VII Summary

It was pointed out at the beginning of this Occasional Paper that the Fund position is to favor an open trading system and to oppose the use of trade restrictions for balance of payments purposes. Protectionism in industrial countries appears to have increased, and there are pressures for further increases, even though the initiation of a new round of multilateral trade negotiations is a hopeful sign. In the case of developing countries, protection tends to be higher and more widespread than for industrial countries, but there have been proposals for liberalization, and in some countries actual moves in that direction.

The paper opened with a discussion of several macroeconomic issues. An increase in protection does not necessarily improve the current account. It all depends on what happens to savings and investment, private and public, and this depends on macroeconomic policies and the way policy responds to the increase in protection. When the exchange rate floats there is no presumption that protection would improve the current account. A uniform import surcharge in the United States, for example, would only be likely to improve the current account if it improved the fiscal situation, but it would not be an efficient way of doing so. Exchange rate instability may well have given rise to protectionist measures, but it provides no justification for protection. Similarly, the existence of unemployment does not justify protection. Devaluation, or macroeconomic policies that bring about depreciation, would normally be preferable to import restrictions if the balance of payments is to be improved at a constant level of overall employment, or if overall employment is to be increased while avoiding a balance of payments deterioration. In the case of real wage rigidity and hence classical unemployment neither method may be able to deal with an unemployment problem. The employment gains by protected industries would be offset by losses in other industries.

Various arguments for protection have been analyzed, notably the infant industry argument, the terms of trade argument and the case for using tariffs and export taxes to raise revenue. In all cases it is possible to make valid arguments for protection applying in particular (but not necessarily common) circumstances. Usually they are arguments only for the short term, so that possible short-term gains have to be weighed against long-term losses. It has been pointed out that one of the main reasons for protection in practice is the maintenance of incomes of particular sectors in response to adverse shocks, this being brought about at a cost in national income as a whole.

Reference has been made to rent seeking and to the special problems created by import quotas as compared with tariffs. There is a strong case, at the minimum, for replacing quotas with tariffs, preferably fairly uniform and not "made to measure." Protection is likely to affect growth adversely through various channels, including the effects on the productivity of investment. There is considerable evidence that outward-looking policies—defined as policies which avoid a bias in the incentive system against exports—have led to higher growth rates.

A key issue for developing countries and for the design of Fund programs is whether import restrictions should be used at a time of balance of payments crisis, and whether, by contrast, it is appropriate to liberalize imports when a country still has a current account problem. This is a complex issue, but it has been noted that any case for import restrictions can only be short term and it may be a matter of balancing possible short-term gains against long-term losses, essentially the losses from providing inadequate incentives for exports, quite apart from all the other costs of distorting and licensing systems.

In general, trade liberalization requires devaluation. It is thus particularly important to think of trade liberalization and exchange rate adjustment as representing a policy package. The relationship between trade liberalization and capital market liberalization has also been discussed. It has been noted that capital movements can present problems for large-scale trade liberalization through their effects on the real exchange rate.

Finally, protection by industrial countries does not justify protection by developing countries (or vice versa), the central point being that protection in both parts of the world reduces the gains from trade and hence real incomes of both. Industrial country markets for the manufactured exports of developing countries are still fairly open, though there is a special and serious problem for clothing and textiles, and the developing countries are certainly damaged by protection in industrial countries, both in agriculture and in manufacturing, espe-

cially when, as in the case of clothing and textiles, such protection actually discriminates against the developing countries.

Subject to various qualifications noted in the paper, the general conclusion follows that, both from the point of view of countries imposing protection—that is, from the point of view of their national interests—and from the point of view of their trading partners and the world system, increases in protection are rarely justified and are undesirable. This conclusion also applies to existing protection and hence justifies moves to trade liberalization, preferably multilateral but also unilateral.