

November 2005

**Policy Space in Historical Perspective**  
**– with special reference to Trade and Industrial Policies<sup>1</sup>**

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<sup>1</sup> An earlier version of the paper was presented at the Queen Elizabeth House 50<sup>th</sup> Anniversary Conference, “The Development Threats and Promises”, Queen Elizabeth House, University of Oxford, 4-5 July, 2005.

## **1. Introduction – the Ever-Shrinking Policy Space**

There is a growing concern that, over the last quarter of a century, the “policy space” available for the developing countries has shrunk so much so that their ability to achieve economic development is being threatened (see the essays in Gallagher (ed.), 2005).

The current phase of shrinkage in policy space started in the 1980s, when the World Bank and the IMF massively expanded their “programme” (as opposed to “project”) loans in the aftermath of the Debt Crisis in 1982 in the form of the Structural Adjustment Programmes (SAPs) – and many of its subsequent re-incarnations, which are too numerous to list – and broadened the scope and enhanced the strength of the conditionalities attached to their loans.

In the early days, the conditionalities set by the Bank and the Fund mainly concerned budget deficits, monetary expansion, privatisation, and trade liberalisation. However, over time, there has been a constant “mission creep”, so much so that, following the 1997 financial crisis, the IMF was actually ordering the Korean government to give independence to the country’s central bank, and, even more amazingly, telling the Korean private sector companies how much debts they can have. These days, there is virtually no area on which the Bank and the Fund do not have (often very strong) influence – democracy, judicial reform, corporate governance, health, education, and what not.

Aid policies of the developed countries have also contributed to the shrinking of policy space. In the old days, the main conditions attached to aid by the donor countries is that the recipients buy (at least a certain portion of) the goods and the services that are needed for the aid-funded projects from the national companies of

the donor countries. However, since the 1980s, the conditions have stretched to include policy recommendations similar to what the Bank and the Fund demand on their loans. This is not surprising, when we recall that after all the Bank and the Fund are controlled by the countries that are main providers of foreign aid to developing countries.

The shrinkage in policy space has been particularly striking in the area of trade and industrial policies. First of all, since the 1980s, the Bank and the Fund have made trade liberalisation – involving tariff cuts, tariffication of quantitative restrictions, and the reduction in non-tariff barriers (NTBs) – a key condition attached to their loans. The conclusion of the Uruguay Round of the GATT talks in 1994 and the subsequent launch of the WTO in 1995 have brought hitherto unthinkable issues into the arena of multilateral trade politics – patents (through TRIPs), regulation of foreign investment (through TRIMs), trade in services (through GATS) – and have also shrunk the space for many of the more “traditional” areas like tariffs.

While it is important to recognise that there is still considerable policy space in the WTO (Akyuz et al., 1998, Amsden, 2005), it should not be forgotten that there is a constant attempt by the developed countries to reduce the remaining space.

For example, in the run-up to the Cancun ministerial meeting of the WTO in September 2003, the developed countries tried very hard – and failed in the end – to put the multilateral investment agreement (MIA), which aims to make virtually all restrictions on foreign direct investment (and possibly those on portfolio investment) “illegal”, on the WTO negotiation agenda (for a critic of the MIA proposal, see Chang & Green, 2003; see Chang, 2003, for an analysis of the result of the Cancun meeting).

Currently, in the run up to the Hong Kong ministerial meeting of December 2005, the developed countries are pushing very hard on the so-called NAMA (non-agricultural market access) negotiations, trying to radically lower industrial tariffs over the next 10 years or so (see Khor & Goh, 2004, Akyuz, 2005, and Chang, 2005, for further details). Especially if the most radical US proposal is implemented, the resulting tariff cuts could be truly drastic.

Even though the “zero-tariff” proposal made by the USA in December 2002 is considered to be a deliberately radical opening gambit, the core US proposal is to bring average industrial tariffs in developing countries down to 5-7% by 2010, 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.<sup>1</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 tables 1 and 2).<sup>2</sup>

And it is not just the WTO that restricts developing countries’ policy space in trade and industrial policies. The developed countries, especially the USA, have used bilateral and regional free-trade agreements (FTAs) and bilateral investment agreements (BITs) to impose on developing countries restrictions that they cannot get accepted in the WTO. And it is not unknown that conditions that have nothing to do with trade policies are imposed in some of the FTAs. For example, when it signed the bilateral FTA with the USA, Chile was required to commit itself not to use any capital control in the future.

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<sup>1</sup> The EC proposal will bring average industrial tariffs down to 5-15%. The Korean and the Indian proposals will bring them down to 10-25% and to 10-50% respectively.

<sup>2</sup> The exceptions are Britain and the Netherlands between the late-19<sup>th</sup> and the early 20<sup>th</sup> centuries, Germany briefly in the late 19<sup>th</sup> century, and Denmark after the Second World War. See tables 3 and 5 for further information.

In addition to these (aid and loan) conditionalities and new international trading rules, the policy space of the developing countries are further limited by the (real and imagined) threat of capital flight in the environment of open capital markets. Fearing the “punishment” by the “foreign investor” (as if all foreign investors share the same interests and want the same things), developing country governments adopt policies that they think (or that they are told will) please the foreign investor – especially in terms of macroeconomic policy, corporate taxation, labour law, and environmental regulation. And there are the international media, the credit rating agencies, consulting firms, and various international organisations, who regularly publish materials that praise countries doing the “right” thing and rubbish those who don’t, although they will do a U-turn when it suits them.<sup>3</sup>

At this point, it is important to note that policy space is also constrained by domestic interest groups in the developing countries themselves. There are those citizens of developing countries whose interests lie in restricting their own government’s policy space. Financiers may want their government to be locked into “prudent” macroeconomic policies through institutions like central bank independence, currency board, autonomous revenue agency, deficit rules, and inflation targeting. Some of them may want their government’s freedom to control cross-border capital movements curtailed or hopefully totally taken away, so that they can take the money out of the country if and when necessary.<sup>4</sup> Exporters of

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<sup>3</sup> For example, the credit rating agencies started downgrading the Asian countries *after* the outbreak of the 1997 crisis. For another example, the IMF started criticising Argentina *after* the policy it used to recommend to the country led to the economic collapse.

<sup>4</sup> The Under Secretary of the US Treasury, John Taylor, is reported to have said that free transfer of capital in and out of a country without delay is a “fundamental right” (testimony on 1 April, 2003, before the Subcommittee on domestic and international

agricultural products may want to keep their government on the “narrow and straight path” of free trade through the WTO, bilateral and regional FTAs, and the restraints by the World Bank and other international organisations. And there are also those who want their own government’s policy space to be restricted for ideological reasons. These days many economists in developing countries are ideologically committed to free market and want the policy space of their governments to be restricted lest that their policies deviate from (what they think are) what the “science” of economic says.<sup>5</sup>

## **2. Policy Space in Historical Perspective**

Policy space may be a new term, but the phenomenon of shrinking policy space is in fact not new. In the days of imperialism, the stronger countries were able to restrict the policy space of the weaker countries in the most blatant way (the details are from Chang, 2002, pp. 51-54; further references can be found there). Therefore, it may be useful to look at the historical experiences in order to put the current debate on policy space in an appropriate historical context.

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monetary policy, trade, and technology of the Committee on Financial Services at the US House of Representatives, as cited in Wade, 2005, p. 92).

<sup>5</sup> And this ideological commitment makes them believe that anything other than strict free-market policies are irrational, short-sighted and giving in to populism. For example, several months before the recent Argentinian financial crisis, Domingo Cavallo, the famous free-market finance minister of the country, wrote an article in the *Financial Times*, and argued that the monetary inflexibility accorded by the country’s currency board was necessary because of his compatriots’ inability to control their spending.

## 2.1 The Age of Imperialism

### (a) Colonies

Policies towards colonies were, naturally, the most limiting in terms of providing the policy space. Typical measures included the following.

First of all, high value-added manufacturing activities were outlawed in the colonies. For example, under Robert Walpole, the British prime minister who is the father of British mercantilist policy, the construction of new rolling and slitting steel mills in America was outlawed, which forced the Americans to specialise in the low value-added pig and bar iron, rather than high value-added steel products.

Second, exports from the colonies that competed with the coloniser's products were banned. For example, the cotton textile industry of India was dealt a heavy blow in the 18<sup>th</sup> century by the British ban on cotton textile imports from India ("calicoes"), which were superior to the British ones. For another example, 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.

Third, 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).

Last but not least, the use of tariffs by colonial authorities were 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%) 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.

#### (b) Semi-Colonies

The weaker countries that were somewhat more fortunate and escaped the fate of colonial occupation were forced into “unequal treaties” that deprived them of tariff autonomy and their jurisdiction over foreigners (“extra-territoriality”) on the ground that their governments were not reliable enough. The deprivation of tariff autonomy involved the imposition of a tariff ceiling, typically at the 5% flat rate.

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 55 years – from 1863 to 1908. From 1824 onwards, Thailand (then Siam) signed various unequal treaties, which ended with the

most comprehensive one in 1855. Persia signed unequal treaties in 1836 and 1857, and the Ottoman Empire in 1838 and 1861.<sup>6</sup>

Even Japan lost its tariff autonomy following the unequal treaties signed after its opening up in 1853 (see table 1). It was eventually able to end the unequal treaties, but that did not happen until 1911 (Johnson, 1982, p. 25). In this context, it is also interesting to note that when Japan forcefully 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.

The larger Latin American countries were able to re-gain tariff autonomy from the 1880s, before Japan did. Many others regained it only after the First World War, but Turkey had to wait for tariff autonomy until 1923, although it came into effect only in 1929 (the unequal treaty had been signed as early as 1838!) and China until 1929.

It is extremely disconcerting to note that binding of tariff at a low, uniform rate (although not necessarily below 5%) 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% for the poorest countries and virtually zero for the more advanced developing countries (pp. 163-4). 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 percent [emphasis added]” (p. 102). And, most disturbingly, industrial tariffs of developing countries will fall to 5-7% (US proposal)

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<sup>6</sup> The 1838 Convention of Balta Liman with Turkey (then the Ottoman empire) bound Turkish import duties at 3% (Fielden, 1969, p. 91).

or to 5-15% (EU proposal), if the proposals from the developed countries get adopted at the NAMA negotiation.

## **2.2. The Post-Imperialist Era – Expansion and Contraction of the Policy Space**

Having looked at the historical experience, some may point out that the developing countries still have a lot more policy space than what they used to in the days of imperialism. This is absolutely true.

However, we cannot console ourselves with that knowledge. First of all, the currently available space is under constant threat. And, more importantly, history shows that things could be better than what they are now.

There was a period between the end of the Second World War and the Second Oil Shock when the developing countries were allowed quite a large policy space. The World Bank and the IMF operated with fairly restricted (and still valid today, in theory) mandate – financing of infrastructural development and the provision of liquidity in times of short-term balance-of-payments crises, respectively – and attached few conditions on policies outside these narrow areas. While the developed countries were whittling down many of their tariffs at the GATT during this period, the developing countries were mostly left to do what they saw fit in terms of tariffs and other trade policy matters. There was no “single undertaking” in the GATT, as it is the case with the WTO, so countries could even opt out of some agreements that they were not happy with.

And this is when the developing countries did the best economically, despite the orthodox propaganda that portrays it as the “bad old days” of import substitution (the following data are from Chang, 2002, ch. 4). While they had minimal growth, indeed often negative growth, during the period of colonialism and unequal treaties,

the developing countries recorded exceptional economic growth during the 1950s to the 1970s.<sup>7</sup> In the 1960s and the 1970s (we are excluding the 1950s, as many developing countries did not gain their independence until the 1960s), per capita income in the developing world grew at 3%, a rate two to three times higher than what was experienced by the developed countries in the 19th century during their Industrial Revolution (1-1.5%). Some countries grew much faster than that, making people talk of “miracle”. Per capita income in countries like Japan (then still a developing country by any reasonable definition), South Korea, Taiwan and Singapore grew at 5-6% per year, doubling the income in 12-13 years, as opposed to 70 years that it would have taken had they grown at 1% per year, as it was the case with many European countries during their Industrial Revolutions in the 19<sup>th</sup> century.

To be sure, the period between the 1950s to the 1970s should not be idealized as some sort of golden age. Aids often came with strings, while there were still a lot of informal influences by the former colonial masters in the management of the economy in many developing countries. The talk of “neo-colonialism” was not simply a radical propaganda. Moreover, the episode was not a totally “innocent” one. There were the Cold War considerations on the part of the USA and other rich capitalist countries, while the developing countries knew and exploited them to the full, often playing the Great Powers against one another. However, compared to the subsequent (and previous) period, the period certainly qualifies as a period when the strong allowed them the weak much bigger policy space.

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<sup>7</sup> Between 1900 and 1950, the Asian developing countries that were colonies or semi-colonies grew extremely slowly. Annual per capita income growth rates were -0.3% for China, -0.1% for India-Pakistan-Bangladesh and Indonesia, 0.1% for South Korea and Thailand, and 0.4% for Taiwan and the Philippines. The data is from Maddison (1989).

From the 1980s, however, the picture started to change. The 1970s debate surrounding the New International Economic Order (NIEO), where a more equal relationship between the developed and the developing nations was called for by the developing countries, galvanized many developed countries into putting the developing countries into their places. This tendency became quite serious with the election of various neo-liberal governments in the developed countries since the late 1970s, starting with the Thatcher government in 1979 in the UK. In the 1980s, the USA became quite aggressive in its dealings with all trading partners, believing that “unfair” practices by its trading partners (e.g., non-tariff barriers, lax intellectual property rights laws) are largely to blame for its relative economic decline. And with the end of the Cold War in the 1990s, the developed countries have become a lot more aggressive in demanding from the developing countries policies that they claim promote development but in fact hamper it.

The important thing to note is that, despite adopting free-trade and other “good” policies, the developing countries have been doing much worse in the last quarter of a century than they used to in the two decades of supposedly disastrous “import substitution” industrialisation during the 1960s and the 1970s. During the last quarter of a century, per capita income in the developing countries have been growing at around half the rate that used to prevail in those countries in the 1960s and the 1970s (roughly 3% vs. 1.5%). Per capita income in Sub-Saharan African countries have actually been shrinking in the last quarter of a century. Income distribution has worsened in the majority of the developing countries, while poverty has increased in many of them. Neo-liberal policies may not be totally responsible for such poor performance, but at the least we can say that those policies have failed to deliver their central promise of accelerated growth.

### **3. Policy Space for Trade and Industrial Policies in the Present Context – A Critical Look at some Key Underlying Principles**

Having put the issue of policy space in its present and historical contexts, let me discuss it in more concrete terms, using the case of policy space for trade and industrial policies as an example, with an emphasis on the NAMA negotiation, which is currently the most important issue at the WTO.

The most useful way to do this may be to critically examine some of the key principles that govern the negotiation processes surrounding the international trading system today and expose their internal contradictions and limitations.

#### **3.1. The “Level Playing Field”**

In the push for the reduction in policy space for developing countries, the rhetoric of level playing field is usually deployed as the most important principle that justifies a drastic shrinkage in that space. 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.

Level playing field is like, as the Americans say, motherhood and apple pie. It is *definitionally* good that it is difficult to oppose it. But it is something that has to be opposed if we are going to build a world trading system that is truly pro-developmental.

Needless to say, level playing field is the right principle to adopt when the players are equal. However, when the players are unequal, it is the wrong principle to apply. For example, 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 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 not have been allowed to box Roberto Duran, the legendary Panamanian boxer, and take away his titles, however likely his victory was.<sup>8</sup>

Weight classes are not the only thing to prevent competition on an equal footing among unequal players. In many sports, including football itself 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 his 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 negotiation, 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 wearing protective gear for his abdomen (agriculture and textile?) on the ground that it is his weak part, we begin to

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<sup>8</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).

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), we begin to see how absurd the rhetoric of 'level playing field' is in the present world trading system.

### **3.2. "Special and Differential Treatment" and "Less-than-full Reciprocity"**

There is, naturally, some unease with the rhetoric of 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 and why the developed countries in the NAMA negotiation say that they happy with "less than full reciprocity" (LTFR) from the developing countries. However, there are serious problems with these "concessions" in the forms of SDT and LTFR.

The problem with SDT is the word "special". To call something "special treatment" is to say that the person getting the treatment is getting an unfair advantage. However, in the same way we wouldn't call stair-lifts for wheelchair users or Braille writings for the blind "special treatments", we should not call the higher tariffs and other means of protection more extensively (but not exclusively) used by the developing countries "special treatments" – they are just differential treatments for countries with differential capabilities and goals.

The notion of LTFR should also be questioned. The notion implies that the developing countries will give less than will the developed countries in the NAMA deal. 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 far as he is treating his rich friend often enough and generously enough, *given his means*. Likewise, even a small cut in tariff may be a lot to ask for a developing country desperate to preserve jobs, develop 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 industrial capabilities.

So, when the tariff cuts asked from the developing countries are much larger in their impacts – due to their greater absolute magnitudes and, more importantly, 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 (although even this is not necessarily the case<sup>9</sup>).

### **3.3. The One-Way-Street View of Flexibility**

The developed countries have tried to sell certain agreements in the WTO to the developing countries on the ground that they give enough flexibility to the latter countries – mainly in the form of keeping some sectors off the agreements. So GATS is said to be flexible because it allows countries to keep some sectors off their market-opening commitments. The same notion of flexibility was bandied about in the (now-dormant) negotiation for the MIA in the run up to the Cancun ministerial meeting in

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<sup>9</sup> 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% to 1.3% (EC formula) or 0.7% (US formula) and that of the USA will go down from 3.2% to 1.7% (EC formula) or 1.0% (US formula). These may be large cuts in proportional terms, but are not larger even in proportional terms than in the case of some developing countries. For instance, the Japanese cut according to the US formula will be about a 70% cut (from 2.3% to 0.7%), whereas the cut for Indonesia will be 82% (from 35.6% to 6.3%) and that for Brazil will be 80% (from 30.8% to 6.2%).

2003. In the 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 liberalised, 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 there is a reasonable ground for it. For example, if a country genuinely under-estimated the adjustment costs when it made a decision to cut the tariffs in particular industries – as it was in fact case with many developing countries in the Uruguay Round – it may be reasonable to allow that country to raise tariff ceilings in those industries. For another example, a country may have set low tariff ceilings in certain industries because it under-estimated the capabilities of domestic producers and did not think any infant industry protection would ever become necessary in those industries. However, it should be allowed to raise tariff ceilings if it later finds that after all there is some hope of viable domestic producers emerging with stronger tariff protections in those industries.

More importantly, it should be recognised 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 are 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

it 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).

### 3.4. National Autonomy – “The Right to be Wrong”

Many free-trade economists like to present themselves as defenders of the interests of the developing countries. The World Bank, for example, 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 wants to be seen as protecting the developing countries from harming themselves by employing policies that have little chance of success. Interestingly, Adam Smith was doing the same for the Americans in his *Wealth of Nations*, when he was advising them not to protect manufacturing.<sup>10</sup>

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 men”, who would benefit from free trade. For example, right after the collapse of the Cancun ministerial talk of the WTO in September 2003, Willem Buiters, the then chief economist of the EBRD (European Bank for Reconstruction and Development), lamented that “although the leaders of

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<sup>10</sup> 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, 1973 [1776], pp. 347-8).

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>11</sup>

Thus seen, whichever variant of the free-trade view one takes, the shrinking of policy space for developing country governments in the area of trade and industrial policies is 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).

What is curious, however, is that that the free-trade economists who display such paternalistic attitude to the developing country policy choice are usually people who would vehemently denounce most government regulations for their underlying paternalism and argue for individual “freedom to choose”. They would say that governments should not try to restrict people’s freedom of choice out of fear that they may make “wrong” choices, because, after all, the ability to make mistakes and learn from them is the genuine sign of autonomy and free choice.

There is something deeply troubling about this. A consistent free-trade economist who values autonomy and choice for individuals should 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, in which case they are contradicting themselves. If so, they cannot avoid the accusation of employing a double standard. They passionately advocate the individual’s “right to

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<sup>11</sup> “If anything is rescued from Cancún, politics must take precedence over economics”, letter to the editor, *Financial Times*, 16 September 2003.

be wrong”, on the ground of individual autonomy, but they are not willing to respect national autonomy of the developing countries, thus denying them the same “right to be wrong”.

## **Conclusion**

Policy space is a matter of vital importance. Long-range historical records suggest that it has an enormous influence on a country’s ability to achieve economic development. When they were colonies or subject to unequal treaties, the developing countries experienced extremely slow economic growth (and we are not even taking into account the issues of political legitimacy, cultural/racial domination, and social inequity associated with colonialism and imperialism). When they were allowed quite large policy space between the 1950s and the 1970s, their growth accelerated beyond expectation. Once the policy space started shrinking from the 1980s, their average growth rate fell to half of what it was in the “bad old days” of import substitution in the previous period.

Historical comparison shows that the policy space available for today’s developing countries is in fact not the smallest by historical standard. However, policy space for developing countries has been constantly shrinking over the last quarter of a century and it is at the risk of shrinking even further, to the point of making the use of any meaningful policy for economic development impossible.

In the paper, I argued that, in order to properly address the issue of policy space, we need to critically re-examine the principles that dominate international negotiations, especially in relation to trade and industrial policies, What pass in today’s international policy negotiations for principles of level playing field, special

and differential treatments, less-than-full reciprocity, flexibility, and national autonomy were critically examined and their contradictions and limitations were exposed. I argued that the notion of level playing field needs to be ditched as a fundamentally unfair principle for the weak. The notions of autonomy, reciprocity, and flexibility employed in international policy negotiation, it was argued, need to be rescued from their present Orwellian distortion, where they mean almost the exact opposite of what they normally mean.

Urgent action is needed. If nothing is done, the policy space available for developing countries will shrink to virtually nothing over the next several years, which could spell the end of development.

**Table 1. 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
Denmark	25-35	15-20	14	10	n.a.	3
France	R	12-15	20	21	30	18
Germany <sup>5</sup>	8-12	4-6	13	20	21	26
Italy	n.a.	8-10	18	22	46	25
Japan <sup>6</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.

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. The 1820 figure is for Prussia only.
6. Before 1911, Japan was obliged to keep low tariff rates (up to 5%) through a series of "unequal treaties" with the European countries and the USA. 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%, 19%, 4%.



**Table 2. 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			
W. 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+ <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

Source: Chang (2005), p. 54, table 5.

Notes:

1. EEC average after 1973 includes Denmark and the UK.

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%, which was considerably higher than that of Japan (7.55%), which had 18% average industrial tariff rate, or that of Austria (8.57%), which had 20% average industrial tariff rate. Given these, it would not be unreasonable to estimate that Finland's average industrial tariff rate in the mid-1960s was well over 20%.

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