TRADE PREFERENCES FOR DEVELOPING COUNTRIES: A JAPANESE ASSESSMENT*

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Among the most important themes of the Second United Nations Conference on Trade and Development in New Delhi earlier this year, 1968, was the discussion of schemes for general trade preferences for developing countries. Japan is one of the developed countries in the process of defining her attitude on this question. Over the last few years, there has been lively debate among Japanese government officials, businessmen, and academic economists about what attitude Japan might best adopt. In November 1967, the Japanese government finally lined up beside other OECD countries and opted for the scheme of general trade preferences. The estimates of the impact of preferences on Japanese trade, spelled out in this paper, played a not insignificant part in leading Japanese opinion towards this more positive position.[1]

General trade preferences will have trade creating effects, trade diverting effects, and dynamic effects. This paper aims, firstly, to assess the impact of preferences for developing countries upon Japan's imports and exports and thereby provide some of the basic information necessary to more effective trade policy decision-making. Secondly, alternative preference schemes, such as the advance cut and tariff quota proposals are compared. Finally, I put forward a new suggestion, a proposal for aid *cum* preferences, which may commend itself to developed and developing countries alike.

I. *The Trade Creation Effect: Increases in Japan's Imports*

Japan's imports of manufactures and semi-manufactures from developing countries are differentiated from imports originating in developed countries in kind and quality. The increase in Japanese imports due to the extension of trade preferences for developing countries can therefore be estimated using a familiar model. The trade diversion effects on developed country exporters are neglected and attention focussed on the trade creation effects on Japanese imports.
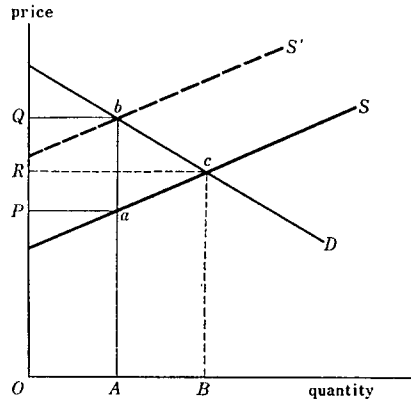
In Figure 1, D represents Japan's (or any preference-giving country's) import demand schedule for some developing country export commodity, X; S repersents the developing countries' export supply schedule; and S' represents the tariff-ridden export schedule. Before

FIG. 1.   TRADE CREATION EFFECTS

the extension of preferences, Japan imported OA units of X at price OP, the value of imports from developing countries being $OPaA$. In Japanese markets, commodity X is sold at the price OQ, higher than the developing countries' export price by the extent of the tariff, t, Japanese tariff revenue being $PQba$.

Now, suppose tariffs on imports from developing countries are abolished. The tariff preference margin, β, then equals unity.[2] The price of the developing country export rises from P to R. The rate of price increase is shown by:

$$\pi_x = \frac{\eta_j}{\eta_j + \varepsilon_u}\left(\beta \cdot \frac{t}{1+t}\right) \qquad (1)$$

The price of X in Japan, inclusive of tariff, falls from Q, or $(1+t)P$, to R. The rate of price decrease is shown by:

$$\pi_m = \frac{\varepsilon_u}{\eta_j + \varepsilon_u}\left(\beta \cdot \frac{t}{1+t}\right) \qquad (2)$$

where η_j is the price elasticity of Japan's import demand and ε_u is the price elasticity of developing countries' export supply. If the original value of Japan's imports is denoted by M,[3] the increase in imports is shown by:

$$\Delta M = \pi_x(1+\varepsilon_u)M \qquad (3)$$

Using this model, estimates of the increase in Japanese imports in consequence of the extension of hundred per cent tariff preferences were made for twelve sensitive commodities of importance to developing countries. The initial estimates were made on a disaggregated basis but they are aggregated and summarised in Table 1. One important problem was the estimation of the price elasticities, η_j and ε_u. As shown in Table 1, the twelve commodities analysed were classified into three broad groups—lightly processed intermediate manufactures, highly processed intermediate manufactures, and finished manufactures—and three broad

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[2] If β is 1, then $\beta \cdot \dfrac{t}{1+t}$ simply becomes $\dfrac{t}{1+t}$ in equations (1) and (2).

[3] If the initial P is taken to be 1, M represents both the volume and value of imports.

elasticity bands assigned accordingly. The precise values of these elasticity bands are ultimately guesswork but their orders of magnitude are pobably accurate enough.[4]

In 1964, developing country exports of these twelve commodities to Japan were valued at \$US 3.69 millions which represented a 10 per cent share in the relevant Japanese markets. The estimates set out in Table 1 suggest that if tariffs were abolished on developing country exports to Japan (that is, β equalled unity), they would expand by \$US 0.91 millions, or 24.7 per cent, on 1964 trade figures.[5] Although the percentage increase appears large, the size of the increase is relatively insignificant when compared with annual increases in Japanese exports of the order of \$US 1,000 millions. The fact is that Japan still maintains a strong comparative advantage in traditional labour intensive manufacturing industries of the type most competitive with potential export industries in developing countries.

In Japan, nonetheless, there remains a strong fear that certain traditional labour intensive industries, typically comprising small scale firms concentrated in particular industrial districts, would be severely damaged by the extension of tariff preferences. This fear tends to be

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[4] The price elasticity of Japan's imports, η_j, is estimated according to the formula:

$$\eta_j = \theta\left(\frac{P}{M}\varepsilon_d + \frac{C}{M}\eta_d\right),$$

where θ, the elasticity of domestic prices in response to changes in prices of competitive imports, is supposed to be 0.5 for all commodity categories; $\frac{P}{M}$, the ratio of domestic production to competitive imports from developing countries, is assumed to be 4 for all commodity categories; $\frac{C}{M}$, the ratio of consumption (i.e. $C=P+M$) to imports, is assumed necessarily to be 5 for all commodity categories; ε_d, the price elasticity of domestic supply, is assumed to be 0.1 for lightly processed intermediate manufactures, 0.2 for highly processed intermediate manufactures, and 0.4 for finished manufactures; and η_d, the price elasticity of domestic demand, is supposed to be 0.2, 0.3, and 0.5 for respective commodity category. It results in that η_j would be 0.7 for lightly processed intermediate manufactures, 1.2 for highly processed intermediate manufactures, and 2.1 for finished manufactures. The values of η_j assumed as above are not unrealistic and well compared with 1.57 estimated by Tatemoto for all imported commodities which involve by more than 80 per cent primary product of low elasticities. (Motohiro Tatemoto, *Econometric Analysis of Foreign Trade* (in Japanese), Tokyo, 1963, Chap. 2.)

Similar method of assuming elasticities of import-demand is seen, for example, in Bela Balassa, "Tariff Protection in Industrial Countries: An Evaluation," *Journal of Political Economy*, December 1965, p. 592, and, for θ, in John E. Floyd, "The Overvaluation of the Dollar: A Note on the International Price Mechanism," *American Economic Review*, March 1965, pp. 95–107.

Practically no estimates are available for the price elasticity of export-supply, ε. It is estimated according to the formula

$$\varepsilon = \left(\frac{C}{X}\right)\eta_d + \left(\frac{P}{X}\right)\varepsilon_d,$$

where $\frac{C}{X}$ stands for the ratio of domestic consumption to exports regarding to a certain commodity and $\frac{P}{X}$ for the ratio of domestic production to exports. Basing upon the Japanese data for commodities concerned in this paper, $\frac{C}{X}$ is supposed to be 2 and $\frac{P}{X}$ to be 3 for all commodities, whilst η_d and ε_d are supposed to be the same as shown above. Thus, ε is assumed to be 0.7 for lightly processed intermediate manufactures, 1.2 for highly processed intermediate manufactures, and 2.2 for finished manufactures. These values are commonly applied for developing countries (ε_u) and Japan (ε_j), which will be used in the following section.

[5] On average, π_x, the percentage increase in the price of developing country exports, would be about 8.6 per cent.

TABLE 1. EFFECTS OF GENERAL PREFERENCE ON JAPAN'S IMPORTS
FROM DEVELOPING COUNTRIES :
AN ESTIMATE BASED UPON TRADE FIGURES IN 1964

Commodity Group	M $1,000	t %	M_u $1,000	ΔM_u $1,000	$\Delta M_u/M_u$ %	π_x %	η_j	ε_u
Plywood	211	20.0	4	—	—	8.33	0.7	0.7
Cotton yarn and thread	45	6.4	24	1	4.2	3.02	0.7	0.7
Yarn and thread of synthetic fibres	1,386	20.0	450	64	14.3	8.33	0.7	0.7
Cotton fabrics, woven	2,635	10.0	910	91	10.2	4.54	1.2	1.2
Floor coverings	1,997	30.0	81	29	35.8	11.29	2.1	2.2
Clothing	7,752	26.4	1,076	352	32.8	10.22	2.1	2.2
Footwear	1,227	26.4	87	28	32.2	10.22	2.1	2.2
Articles of plastic materials	4,193	25.0	95	30	31.6	9.78	2.1	2.2
Travel goods, handbags	556	20.0	42	11	26.2	8.15	2.1	2.2
Small-wares and toilet articles	2,917	35.7	341	140	41.0	12.87	2.1	2.2
Children's toys	12,210	20.0	328	86	26.2	8.15	2.1	2.2
Lighters	1,343	25.4	255	81	31.7	9.91	2.1	2.2
Total or Average	36,472		3,693	913	24.7	8.56		

Source : Based on data and methods described in the text.

exaggerated both by the vested interests concerned and the Ministry of International Trade
and Industry. It is true that in recent years, Japan's imports of manufactured goods from
Hong Kong, Taiwan, Korea, Singapore and India have been increasing rapidly, but they are
still insignificant. However, taking this trend into account, and broadening the commodity
coverage, it might be that around $US 50 millions worth of Japanese imports could be affected
by the extension of trade preferences. If tariffs against developing country exports were
completely eliminated, imports would increase by $US 13 millions only. A fifty per cent
tariff cut is probably a more realistic possibility, and besides some commodities are likely to
be excepted. On this basis, the increase in Japanese imports would be somewhat less than
$US 6.5 millions. There seem no strong grounds for Japan to oppose the provision of general
trade preferences for fear of unmanageable increases in her imports.

II. The Trade Diversion Effects : Decreases in Japan's Exports

A more serious problem for Japan is that her exports, particularly to North American
markets, might suffer from the trade diversion effects of trade preferences extended by other
developed countries to developing countries. A more complicated model is required in order
to estimate the effects of both trade creation and trade diversion in a given developed country
market, such as the United States.

Suppose Japan competes with developing countries in the export of some manufactured
commodity X to the American market. In figure 2, D represents the American demand
schedule; S_j Japan's export supply schedule; and S_u the developing countries' export supply

FIG. 2. TRADE CREATION AND TRADE DIVERSION EFFECTS
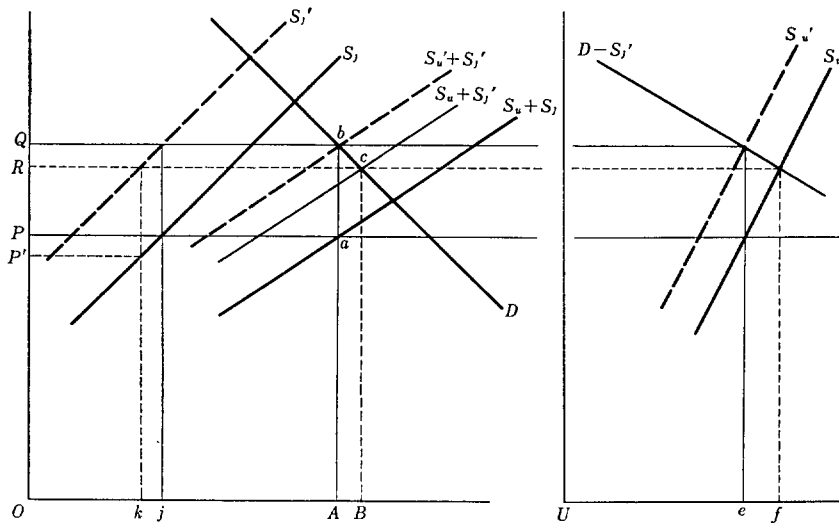
schedule. By summation, a composite export supply schedule, $S_u + S_j$ is obtained. If tariffs are imposed against all imports by the United States, the tariff-ridden export supply schedules are represented by $S_j{}'$, $S_u{}'$, and $S_u{}' + S_j{}'$. If tariffs are imposed only against Japanese imports $S_u + S_j{}'$ is the composite export supply schedule. And $D - S_j{}'$ represents United States' demand for X from developing countries alone.

Before the introduction of trade preferences, equilibrium is determined at b where D and $S_u{}' + S_j{}'$ intersect. This equilibrium is exactly equivalent to that described in Figure 1. The United States imports OA units of which Oj are supplied by Japan and the remainder, jA equal to Ue, are supplied by developing countries. The international price of imports is OP, whilst the price inclusive of tariff is OQ.

Suppose that tariffs on commodities imported from developing countries are abolished (that is, the preference margin, β, is unity) and tariffs on Japanese imports remain unchanged. After the extension of trade preferences, a new equilibrium is reached at c where D and $S_u + S_j{}'$ intersect. America increases her imports from OA to OB, of which Ok are supplied by Japan and the remainder, kB equal to Uf, are supplied by developing countries. The price of imports, inclusive of the tariff on Japanese supplies, falls from OQ to OR. Japanese export prices are forced down from OP to OP', equivalent to the decrease in the American import price inclusive of tariff, that is, QR equals PP'.

Thus, the quantity of American imports increases by $\varDelta M^*$ due to the trade creation effect of preferential tariff reductions, while the quantity of Japanese exports decreases by $-\varDelta M_j{}^*$ due to the trade diversion effects. Developing country exports increase by $\varDelta M_u{}^*$ which is the sum of the trade creation and trade diversion effects.

$$\varDelta M_u{}^* = \varDelta M^* - (-\varDelta M_j{}^*) = \varDelta M^* + \varDelta M_j{}^* \qquad (4)$$

The export price from developing countries after the extension of preferences, OR in

Figure 2, is shown by $\{1+(1-\beta)t\}P(1+\pi_x)$, or simply $P(1+\pi_x)$, if β equals unity. This will equal the price of exports from Japan inclusive of the tariff, $P(1+t)(1-\pi_m)$.

$$P(1+t)(1-\pi_m)=\{1+(1-\beta)t\}P(1+\pi_x) \qquad (5)$$

The rate of decrease in the United States' import price inclusive of the tariff will be:

$$\pi_m=\frac{\alpha\varepsilon_u}{\eta+\alpha\varepsilon_u+(1-\alpha)\varepsilon_j} \cdot \frac{t\cdot\beta}{1+t} \qquad (6)$$

and the rate of increase in the export price from developing countries will be:

$$\pi_x=\frac{\eta+(1-\alpha)\varepsilon_j}{\eta+\alpha\varepsilon_u+(1-\alpha)\varepsilon_j} \cdot \frac{t\cdot\beta}{1+t} \qquad (7)$$

where η is the price elasticity of American import demand, ε_u and ε_j are the price elasticities of export supply from developing countries and Japan respectively, and α is the developing countries' share in American markets.

Finally, the decrease in the value of Japan's exports, ΔM_j, and the increase in the value of developing countries exports, ΔM_u, will be:

$$\Delta M_j=\pi_m(1+\varepsilon_j)M_j \qquad (8)$$

$$\Delta M_u=\pi_x(1+\varepsilon_u)M_u \qquad (9)$$

Table 2 records nineteen manufactured commodities of importance to developing countries which compete with Japanese exports in the American market. In 1964, United States' imports of these commodities were valued at \$US 1,600 millions. Japan supplied \$US 540 millions and developing countries supplied \$US 465 millions. The nineteen items cover almost all the manufactured and semi-manufactured goods for which developing countries, as well as Japan, seek larger markets in the United States. The elasticity assumption,[6] relevant American tariff rates, and results of calculations using the model described above are also detailed in Table 2.

If the preference margin, β, is unity, it appears that developing countries would increase their exports to America by \$US 176 millions, or 37.8 per cent on 1964 trade figures. The rise in developing country export prices, π_x, would average 18.3 per cent. On the other hand, \$US 22.5 millions or 4.1 per cent of Japanese exports would be diverted to developing countries and Japanese export prices would be forced down on average by 2.0 per cent. Thus, the United States would increase her imports by \$US 153.5 millions or about 10 per cent on 1964

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[6] The method of assuming elasticities is the same as shown in the previous note 4. The price elasticity of American import-demand, η, is estimated to be 0.9 for lightly processed intermediate manufactures, 1.4 for highly processed intermediate manufactures, and 2.5 for finished manufactures. These values are higher than those for Japan, since $\frac{C}{M}$ (=5.0) and $\frac{P}{M}$ (=6.0) for the United States are supposed to be larger than for Japan. The values of η as supposed as above may be compared with those of the Ball-Mavwah study, for example, which shows that elasticities are 0.26 for crude materials, 1.38 for semi-manufactures, and 3.5 for finished manufactures. (J. Ball and K. Mavwah, "The U.S. Demand for Imports, 1948-1958," *Review of Economics and Statistics*, November 1962, pp. 395-401.) If it is taken into account that imports from developing countries and Japan in this study consist of labour-intensive and less sophisticated manufactures with lower elasticities, the lower elasticities assumed here for finished manufactures than those of the Ball-Mavwah study may not be unrealistic.

TABLE 2. EFFECTS OF GENERAL PREFERENCES ON EXPORTS FROM JAPAN AND DEVELOPING COUNTRIES IN AMERICAN MARKETS: AN ESTIMATE BASED UPON TRADE FIGURES IN 1964

Commodity Group	M $1,000	t %	M_f $1,000	$-\Delta M_f$ $1,000	$-\Delta M_f/M_f$ %	$-\pi_m$ %	M_u $1,000	ΔM_u $1,000	$\Delta M_u/M_u$ %	π_x %	η	ε_f	ε_u
Cotton fabrics, woven	104,998	12.9	31,251	1,656	5.3	2.31	44,200	10,431	23.6	10.28	1.4	1.2	1.2
Yarn of wool	21,303	25.0	4,621	9	0.2	0.14	322	136	42.2	24.83	0.9	0.7	0.7
Woollen fabrics, woven	80,372	48.9	46,532	419	0.9	0.39	2,011	223	11.1	48.31	1.4	1.2	1.2
Jute fabrics, woven	170,655	12.4	753	83	11.0	4.79	154,582	24,888	16.1	7.01	1.4	1.2	1.2
Floor coverings	54,373	22.5	27,151	1,901	7.0	2.20	13,987	8,868	63.4	19.80	2.5	2.2	2.2
Clothing	451,836	22.8	113,414	9,980	8.8	2.76	144,463	89,711	62.1	19.40	2.5	2.2	2.2
Manufactures of leather	7,126	10.0	1,339	31	2.3	0.73	1,235	363	29.4	9.19	2.5	2.2	2.2
Footwear	141,436	19.6	50,319	554	1.1	0.34	6,816	4,178	61.3	19.17	2.5	2.2	2.2
Sporting goods	38,578	20.2	13,807	166	1.2	0.37	1,847	1,167	63.2	19.76	2.5	2.2	2.2
Children's toys	88,196	31.4	54,893	3,458	6.3	1.98	15,682	14,443	92.1	28.79	2.5	2.2	2.2
Articles of rubber	40,249	10.7	3,837	1	0.02	0.01	88	22	24.6	10.69	1.4	1.2	1.2
Plywood	123,238	20.0	50,890	2,799	5.5	3.24	54,922	15,049	27.4	16.10	0.9	0.7	0.7
Cement	9,235	5.0	229	2	0.7	0.41	1,855	145	7.8	4.56	0.9	0.7	0.7
Glass	60,046	15.7	9,768	49	0.5	0.27	2,742	718	26.2	15.39	0.9	0.7	0.7
Glassware	34,159	27.6	2,916	41	1.4	0.45	1,575	1,362	86.5	27.02	2.5	2.2	2.2
Soaps	1,562	14.0	20	1	0.5	0.16	45	20	44.2	13.82	2.5	2.2	2.2
Sewing machines	61,041	10.0	36,616	22	0.06	0.02	367	117	31.9	9.98	2.5	2.2	2.2
Bicycles	29,668	30.0	6,058	12	0.2	0.07	218	209	95.7	29.91	2.5	2.2	2.2
Radio broadcast receivers	111,915	12.5	84,667	1,355	1.6	0.49	10,648	4,068	38.2	11.95	2.5	2.2	2.2
Total or Average	1,578,923		539,070	22,538	4.1	1.96	465,531	176,118	37.8	18.26			

Source : Based on data and methods described in the text.

figures—the difference between the increase in developing countries' exports and the reduction in Japan's exports. The increase in American imports is the trade creation effect of preferences resulting from the average fall of 2.0 per cent in American import prices inclusive of the tariff.

The question is would the effect of trade diversion on Japanese exports be really serious? The Japanese Ministry of International Trade and Industry presented a very exaggerated estimate in early September 1967[7] which called forth considerable critical comment. It suggested that Japanese exports to developed country markets valued at $US 900 millions would be affected by general trade preferences and that the loss of exports could be as large as $US 135—180 millions since Japanese export prices would be forced down to the full extent of tariff reductions in order to maintain export volumes. This Ministry of International Trade and Industry estimate is fundamentally in error since it completely neglects the probable increases in developed country imports in consequence of tariff reductions. Where the import price inclusive of tariff is reduced by 15 or 20 per cent, the value of exports, both from developing countries and Japan, will increase to the extent that the price elasticity of developed country import demand is greater than unity.

Interestingly, in mid'October 1967, the Japanese Ministry of Finance published another estimate of the effects of tariff preferences[8] which employed methods, and yielded results, similar to those found here. The Ministry of Finance estimate covers trade in six commodities additional to those analysed in Table 2 (cotton yarn and thread, manufactures of asbestos, furniture, leather, essential oil and resinoids, and electric fans) and is based on 1966 trade data. Japan's exports to the United States of the twenty five commodities studied were $US 702 millions in 1966 and the Ministry of Finance estimated that they would fall by $US 27.7 millions or 4.0 per cent, with a 2.0 per cent fall in average export prices (π_m), if United States tariffs were completely eliminated on imports from developing countries. If these estimates are extended to include Japanese exports not only to the United States but also to Canada, the EEC, EFTA, Finland, Australia, and New Zealand, the decrease in exports would amount to around $US 40 millions. This seems a fairly reasonable estimate.

Again, the trade diversion effect of general trade preferences upon Japan would not be nearly so serious as is widely feared. If the preference margin, β, were 0.5 instead of unity, exports would fall by only $US 20 millions. This would, however, be greater than the increase in Japan's own imports of approximately $US 6.5 millions. Japan is, indeed, the only advanced country, with perhaps the exception of Italy, which exports traditional labour intensive manufactures in competition with developing countries and is open to significant trade diversion losses. It is for these reasons that, within the OECD, the Japanese government has pressed for sharing the burden of tariff preferences, not only in terms of their effect through increasing imports but also in terms of their effect in diverting developed country exports away to developing countries. How exactly this might be effected is a separate and difficult problem for the governments concerned.

Is there any means whereby Japan could overcome the trade diversion effect of trade preferences and expand her exports along with, though more slowly than, developing countries? This, I feel, depends on the kind of trade preference scheme adopted.

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[7] Mamoru Okita, "Impacts on Japanese Trade of Preferences to Developing Countries," *Economist* (Tokyo), September 26, 1967.

[8] Bureau of Customs, Ministry of Finance, *A Report on Preferences*, October 11, 1967.

III. *Advance Cut* versus *Tariff Quota Preference Schemes*

Two alternative preference schemes have been presented to OECD countries : the advance cut plan advocated by the United States and the tariff quota plan supported by EEC countries. It has been suggested that the advance cut preference scheme could be applied *either* by reducing tariffs on developing country products to the full extent of concessions agreed under Kennedy Round negotiations *or* by reducing tariffs on developing country products under negotiations between developing countries and developed countries within GATT, to be followed by a new round of negotiations among developed countries designed to effect the staged reduction of MFN tariffs over 5 or 10 years. Either way, the advance cut plan ensures that general preferences are temporary and that they are consistent with progress towards global free trade. These are the significant merits of the advance cut proposals.

On the other hand, the tariff quota scheme appears more open to protectionist abuses, and unlikely to promote trade liberalisation in developed countries. Quotas on selected commodities from particular developing country sources would be subject to arbitrary alteration and MFN tariffs could even be raised to provide larger preference margins. Fundamentally, the tariff quota plan does not aim at progress towards global free trade but sets out to prevent "market disruption" by developing country products. From the standpoint of encouraging the expansion of world trade, the advance cut proposals seem preferable.

From Japan's viewpoint also the advance cut proposals seem superior to the tariff quota proposals. Under the tariff quota plan, Japan would suffer trade diversion effects of the kind analysed above. On the other hand, if, as envisaged under the advance cut plan, MFN tariffs were gradually reduced, Japanese exports would expand along with exports from developing countries. In the early phases of implementing an advance cut scheme, preference margins would induce trade diversion at Japan's expense. In later phases, as preference margins narrow and larger MFN tariff reductions apply, the expansionary effect on Japanese exports would more than compensate for the losses from trade diversion, whilst developing country exports would continue to expand because of the effects of scale economies and increased productivity on international competitiveness.[9]

Thus, Japan would not be harmed so much by the advance cut as by the tariff quota plan and could even benefit from it provided developed countries ultimately undertook MFN tariff reductions. Under the advance cut plan trade expansion among developed countries would offset the impact of trade diversion towards developing countries. Indeed, the Japanese government should press for sharing the burden of trade diversion by insisting on MFN tariff

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[9] Suppose that 1) America imported, in the initial year, $US 600 millions from Japan and $US 400 millions from developing countries; 2) American tariffs were 30 per cent; 3) β equals 0.5, both under an advance cut and a tariff quota plan; 4) tariffs are reduced by 10 per cent in each of five years under the advance cut plan while they are reduced by 50 per cent from the first year but quotas are not reached within five years under the tariff quota plan; 5) $\eta = 2.5$ and $\varepsilon_j = 2.2$; and 6) ε_u will increase from 1.1 in the first year to 1.65, 2.2, 2.75 and 3.3 in successive years. Under these assumptions, over the whole five years, Japanese exports would fall by $US 205 millions or 6.8 per cent under the tariff quota plan, whilst they would increase by $US 306 millions or 10.2 per cent under the advance cut plan. Exports of developing countries would increase by $US 671 millions or 33.4 per cent in the case of the tariff quota plan and by $US 514 millions or 23.7 per cent in the case of the advance cut plan.

reductions among developed countries, particularly on those commodities on which she would suffer most trade diversion.

Japan has many interests in common with developing countries. She still depends heavily on the export of traditional labour intensive manufactures in competition with developing countries but, like them, she desires freer access to developed country markets for these exports. If the second variant of the advance cut proposals were applied again and again it would serve to break down protectionism in high wage developed countries. It is important to emphasise that for developing countries, too, the benefits of trade preference schemes derive not so much from *discrimination* in tariff treatment but more from the *reduction* of tariffs in developed countries.[10]

IV. *A Scheme for Aid* cum *Trade Preferences*

Trade preferences for developing countries are justifiable if divergence from the principle of non-discrimination within GATT is temporary and they foster liberalisation of world trade. They are positively desirable if they encourage transformation in the international division of labour in such a way as to strengthen specialisation in the export of labour intensive exports from developing countries.[11] But what this study and others have shown is that the static effects of preference schemes are not likely to be substantial.[12] The prospects are generally discouraging for developing countries. The benefits for them may be even too small to justify the cost of carrying out the cumbersome administration of preferential treatment. The increased earning power of developing countries which results from trade preference is certainly not likely to fill their huge foreign exchange gap.[13]

Moreover, there are conflicting interests among the potential preference-receivers. The main interest of the less developed among the developing countries is not so much preferential tariff treatment on manufactured exports but, first, the expansion of traditional primary commodity exports and, second, the initiation of industrialisation with heavy dependence on aid from developed countries.

In fact, developed countries have been reluctantly lead towards the provision of general trade preferences, not because they expect any substantial benefits to flow to developing countries but because they recognise the political expedience of providing them.

An aid *cum* preference scheme could offer more benefits to developing countries. Aid, linked directly to preferential tariff treatment, appears consistent with the Prebisch report's

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[10] In the footnote above, it has been shown that the benefits of the advance cut and tariff quota plans are not significantly different for developing countries, provided that the preference margin, β, is the same in both cases.

[11] Harry G. Johnson, "Trade Preferences and Developing Countries," *Lloyds Bank Review*, April 1966, p. 18; Harry G. Johnson, *Economic Policies Towards Less Developed Countries*, Brookings Institution, Washington, 1967, Chapter 6.

[12] See, Gardner Patterson, *Discrimination in International Trade, The Policy Issues, 1945-1965*, Princeton, 1966, pp. 358-359, pp. 381-383. John Pincus, *Trade, Aid and Development*, Council on Foreign Relations, 1967, Chapter 6.

[13] Grant L. Reuber, *Canada's Interest in the Trade Problems of Less-Developed Countries*, The Canadian Trade Committee and Private Planning Association of Canada, 1964, p, xii.

emphasis on the infant industry argument for preferences.[14] Firstly, directly productive aid[15] in the form of capital goods, advanced techniques of production, managerial know-how, and worker training, should be provided to developing countries on an increasingly large scale if the efficiency of new export-oriented industries, primary as well as manufacturing, is to be improved to the point where they become increasingly competitive in world markets. Secondly, developed countries should provide preferential treatment, say for five or ten years, to developing country exports launched with the help of directly productive aid. Preferences aimed at ensuring wider markets would serve as a sort of aid 'after-care', and might well be regarded as indispensable to realising the full benefits of aid. It is important that the provision of preferences should be closely linked with the provision of aid since either is likely to be ineffective and result in waste of resources if applied independently.

The aid *cum* preference scheme need not be confined to manufactured goods. It could also be useful for agricultural and mineral commodities of interest to developing countries. Commonly, however, developed country tariffs on these latter products are very low or non-existent and there is little margin for granting preferences. In such cases, governments of the developed countries could provide a subsidy on imports from the developing countries for some specific period, say five years, until competitiveness is sufficiently well established.

In the past, Japan has stressed "development investment for import" as a useful form of aid to assist primary product exports from developing countries. The development of maize exports from Thailand to Japan is one successful example. It is in Japan's interests to switch purchases of raw materials and foodstuffs from developed to developing countries as much as possible, particularly since Japan usually has export surpluses with developing countries.[16] The main difficulty, of course, is that developing countries are presently more expensive and less reliable sources of supply than developed countries. Large scale aid *cum* trade preferences could help overcome this difficulty.

The aid *cum* preference scheme might well be subject to criticism from developing countries on the grounds that it is not a 'general' preference scheme but, of its nature, would have to be selective of both commodities and countries. However, if preferences are justifiable on infant industry grounds it seems appropriate for them to be both selective and temporary. In any case, the so called general trade preference schemes discussed above would involve selectivity in practice, and the beneficial effects of their 'generality' are likely to be nullified by selective administration.

The aid *cum* preference scheme involves the provision of aid by developed countries, through the use of government funds and private capital, to selected industries in developing countries, and the import and marketing of the output by developed countries. The developed country should be not only ready to provide trade preferences but also press other developed countries to provide equivalent preferences[17] (a procedure similar in principle to the

[14] United Nations, *Towards a New Trade Policy for Development*, New York, 1964.

[15] See, Kiyoshi Kojima, "A Proposal for International Aid," *The Developing Economies*, The Institute of Asian Economic Affairs, Tokyo, December 1964, and "Japan's Role in Asian Agricultural Development," *The Japan Quarterly*, April–June, 1967.

[16] See, Kiyoshi Kojima, "A Pacific Economic Community and Asian Doveloping Countries," *Hitotsubashi Journal of Economics*, June 1966, and "Japan's Foreign Aid Policy," *Hitotsubashi Journal of Economics*, February 1966, pp. 54–55.

[17] See, David Wall, *The Third World Challenge, Preferences for Development*, The Atlantic Trade Study, London, 1967, pp. 44–48.

multilateralisation of bilateral negotiations through MFN treatment within GATT). In this way, the generality of the preferences could be assured for preference-giving countries. Although industries to which aid and preferences are extended may be limited, the industries selected would be fully insured by developed countries in the production and marketing of their output. Thus, the aid *cum* preference scheme is potentially more useful than 'general' preference schemes which are only formally general in character. It should be remembered, for example, why British Preferences have benefited developing countries. The benefits derived not so much from the preferences themselves but from all-round assistance with the provision of capital, management, and marketing skills.[18]

Certainly, there are many technicalities of the aid *cum* preference proposal that require further detailed study. For example, what should be the range of aid with which trade preferences are linked? How could preferences be linked with aid through multi-national organisations? There are questions which need to be studied along with ways in which to soften the terms upon which aid is provided, both by developed and developing countries alike.

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[18] See, Donald MacDougall and Rosemary Hutt, "Imperial Preference: A Quantitative Analysis," *Economic Journal*, June 1954, p. 269.