behind the growth successes of these economies are many and their relative weights debatable, it is certain that radical trade liberalization of the kind advocated in the current NAMA negotiations is *not* one of them.

China had more than two decades of rapid growth by explicitly *not* listening to the advice to the IMF and the World Bank, blindly following which drove the former Soviet Union and many Eastern European countries into a massive economic decline.

While it has gradually liberalized its trade, especially in order to join the WTO (which it did in 2001), China's average tariff rate throughout the 1990s was above 30 per cent (UNDP, 2003, p. 29, figure 1.2). As late as 1992, its average tariff was still over 40 per cent, about four times the level Latin America had in 1974, before liberalization was introduced (Weisbrot et al., 2005, p. 22). As Weisbrot et al. (2005) nicely sums up, "[t]o the extent that trade liberalization contributed to China's growth, it may be because it was done carefully so as not to disrupt existing production – unlike the indiscriminate opening up to imports that was adopted in many other countries".

A similar story holds in Viet Nam. Although it has recently signed a bilateral FTA with the United States for political reasons, its trade policy has been far from that of free trade.

According to the UNDP (2003), Viet Nam "engages in state trading, maintains import monopolies, retains quantitative restrictions and high tariffs (30-50 per cent) on agricultural and industrial imports and is not a member of the World Trade Organization (WTO). Yet it has been phenomenally successful, achieving GDP growth of more than 8 per cent a year since the mid-1980s, sharply reducing poverty, expanding trade at double-digit rates and attracting considerable foreign investment. Despite high trade barriers, it has rapidly integrated with the global economy" (p. 28).

India's recent growth acceleration, while not as spectacular as those of China or Viet Nam, is also notable in that it was not the result of trade liberalization, contrary to what is often claimed by free-trade economists.

According to Rodrik & Subramanian (2004), India's growth acceleration happened in the 1980s, not after the 1991 economic lib-

eralization as is commonly believed. They accept that there was some liberalization of foreign trade and investment in the 1980s but argue that this was a very controlled affair.

UNDP (2003) points out that “[t]ariffs were actually higher in the higher growth period of the 1980s than in the low-growth 1970s. Although tariffs are hardly the most serious trade restrictions in India, they reflect trends in its trade policy fairly accurately” (p. 31).

Thus, the three success stories of the 1990s – China, Viet Nam, and India – show that, while some trade liberalization may be necessary and beneficial, trade should be liberalized gradually, in line with the economy’s ability to upgrade its capabilities. Their experience conforms to the historical pattern that we have identified among the successful industrializers, from 18th century Britain down to late-20th century Republic of Korea and Taiwan Province of China.

### **III.5 Summary and Conclusions**

Part III of the paper has examined a wide range of historical and contemporary evidence on the use of tariffs and their impacts on economic performance. We have examined the experiences of both the developed countries and the developing countries since the rise of modern capitalism. In doing this, we have looked at cross-section statistical analyses, time-series statistical analyses, and individual country cases, arriving at the following conclusions:

- It is extremely misleading to suggest, as the “official history” does, that today’s developed countries have pursued free trade since the late-19th century, except for the aberration of the period between the Great Depression and the Second World War. Most of these countries have used protectionism, and in particular tariffs, in order to promote their industries from the start of their industrialization in

the 18th century until the 1960s, with the exception of a short period between 1860 and 1880.

- It is wrong to suggest that developing country policy-makers adopted protectionism after the Second World War largely because they were misled by anti-capitalist intellectuals. On the contrary. They knew exactly what they were doing. They adopted protectionism largely because their countries' economic performance under forced free trade through colonialism and unequal treaties was truly abysmal.
- The “conventional wisdom” that adoption of free trade (or at least freer trade) by most developing countries since the 1980s has improved their economic performances is simply not true. Most developing countries performed much better under protectionism than they have in the last 20-25 years under freetrade, free-market policies. Countries that have succeeded since the 1980s, such as India, China, and Viet Nam, are the ones that did not start with trade liberalization but, following the well-established historical pattern, liberalized their trade as they grew richer. In doing so, they once again demonstrated that trade liberalization is better seen as the outcome of development, rather than its prerequisite.
- We need to question the allegedly robust cross-section statistical evidence that more “open” trade, however it may be defined (which is itself not a trivial issue), promotes growth. Even if we ignore the numerous methodological and statistical problems associated with these econometric exercises, some of the more recent studies show that the relationship holds *at best* only for the 1960s-80s period (or for the 1970s-80s period, depending on which study one believes), with some even denying altogether that such a relationship exists at all.

- Needless to say, not all countries that used protectionism have succeeded but, most of the successful countries – not just the East Asian countries in the post-SWW period but also most of today’s rich countries in the past – have used tariffs and other measures of protectionism and generally benefited from them until they became rich, at which point the benefit of free trade came to outweigh the costs. Conversely, few countries in catching-up positions have benefited from free trade. The economic records of the developing countries under forced free trade in the imperialist period and in the recent periods of deregulation and liberalization have been very poor. Even the supposed “liberalization success stories” of Ghana and Mexico turn out to have managed only patchy performances.

Of course, none of our own evidence, on its own, “proves” our central proposition that tariff protection (and other means of trade protection) is a necessary, although not sufficient, condition for industrial development in developing economies. However, when virtually all of the available evidence points in the same direction – with the questionable exception of cross-section regressions for the 1970s-1980s period – the collective weight of the evidence becomes too great for us not to accept the proposition, and thus to question the whole basis of the current framework for the NAMA negotiations.

Given all these, we can only reject the starting assumption of the current NAMA negotiations, which asserts that tariffs and other forms of trade protection are bad for the growth of developing countries.



## **IV. BACK TO NAMA: THE “PRINCIPLES” BEHIND NAMA (AND THE WTO) AND WHY THEY ARE WRONG**

Having looked at the theoretical debate behind the role of tariffs in economic development and also a wide range of historical and contemporary evidence, we now critically examine the “principles” that govern the process of the NAMA negotiations.

As is the case with many key issues in international politics, the NAMA debate is often conducted in terms of vague rhetoric that is supposedly based on some “universal” sense of justice and fairness, rather than on the basis of logical arguments and carefully marshalled evidence.

In this Part, we show how such “universal” rhetoric in fact disguises the attempts by the developed countries to pursue their “particular” interests and thus bias the whole negotiation framework against the interests of the developing countries.

### **IV.1 The “Level Playing Field”**

In the push for radical industrial tariff cuts by the developing countries, the rhetoric of the level playing field is invariably trotted out. The developing countries should “level the playing field”, it is argued, by removing the “unfair” advantages that they are currently enjoying in their competition with the developed countries, such as higher tariffs, weaker protection of intellectual property rights and, more stringent restrictions on foreign investment.

As the Americans say the level playing field is like motherhood and apple pie. It is so good by definition that it is difficult to oppose. But it is something that has to be opposed if we are going to build a world trading system that is truly pro-developmental.

Let us stay with sporting analogies. The level playing field is the right principle to adopt when the players are equal, but what if the players are unequal? If a team of 13-year-old children are playing football against the Brazilian national team, it is only fair that the playing field is not level and that the children are allowed to attack from up the hill.

Indeed, in most sports, unequal players are not even allowed to compete against each other. In boxing, wrestling, and many other sports, they have weight classes. A heavyweight boxer like Muhammad Ali would never have been allowed to box Roberto Duran, the legendary Panamanian boxer, and take away his titles, however likely his victory was.<sup>59</sup>

Weight classes are not the only thing to prevent competition on an equal footing among unequal players. In many sports, including football and baseball (the Little League in American baseball), there are age classes – adult teams are not allowed to play against children and juvenile teams. In sports like golf, we even have an explicit system of “handicaps” that allows weaker players to compete with advantages in (inverse) proportion to their playing skills, and so on.

To take the boxing analogy further, the developed countries seeking a radical tariff reduction, as they are currently doing in the NAMA negotiations, are like a heavyweight boxer who sweet-talks a host of lighter boxers into fighting games with him by promising that they will be allowed to use protective gears and then suddenly turns around and accuses the others of playing foul by arguing that they have “unfair” protection. And when the heavyweight boxer insists on

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<sup>59</sup> Duran is one of only four boxers in history to hold four different world titles — lightweight (1972-79), welterweight (1980), junior middleweight (1983) and middleweight (1989-90).

wearing protective gear for his abdomen (agriculture and textile?) on the ground that it is his weak part, we begin to wonder whether there is any sense of fair play in his mind. Added to this, the fact that the heavyweight boxer almost single-handedly writes the rules of the game, owns the only bank in town (and may refuse to lend money to those boxers who complain about his tactics), and also controls the town newspaper (which will assassinate the characters of those boxers who speak against him), and we begin to see how absurd the rhetoric of “level playing field” is in the present world trading system.<sup>60</sup>

## **IV.2 “Special and Differential Treatment”**

Naturally there is some unease with the rhetoric of the level playing field among the developing countries, which the developed countries cannot totally ignore. This is why we have “special and differential treatments” (SDT) in the WTO, albeit in a much watered-down form compared to the kind of SDT included in the WTO’s predecessor, the GATT. However, there are serious problems with the notion of SDT, the main one being the word “special”.

To call something “special treatment” is to say that the person getting the treatment is being given an unfair advantage. However, in the same way we would not call stair-lifts for wheelchair users or Braille text for the blind “special treatments”, we should not call higher tariffs and other means of protection more extensively (but not exclusively) allowed for the developing countries “special treatments” – they are just different treatments for countries with different capabilities and needs.

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<sup>60</sup> Historical examples, such as the Indian cotton textile industry under the British imperial rule (section III.3.1), also testify to the absurdity of the level-playing field argument when it involves unequal partners.

As we have repeatedly shown throughout this paper, developing countries have much greater need for trade protection than do the developed countries, because they need to develop new industries in order to diversify and upgrade their economic activities so that they can achieve higher living standards. Therefore, infant industry protection is an absolute must for these countries. However, the kind of tariff regime that is likely to emerge out of the NAMA negotiations if the developed countries have their way, will be that of very low (or even zero) industrial tariffs across the board, which means that infant industry protection is going to become practically impossible (even though there *is* at the moment a provision for infant industry protection of up to eight years in the WTO – a legacy from the days of the GATT. ).

As the developing countries are in need of higher tariff protection, allowing higher tariffs for them is simply a “differential” treatment, and *not* a “special” treatment.

### **IV.3 “Less-than-full Reciprocity”**

Particularly in relation to the NAMA negotiations, developed countries have also tried to allay the fears of the developing countries through the principle of “less-than-full reciprocity” (LTFR), a concept that was also part of the GATT. They say that the developing countries will be allowed to give less than they receive from the developed countries, by being allowed to cut their industrial tariffs less *in proportional terms* than the developed countries.

However, the notion of reciprocity cannot be discussed without some reference to the relative positions of the parties involved. We would not say that a poor friend is being “less than reciprocal” simply because he cannot buy champagne and caviar for his rich friend, as long as he is treating his rich friend often enough and generously enough, *given his means*. Likewise, even a small cut in tariffs may be much to ask for a developing country desperate to preserve jobs, de-

velop industrial capabilities, and collect government revenues, while even a relatively large cut may not be such a big burden on countries with greater wealth and higher adjustment capabilities.

So when the tariff cuts asked from the developing countries are much larger in their *impacts* than the ones to be made by the developed countries – due to the greater absolute magnitudes of those cuts and, more importantly, due to their weaker adjustment capabilities and their greater needs to use the tariffs – it is wrong to say that these countries are being less than fully reciprocal, even if they are making less cuts in proportional terms than are the developed countries. In the smoke and mirrors of the Doha Round, the reality for many developing countries is closer to “more-than-full reciprocity”.

To make matters even worse, it is often not even true that the developed countries are necessarily making larger cuts in proportional terms. For example, according to the calculation by the Indian government presented in Khor & Goh (2004), the average industrial tariff of Japan will go down from 2.3 per cent to 1.3 per cent (the EC formula) or 0.7 per cent (the United States formula) and that of the United States will go down from 3.2 per cent to 1.7 per cent (the EC formula) or 1.0 per cent (the United States formula). These may be large cuts in proportional terms, but they are not larger even in proportional terms than in the case of some developing countries. For instance, the Japanese or the United States cuts according to the United States formula will be about 70 per cent (from 2.3 per cent to 0.7 per cent and from 3.2 per cent to 1.0 per cent respectively), whereas the cut for Indonesia will be 82 per cent (from 35.6 per cent to 6.3 per cent) and that for Brazil will be 80 per cent (from 30.8 per cent to 6.2 per cent).

Even when tariffs are reduced in a truly reciprocal manner, developed countries are much more adept at using NTBs, anti-dumping measures, sanitary and phytosanitary standards, etc., to restrict access to their markets by developing country producers. Of course, they can be, and sometimes are, taken to WTO dispute settlement panels for abusing these measures by their trading partners

but, many developing countries lack the legal and intellectual resources to do so, except in the most obvious cases.

On top of all these, developed country negotiators have added to the confusion by suggesting that LTFR would be satisfied if, at the end of the negotiations, developing countries end up with higher tariffs than developed countries, or that LTFR should be judged on the basis of the overall agreement, not just on tariff cuts.

#### **IV.4 Flexibility (but there is no turning back)**

The developed countries have tried to sell certain agreements in the WTO to the developing countries on the grounds that these agreements give them enough flexibility, mainly in the form of keeping some sectors off the agreements. Therefore, the GATS is said to be flexible because it allows countries to remove some sectors from their market-opening commitments. The same notion of flexibility was bandied about in the (now-dormant) negotiation for a possible WTO investment agreement in the run up to the Cancún ministerial meeting in 2003. In NAMA, it is said that there is some flexibility because countries can reserve some sectors from their tariff-binding and -cutting commitments, although the scopes for these are supposed to be quite limited.

However, this is a very peculiar notion of flexibility. For, once a sector is liberalized, there is no going back. Indeed, the whole idea of tariff binding in the WTO is based on this notion. The exercise is based on the belief that there is a tariff rate in a sector above which the tariff should *never* rise.

If there is going to be genuine flexibility, countries should be allowed to unbind and raise their tariffs, if they have reasonable grounds. For example, if a country genuinely under-estimated the adjustment costs when it made a decision to cut tariffs in particular industries – as in fact was the case with many developing countries

in the Uruguay Round – it would be reasonable to allow that country to raise tariff ceilings in those industries.

More importantly, it should be recognized that the developing countries, whose economic structures have to evolve a good deal before they can become rich, will need to vary the tariff rates for individual industries in the future to a far greater extent than will the developed countries. As a country climbs up the ladder of international division of labour, tariff protection needs to go down in some of the old infant industries that have now matured, while protection needs to be accorded to new emerging infant industries. If tariffs are cut and bound for each and every industry, as is currently proposed by the developed countries in the NAMA negotiations, this kind of flexibility, which is absolutely crucial for the developing countries, will not exist (see Akyuz, 2005, for an elaboration of this point).

#### **IV.5 Concluding Remarks: National Autonomy – “The Right to be Wrong”<sup>61</sup>**

Many freetrade economists like to present themselves as defenders of the interests of the developing countries. For example the World Bank in its famous *East Asian Miracle* report, warned that other developing countries should not try to emulate the interventionist trade and industrial policies of East Asia, because they do not have the administrative capabilities to make these complex policies work (World Bank, 1993 – for example, p. 26). In doing so, the Bank portrayed itself as protecting the developing countries from harming themselves through “wrong” policies. Adam Smith was doing the same for the Americans in his *Wealth of Nations*, when he was advising them not to protect manufacturing, as we have pointed out earlier.

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<sup>61</sup> I have borrowed the expression, “right to be wrong”, from Jose Antonio Ocampo.

Some would go even further. They would quite explicitly pitch themselves against the ignorant and often corrupt developing country governments beholden to interest groups, in defence of the “common man” in those countries, who would benefit from free trade. For example, right after the collapse of the Cancún ministerial meeting in September 2003, Willem Buiter, the then chief economist of the EBRD (European Bank for Reconstruction and Development), lamented that “although the leaders of the developing nations rule countries that are, on average, poor or very poor, it does not follow that these leaders necessarily speak on behalf of the poor and poorest in their countries. Some do; others represent corrupt and repressive elites that feed off the rents created by imposing barriers to trade and other distortions, at the expense of their poorest and most defenceless citizens”.<sup>62</sup> As seen in our earlier quote, Sachs & Warner (1995) go as far as calling the developing countries’ right to choose their own trade (and other) policies “the proverbial rope on which to hang one’s own economy” (section III).

Thus seen, freetrade economists believe that the shrinking of policy space for developing country governments in the area of trade (and industrial) policies is actually a good thing, as it prevents the developing countries from making costly policy mistakes, whether out of misguided belief in interventionism (the World Bank version) or due to interest group politics (the Buiter version).

This is unwarranted paternalism towards the developing countries, especially coming from people who otherwise oppose paternalism.<sup>63</sup> Interventionism can of course fail, but it has often succeeded,

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<sup>62</sup> “If anything is rescued from Cancún, politics must take precedence over economics”, letter to the editor, *Financial Times*, 16 September 2003.

<sup>63</sup> Free-trade economists tend to criticize government regulations for their paternalism, where government tries to restrict people’s freedom of choice in order to prevent them from making “wrong” choices. They argue that the ability to make mistakes and learn from them is the genuine sign of autonomy and free choice. However, when it comes to choice of policies by developing countries, they are quite happy to be paternalistic. A consistent freetrade economist who values autonomy and choice for individuals should

and tellingly, *non-interventionism* has almost never produced long-term development. If such failure is due to interest group politics, the answer is to strengthen democracy and accountability, not deprive developing countries of their economic sovereignty.

The possibility of policy failure should not be used as an excuse to curtail policy space for sovereign countries. They need to learn from failures as well as successes. Indeed, as free-trade economists often argue in relation to individual choices, true autonomy means the “right to be wrong”.

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be willing to do the same for developing countries as independent entities – that is, unless they adopt the Libertarian view and deny the legitimacy of any collective decision. However, if they did that, they would also have to deny the legitimacy of WTO decisions, which few of them are doing. If so, they cannot avoid the accusation of employing a double standard.



## **V. CONCLUSION: THE RIGHT TO A FUTURE**

The NAMA negotiations could be the watershed for the future of development. If the developed countries have their way and force the developing countries to massively cut (or even altogether eliminate) industrial tariffs on a line-by-line basis in an irreversible manner, the future prospect for industrial development and therefore, economic development, in today's developing countries is truly bleak.

In debating the kind of trade agreements that would help alleviate poverty and bring about development, history is the most reliable guide. Policies that are tried and tested should be defended: those that have failed should not. In the case of NAMA, contrary to what the developed countries would have us believe, there is a respectable theoretical and empirical case for tariff protection for industries that are not yet profitable, especially in developing countries. By contrast, free trade works well only in the fantasy theoretical world of perfect markets.

Historical and contemporary evidence show that it is extremely difficult, if not totally impossible, for technologically-backward countries to develop without trade protection (of which tariffs are the main element) and subsidies. The evidence shows that trade liberalization works only when it happens "gradually and selectively as part of a long-term industrial policy" (Shafaeddin, 2005, p. 53).

Virtually all of today's developed countries built up their economies using tariffs and subsidies (and many other measures of government intervention) throughout the 19th century and most of the 20th century (in particular, until the early 1970s). Therefore, a big "double standard" is involved when these countries preach the virtues of free trade and free market to today's developing countries, many of which in fact have tariff rates lower than those that pre-

vailed in today's developed countries at similar levels of development.

The evidence from the developing countries also supports this. They did very poorly when they were deprived of policy autonomy (most notably tariff autonomy) until the Second World War, while their performance after they gained policy autonomy was a great deal better. With very few exceptions, the tariff cuts and other measures of trade liberalization in these countries during the last two decades or so have produced at best very disappointing economic performances and, at worst economic collapses.

Some of the principles that govern the NAMA negotiations (and the WTO as a whole) – notably the 'level playing field' - are profoundly flawed. Others, such as special and differential treatment, less-than-full reciprocity, and flexibility, are interpreted in such a narrow way as to seriously undermine their practical value.

All in all, there are thus strong theoretical and empirical arguments that show that the kind of tariff cuts proposed in the current NAMA negotiations are likely to damage the future of the developing countries. It may not be too much of an exaggeration to say that the developing country trade negotiators have to fight the developed countries' NAMA proposals as if the future of their countries depended on it.

If the developed countries have the right to protect their past through agricultural protection and subsidies, the developing countries have the right to build a new future through industrial protection and subsidies. Granted, some countries are going to fail in their attempt to do so, but on the whole the developing countries have been good at handling the risk involved. When they used industrial protection and subsidies more actively during the so-called ISI period, they did much better than when they were severely constrained in the use of those measures in the subsequent period of trade liberalization and other neo-liberal economic "reforms".

Given this reality, the paternalistic arguments against the use of protection and subsidies by developing countries, especially if they are deployed by freetrade economists who otherwise condemn paternalism, can only be understood as another weapon in the rich world's arsenal for "kicking away the ladder" of development for developing countries

If they are to fulfil the developmental promises made in Doha and prevent the creation of a world economy divided by a growing gulf between haves and have-nots, the powerful players in the WTO must ensure that it gives developing countries the largest possible policy space, so that that they can work out what is good for them and find their own ways to achieve it. An immediate suspension of the NAMA negotiations would be a good place to start.

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