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TRADE POLICIES, STRUCTURAL ADJUSTMENT AND ECONOMIC REFORM: DEVELOPMENTS RELATING TO STRUCTURAL ADJUSTMENT POLICIES IN DEVELOPED COUNTRIES AND THEIR IMPLICATIONS

Report by the UNCTAD secretariat

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Summary and conclusions

1. Structural adjustment pressures are likely to increase in the world economy. Developed countries, in particular, will need to adjust in response to growing competition that will result from the implementation of Uruguay Round commitments, from the increasing liberalization of entire hitherto highly protected production sectors and, in the case of some countries, from growing regional integration.

2. Continuous investment, disinvestment and relocation in line with changes in comparative advantage, as well as technological innovation and human skill development, are at the heart of the structural adjustment process. Enterprises increasingly pursue corporate strategies on a global scale to take best advantage of each country’s ability to produce.

3. Besides trying to ensure macro-economic conditions which are favourable to the adjustment process, governments of developed countries have implemented structural adjustment policies which aim to influence the micro-economic process of adjustment, in particular through assistance with investment, innovation, R & D and labour training. Structural adjustment policies are still anchored essentially in a national setting.

4. Governments recognize that such policies need to have a "positive" approach which promotes structural adjustment in line with changes in comparative advantage. They are increasingly emphasizing the importance of support for investment in technological innovation, basic research and human skill development to promote shifts in production patterns into new technology- and skill-intensive industries where they see their comparative advantage. Moreover, support for traditional industries has been provided to a greater extent to assist with moves within these industries into competitive higher-value products.

5. Such orientation of adjustment assistance may encourage developed countries to move out of production in many low- and middle-market segments of traditional industries where many developing countries and economies in transition have competitive supply capabilities.

6. However, assistance policies are not fully committed to the exit from unviable lines of production in traditional sectors. Subsidies in support of such production are still provided, as well as import protection, in response to political and social constraints. But such aid denies new market opportunities to competitive suppliers in lower-cost countries. Governments would need to show greater resistance to pressures to grant wasteful subsidization. Assistance which helps shift output into competitive up-market segments may be linked more rigorously to the termination of unviable capacities.

7. A growing number of developing countries are, for their part, moving their export supply capabilities into more skill- and technology-intensive industries. They will gain new market opportunities through intra-industry specialization. However, liberal market access will be a crucial prerequisite.

8. A number of developed countries are increasingly directing assistance with labour training towards adapting workforce qualifications to the skill requirements of expanding sectors. They also aim to strengthen the adaptiveness of industries through assistance to workers with "life-time learning". Such training policies may help to reduce reliance on sectors with declining competitiveness as a source of employment and thus facilitate the disengagement from these sectors.

9. Adjustment assistance in agriculture has not as yet led to significant adjustments based on comparative advantage. Assistance would in particular need to promote a restructuring in line with shifts in competitive positions that will result from the longer-term process of liberalization initiated by the Uruguay Round.

10. Governments need to examine carefully the compatibility of adjustment assistance with GATT rules, in particular the Uruguay Round Agreements on Subsidies and Countervailing Measures and on Agriculture. Such compatibility helps ensure that the market opportunities of trading partners are not adversely affected.

11. Policies which stimulate "cross-border" adjustments at global levels should play a more important role. Developed countries’ policies widely neglect support for the relocation of declining lines of production to those developing countries and economies in transition that have a comparative advantage in these activities. Schemes of developed countries in support of FDI and other forms of industrial cooperation may serve to a much greater extent to facilitate such relocations.

12. A major objective of the formation of large economic spaces (European Union, NAFTA) has been to raise competitiveness through a process of structural adjustment which is induced by economic integration. Such policies need to be outward-oriented. They should not dampen the impact of import competition on a more efficient reallocation of resources within regions.

13. Policy makers in developed countries must pay greater attention to the contribution of structural adjustment policies to positive adjustment in industries in which liberalization in fulfilment of Uruguay Round commitments is likely to lead to increased imports from developing countries and economies in transition. Important cases in point are agriculture, textiles and clothing. Structural adjustment policies, both horizontal and sector-specific measures, which can facilitate further the opening-up of new market opportunities in such industries require more in-depth analysis.

INTRODUCTION

14. At its eighth session, the United Nations Conference on Trade and Development recognized that the translation of a new international partnership for development into operational terms required mutually supportive efforts at the national and international levels. In this context, structural adjustment in developed countries was seen as one avenue, among others, to ensure the enhanced participation in the world economy of developing countries and countries undergoing the process of transition to market economies (para. 63 (1) of the Cartagena Commitment). The Conference stipulated that the Board would address at one part of its regular annual sessions a topic related to trade policies, structural adjustment and economic reforms (para. 66 of the Cartagena Commitment).

15. At the first part of its thirty-ninth session (28 September to 14 October 1992) the Board considered issues relating to national transparency mechanisms in the context of the fight against protectionism. A specific topic on trade policies ("Trade policy reform in developing countries and the international support required") was considered at the second part of the thirty-ninth session (15 to 26 March 1993). At the second part of the fortieth session (18 to 29 April 1994), a topic related to economic reform ("Increased participation in international goods and services by developing countries and economies in transition: some problems and opportunities") was addressed. At the second part of its forty-first session (spring 1995), the Board will turn its attention to structural adjustment by considering developments relating to structural adjustment policies in developed countries, and their implications.

16. This report has been prepared to facilitate the Board's deliberations. The report assesses major features of structural adjustment policies of developed countries against the backdrop of a world economic setting which is characterized by the gradual opening of frontiers to free trade, growing economic integration across national borders, rapid technological changes and equally fast changes in the skill requirements of the workforce.

Chapter I

STRUCTURAL ADJUSTMENT POLICIES OF DEVELOPED COUNTRIES

A. Overview

17. In the years to come, the pressures on economic agents to adjust will increase in many countries. Above all, adjustment pressures are likely to grow as and when the liberalization commitments of the Uruguay Round are implemented and lead to a greater exposure of domestic producers to international competition. Furthermore, policies directed at regional economic integration will induce structural adjustment beyond the realm of national economies.

18. In the agricultural sector, the Uruguay Round has initiated an important longer-term process of liberalization. In a shorter-term perspective, additional trade flows as a result of access commitments and tariff reductions may prove to be significant only for a few agricultural products (e.g. beef, certain dairy products, some vegetables, fruit and fruit preserves) as tariffication has resulted in rather prohibitive tariff levels in many cases.

19. In industry, improvements in market access will be more immediate and lead more rapidly to new adjustment pressures. Besides tariff reductions, liberalization in the area of non-tariff measures, in particular the phase-out of grey area measures by the Uruguay Round Agreement on Safeguards, will add considerably to the exposure of domestic markets to import competition. Tariffs have, for instance, been eliminated in many product lines in the pharmaceutical, steel, farm equipment, furniture and toys sectors. Significant tariff reductions have been made in some major markets in a greater number of product lines in the footwear sector. In textiles and clothing, import competition will build up over the 10-year transition period at the end of which the Multi-Fibre Arrangement with its numerous quantitative import restrictions, will be terminated and the sectors be reintegrated into GATT.

20. The Ad Hoc Working Group on Trading Opportunities in the New International Trading Context will undertake a detailed analysis of new market opportunities arising from the implementation of the Uruguay Round agreements. The findings will allow an assessment of new adjustment pressures at sectoral levels in developed countries.

21. In a market economy, the main initiative and responsibility for structural adjustment lie with entrepreneurs and the members of the workforce. The role of governments, first of all, is to put in place "framework conditions" which are favourable to the process of adjustment. Thus, governments have to: (i) maintain a stable macroeconomic environment; (ii) secure a competitive economic environment and, more specifically, openness to international trade and investment; (iii) create an environment of fiscal and monetary policies which are conducive to capital formation; (iv) avoid over-regulation in financial and labour markets, and promote wage flexibility; (v) provide physical infrastructure; (vi) ensure a high level of educational attainment and professional training; and (vii) maintain an adequate level of social protection.

22. Notwithstanding these measures, markets can fail to fulfil their resource allocative functions satisfactorily. Besides trying to ensure favourable macroeconomic conditions, governments have therefore also implemented structural adjustment policies which aim to influence the process of adjustment at the micro-economic level, in particular by providing assistance to industries and the labour market. Such policies need to have a "positive" approach which promotes structural adjustment in line with shifts in comparative advantage. They must complement market forces, but also ease the position of people who are hurt in the adjustment process.

23. The OECD has articulated certain principles to guide policies of "positive" structural adjustment. Noting that government support will, as a rule, only be justified if the economic or social cost of the necessary adjustments are likely to be unacceptably high in the short run, the OECD holds that assistance should be temporary, transparent (e.g. observable by trade partners), linked to the phasing out of obsolete capacity and free of protectionist measures against imports. 1/

24. Actual structural adjustment policies have deviated from these principles in many cases. As a result, there remains substantial need for action to foster structural adjustment in those sectors which will become increasingly exposed to international competition in the medium term: textiles, clothing, steel, shipbuilding, agriculture, certain services and others. A second task ahead is a thorough re-evaluation of the policy instruments applied: to what extent have they been efficient and met the requirements of a "positive approach"? Possible criteria include the extent to which they promote flexibility, facilitate shifts in production, stimulate innovation, or cushion adverse social effects of opting out of production lines and of plant closures.

25. Positive adjustment policies may considerably enlarge market opportunities for third countries and improve worldwide efficiency of production and development prospects. Most of the remaining sensitive sectors are of particular export interest to developing countries. However, present support policies of developed countries are essentially geared to improving the competitiveness of their domestic production and exports. Creation of new export opportunities for developing countries is not a primary consideration, but rather a side-effect of such policies. None the less, disengagement from unprofitable sectors or shifts into higher-quality products could open up markets for exports from developing countries.

26. While corporate strategies are becoming increasingly global, national structural adjustment policies essentially lack a global dimension. It would appear useful to explore to what extent developed countries could employ the promotion of international enterprise cooperation and the relocation of production (and stages of production) as instruments of a positive structural adjustment policy. Such support could help increase the international competitiveness of their enterprises, facilitate existing trends in enterprise strategies, and widen their scope for small- and medium-scale enterprises. Use of regional integration for structural adjustment purposes is on the increase. However, substantially greater opportunities for solving structural

adjustment problems through enterprise cooperation lie in a number of developing countries and economies in transition. Structural adjustment policies should therefore move from national and regional perspectives to a global one.

B. Structural adjustment policies of developed countries in the industrial sector

27. At the industry level, structural adjustment requires continuous capital formation and innovative efforts which introduce new product and process technologies, boost the production of higher value-added goods and diversify into new growth sectors, while declining lines of production have to be discarded or relocated in lower-cost economies. Investment, disinvestment and relocation in line with changes in comparative advantage, and technological innovation and human skill development are at the heart of a "positive" structural adjustment process. In this context the question arises as to what an extent actual government policies correspond to this concept.

28. Governments of developed countries have put in place a wide range of support schemes, horizontal or sector-specific in their orientation, which assist in particular with investment, R & D and labour market training, besides regional aid programmes and export promotion measures. The total cost of these support programmes has been estimated to average $66 billion per annum over 1986-1989, representing approximately 2.5 per cent of total value added in manufacturing industries in developed countries. 2/ The order of magnitude of government support has not changed dramatically since then. Estimates of the cost incurred by developed countries to protect sensitive industries and agriculture exceed these sums by a multiple.

29. Three types of positive adjustment instruments appear to offer particularly interesting perspectives with regard to external effects and global efficiency gains: (i) assistance to research and development and innovation; (ii) assistance to sensitive industries; and (iii) assistance to labour training.

1. Assistance for research and development and for innovation

30. Government policies attach increasing importance to support for investment in technological innovation, basic research and human skill development. The communication of the European Commission on "Industrial policy in an open and competitive environment - guidelines for a Community approach" stresses that "a positive approach to industrial adjustment" implies recourse to policies which develop technological capacity and human capital as key determinants of industrial competitiveness. 3/ The Fourth Technology Framework Programme of the European Union (1994-1998) has increased the resources in support of innovation investment and R & D to ECU 13.1 billion as compared to ECU 8.6 billion for the Third Framework Programme (1990-1994).

31. In the same vein, the approach of the United States of America is placing greater emphasis on the promotion of civilian research in key technology areas and human resource development. A technology programme of some $12.5 billion sets out a number of initiatives for bolstering the country’s competitive strength through the encouragement of investment in various fields of

technology of long-term significance. In Japan, MITI's vision of the country's science and technology policy for the 1990s has placed greater emphasis on basic research. 4/ The relative neglect of such research in the past had become a serious constraint on the further up-grading of industrial production structures.

32. The rationale of the new emphasis on investment in R & D, innovation and human skill development is to enhance the competitiveness of national production bases through the promotion of shifts in production patterns into new technology- and human-skill-intensive industries where developed countries see their comparative advantage. Similarly in traditional industries, assistance with innovation, plant and equipment modernization, and skill development has been provided to a greater extent to move output within these industries into competitive higher value-added products and to raise productivity. To some extent, assistance has also helped to diversify traditional production into other more promising sectors.

33. Where firms use support to move into higher quality products, their withdrawal from lower market segments should open up new market opportunities. However, R & D support can also strengthen productivity and competitiveness of mature industries and may, therefore, raise concern that developing countries might lose the advantage of their low labour cost (see chap. II). With regard to certain high-technology industries, some developing countries which are about to enter world markets in such sectors may face difficulties to match the combined financial capacity of developed countries' enterprises and government support for R & D and innovation.

2. Assistance to industries in difficulties

34. In the European Union, governments have to a substantial extent relied on protective measures to shield industries in difficulties from external competition. These defensive policies have coexisted with positive assistance measures which have facilitated structural adjustment. Such assistance, in particular with capital investment, R & D and innovation activities, is seemingly gaining ground and has, for instance, helped the textiles, clothing, leather and footwear industries to move production into higher-quality, high-fashion and more differentiated goods and raise productivity.

35. Investment aid has helped the shipbuilding industry to move into the production of more technologically advanced ships. Research programmes of the European Coal and Steel Community aim to strengthen the competitiveness of the steel industry through the development of new product technologies and production processes, with particular emphasis on promoting the use of steel *vis-à-vis* competing products in a number of applications (e.g. transport, engineering, energy, environment). In the electronics sector, government assistance, essentially with R & D activities, has been made available to reduce Europe's lag in semi-conductor component technology.

36. Assistance under regional development programmes has also been provided to strengthen the competitiveness of industries with adjustment problems (e.g. agro-industries, textiles and clothing, footwear). They also assist with the diversification of production into new activities with better growth potential (e.g. electronics, telecommunications technology, information technology,

measurement technology). The experience gained offers a mixed picture of successes and failures. A key difficulty with moving into "sunrise" industries has been a relative lack of receptiveness to new technologies and scarcity of skilled human resources in less developed regions.

37. Many traditional production sectors have continued to benefit from subsidies which enabled firms to maintain uncompetitive lines of production and, hence, inhibited structural adjustment, rather than promoting it. The steel sector and the motor vehicle industry have been prominent cases in this regard. Subsidies have sometimes even been granted to establish new capacities in sectors which already suffered from overcapacity. Regional aid has, to some extent, also served to keep uncompetitive production in operation. Grey area measures such as the use of anti-dumping and countervailing measures with a protectionist intent have also helped to maintain uncompetitive activities.

38. Such policies have largely been implemented in response to political and social pressures. Vested interests have lobbied for the subsidization of uncompetitive industries, and an unfavourable economic environment, characterized in particular by high and persistent unemployment, has heightened the social hardship of plant closures. Thus, governments are not as yet fully committed to the disengagement from unviable production capacities in traditional industries.

39. Little assistance has been made available to help enterprises to disengage from uncompetitive sectors. Such aid has mainly been provided to cushion the social cost of plant closures, in particular through support for early retirement schemes. Aid of this kind has been confined to a few sectors, especially steel and shipbuilding, which were important at the regional level and, therefore, posed particular political and social problems.

40. The European Commission is striving to keep aid by member States under tight surveillance. The Commission monitors the compatibility of State aid with the competition rules of the Treaty on European Union. Sector-specific codes on State aid have been established for the shipbuilding, steel, synthetic fibres, motor vehicles and textiles and clothing industries. The Commission’s basic policy orientation is to restrict aid by member States for industries in difficulties to cases where government-assisted restructuring is likely to re-establish the longer-term viability of the aid recipient. Assistance with investment in modernization and innovation should serve to shift production "up-market" and improve productivity. Moreover, the authorization of investment aid has increasingly been linked to the implementation of capacity reductions, in particular in textiles, clothing, synthetic fibres, steel and shipbuilding. However, in the case of investment aid under regional programmes the Commission has generally shown a more lenient attitude.

41. Japan began in the late 1970s to manage structural adjustment within a comprehensive legislative framework which applied indiscriminately to all industries that came under adjustment pressures. 5/ All together, some 25 industries received assistance within this framework: 3 mineral

processing industries (electric furnace steel, aluminium, and ferro-silicon), 5 synthetic fibre industries, 5 petrochemical industries, 5 chemical fertilizer industries, 2 textile industries (cotton and wool), and the linerboard, shipbuilding, paper production, cement and sugar refining sectors.

42. A major objective of assistance was the reduction of underutilized, high-cost capacities in accordance with industry-specific Structural Improvement Plans. Exemptions from the Anti-Monopoly Act allowed firms to form "capacity-reduction" cartels, "business tie-ups" and mergers. Furthermore, modest financial assistance backed up capacity reductions.

43. In 1983, government policy shifted, to some extent, from "adjustment out" towards "modernization". In addition to help with the downsizing of capacities, assistance to industries under adjustment pressures was provided for modernization of plant and equipment, product improvements and developments, and shifts into new lines of production. A major government tool has been industrial credit programmes administered by government development banks.

44. Actual capacities scrapped have on average amounted to 98 per cent of the targets set in the Structural Improvement Plans. 6/ Still, it is difficult to determine the efficiency of government assistance in bringing about these capacity reductions. Much depends on the degree to which the achieved reductions deviate from an outcome which would have resulted from the operation of market forces. Some analysts have pointed out that the conservatism displayed in setting capacity-reduction targets has prevented more important reductions that would have happened under normal market forces. 7/

45. In 1987 facilities for forming capacity-reduction cartels were terminated, but fiscal and financial support measures were retained to assist industries under adjustment pressures with restructuring efforts. The number of "depressed" industries receiving adjustment assistance was reduced considerably. MITI’s latest "vision" of the process of industrial restructuring, promulgated in 1994, confirmed the shift towards a greater determination of capacity reductions in declining industries through the influence of market forces. 8/ Moreover, since the mid-1980s, strategies of industrial relocation in lower-cost countries have played an important role in the adjustment process (see chap. IV).

46. The United States has generally relied on trade-oriented and primarily protective measures, such as tariffs, quotas, or voluntary export restraints to ease adjustment pressures on industries in difficulties. Anti-dumping and countervailing measures have also been applied upon the initiative of industries under import pressure. Moreover, military procurement and research have been used as tools to support civil industries. Financial assistance, however, has been relatively sporadic at the Federal level.

47. A greater number of typically smaller industries with adjustment problems have obtained temporary import protection by petitioning the International Trade Commission (ITC) of the United States. Such temporary protection has been granted on the basis of section 201 of the Trade Act of 1974 (which followed article 19 of GATT) with a view to "preventing serious injury or

threat thereof to the industry ... and facilitating the orderly adjustment to new competitive conditions". Since 1988, an industry requesting relief has been encouraged to submit a plan with concrete steps to adjust to foreign competition. Such a plan is an important factor in decisions on whether or not relief will be granted.

48. However, the ITC's safeguard route has not, as a rule, been used by large declining industries. Such industries have rather exerted political pressure to obtain protection which typically lasted much longer than the four- or five-year customary period of the ITC's escape clause relief. The main industries which succeeded at this level were textiles and clothing, steel, automobiles and, in the agricultural sector, meat and sugar.

49. Some analysts have pointed out that many industries which had been given temporary protection by the ITC had undergone considerable adjustment. 9/ In many cases firms reduced or eliminated productive capacities during the period of protection and managed to remain competitive. While some industries returned to the ITC in efforts to secure additional protection, the ITC generally found that adjustment had occurred, so that the remaining firms required no further protection to escape injury.

50. This has been taken as an indication that trade relief via the ITC's safeguard route has facilitated adjustment relatively successfully. The key to adjustment in these cases has been seen in the fact that protection was credibly regarded as temporary so that firms had no choice but to yield to market pressures. In contrast, in industries which had received protection of a more permanent nature through political pressure, there had been little evidence of strengthened competitiveness, although employment had decreased. 10/

51. Causality between temporary protection and positive adjustment, however, is hard to establish. Capacity reductions would most likely have resulted to an even greater extent without protection. Moreover, protection has narrowed market opportunities of more competitive foreign suppliers, in particular from developing countries.

3. Assistance with labour training in support of structural adjustment

52. In most developed countries, the skills profile of labour required in expanding industries does not, to a large extent, coincide with the qualifications of workers released by contracting industries. Government assistance with labour training aims to help mitigate this "structural mismatch" in labour markets. In practice, however, such assistance has often not been very effective in facilitating employment transition and has encountered various difficulties.

53. First, retraining has proved to be particularly difficult in the case of workers made redundant in import-competing mature industries where many developing countries and economies in transition have competitive export supply capabilities, due to the high proportion of older workers and those with relatively low skills and educational levels.

54. Secondly, training activities have in many cases inadequately responded to labour market needs. Emphasis has, in large part, been placed on basic training of the unemployed, rather than on training for higher-level skills. Thirdly, the financial resources available for assistance with labour training are relatively limited. In nearly all developed countries, government resources spent on training schemes amount to less than half a per cent of GDP (while expenditure on unemployment benefits ranges up to 5 per cent of GDP). Finally, in less developed regions where training is most needed, there is seemingly least provision for training facilities.

55. The contribution of government-supported training programmes to structural adjustment would be strengthened if they were, to a greater extent, designed to respond to the manpower demands of expanding industries, impart the knowledge and skills required for the use of new technologies and adapt workers to more complex organizational structures of production. Moreover, the development of training programmes in close consultation with the business sector would help to ensure that they meet enterprise needs and support on-the-job training.

56. Thus, in the European Union, the "adaptation (of workers) to industrial changes and to changes in production systems, in particular through vocational training and retraining" was added as a further major objective of financial assistance from the Community Structural Funds, in particular the European Social Fund (see art. 123 of the Treaty on European Union). In line with this objective, the European Union assists training programmes for workers and managers who are in employment but are likely to be affected by industrial change. Attention is also given to improving the adaptative strength of industries through regular access of workers and employees to training throughout their working lives. The intention is to safeguard employment and develop new employment possibilities for persons at risk of unemployment through timely retraining in line with structural change, rather than having to finance efforts to reintegrate workers made redundant into the labour force. The implementation of this strategy requires that enterprises analyse and anticipate correctly and in good time changes in the skill and qualification needs of their workforce. Such training-related assistance is likely to become more sector-specific and assign in future growing importance to the link between training and jobs (e.g. courses which combine a theoretical stage with practical experience in the workplace).

57. Increased financial resources would allow a wider participation in training programmes. At present, participation amounts to less than 3 per cent of the labour force in most developed economies. Few of them have recorded a participation of more than 5 per cent. These participation rates are low in light of the increasing need for frequent retraining of workers. On the other hand, it should not be overlooked that bleak employment prospects may constitute a disincentive for unemployed labour to seek retraining.

58. In the European Union, ECU 2 billion have been allocated to the new training-related objective of Structural Fund finance during 1994-1999 for retraining workers in sectors undergoing particularly severe structural changes (including textiles and automobiles). Assuming that retraining costs

about ECU 10,000 per worker, and that funds of the European Commission bear half of this amount, 80,000 workers could be retrained under this facility. 11/

59. In the United States the number of participants in training schemes under the Job Partnership Training Act (JTPA) has rarely exceeded 100,000 in any one year in the 1980s, while on average some 4 to 5 million workers annually involuntarily lost their jobs. Under the Trade Adjustment and Assistance Programme (TAA) which provides training benefits to displaced workers in cases where imports contributed to their job losses, the average number of workers who received training amounted to about 12,000 participants per year in 1980-1990. 12/ Likewise, State programmes have covered only a tiny proportion of the workforce that required remedial training and skill upgrading.

60. Similarly, the take-up by potential beneficiaries of assistance under government-supported training schemes has been very limited in Japan, even in industries that have faced severe difficulties such as textiles, steel, and shipbuilding. However, in Japan private efforts of employers, the workers made redundant and trade unions have been most successful in identifying alternative employment opportunities and raising skill levels. Large firms have generally endeavoured to ensure long-term job security for their core labour force through a life-time employment system. Employment adjustment has been facilitated by a purely private practice of placing discharged employees in jobs with other enterprises in the same business group. Moreover, such redeployment was made easier by an increasing diversification of production in large firm conglomerates. Employees have, on their part, shown a high degree of intersectoral and geographical mobility. Low unemployment rates in Japan reflect the relative success of employment strategies of the private sector in reallocating workers to new competitive industries.

C. Structural adjustment policies of developed countries in the agricultural sector

61. Adjustment assistance has not as yet led to significant structural adjustment in agriculture as is strikingly reflected in broad-based surplus production in many developed countries. Over the past decades, the policy emphasis in agriculture has been on protectionist support policies, rather than on assistance for adjustment in agricultural structures. The financial resources made available by Governments for the latter purpose have been small in comparison to the enormous public expenditures on market and price support and export subsidies.

62. Schemes for temporary land set-aside have to some extent contained surplus production, but have contributed little to a lasting retirement of land from agriculture. Government assistance with farm modernization (e.g. new investment, introduction of new agricultural technologies) has in many cases improved productivity, but not necessarily in sectors with comparative advantage, and, thus, simply added to surplus production. Government assistance, including R & D support, for diversification into other crops having a better growth potential (e.g. certain fruit and vegetables) as

well as into forestry and aquaculture have had seemingly some effect, though on a limited scale. Some assistance has also been provided to facilitate moves out of agriculture into small-scale industrial and service activities.

63. Assistance with human resource adjustment in agriculture has included early retirement schemes. However, payments to outgoers have frequently been too small to constitute a real incentive. Furthermore, many Governments have provided assistance with the training of farmers to help improve managerial capabilities, raise technical skill levels and acquaint farmers with new orientations of agricultural production, technology and marketing. Still, evidence suggests that assistance with agricultural training has in the past paid insufficient attention to the conduct of farming operations in a market-determined environment.

64. The results of the Uruguay GATT Round of Multilateral Trade Negotiations have established a framework for the long-term reform of agricultural trade and domestic policies. The main elements of the Agreement on Agriculture are phased reductions in border protection, domestic support and export subsidies. Non-tariff measures have to be converted into tariff equivalents. On the other hand, domestic support exempt from the reduction commitments includes structural adjustment assistance, besides income support decoupled from production, and payments under environmental and regional assistance programmes.

65. Adjustment pressures in agriculture can be expected to grow in a longer-term perspective. However, over the medium term the impact of liberalization is unlikely to lead to structural adjustments on a significant scale. High tariffs as a result of tariffication will mitigate adjustment pressures in many production sectors. Moreover, the reduction in aggregate domestic support to farmers by 20 per cent still leaves considerable support in place, and besides is not product specific. The payment of direct income support will further reduce adjustment pressures. In addition, the application of new safeguard provisions would dampen import expansion and market exposure.

66. Adjustment assistance, therefore, has an important role to play in the advancement of more competitive agricultural structures in developed countries. It would have to be based rigorously on comparative advantage. In particular, it should promote a restructuring in line with shifts in competitive positions and facilitate effective implementation of the longer-term process of liberalization initiated by the Uruguay Round.

67. Instead of continuing the current somewhat sketchy approach towards adjustment assistance with seemingly little impact, policy-makers in developed countries may examine options for more comprehensive strategies of adjustment assistance if they want to help agricultural sectors effectively to adapt to a growing exposure to market forces and exit from surplus production. Such strategies may, in particular, aim to strengthen measures which facilitate the disengagement from uncompetitive lines of production, the diversification into agricultural output with better growth potential as well as the exit from agriculture and moves into new activities (e.g. forestry, farm tourism, craft activities, small-scale services).

Chapter II

MARKET IMPLICATIONS FOR DEVELOPING COUNTRIES AND ECONOMIES IN TRANSITION

68. Structural adjustment policies of many developed countries are not as yet rigorously geared to a "positive" approach which supports and facilitates structural adjustment in line with changes in comparative advantage and widens markets for exports from developing countries and economies in transition. Severe adjustment problems due to declining or lost competitiveness and overcapacity persist in major traditional sectors, including textiles and clothing, footwear, iron and steel, and shipbuilding. In agriculture, little progress has been made in developed countries towards meaningful structural adjustment.

69. The new emphasis on adjustment assistance with investment in innovation, research and human skill formation which aims to promote shifts in production patterns into new skill- and technology-intensive industries may prove to be conducive to the closure of industries in low- and middle-market segments where many developing countries and economies in transition have competitive supply capabilities.

70. Moreover, assistance to traditional industries with moves within these industries into high-value products may entail the same beneficial effect. Such assistance could be linked more rigorously to capacity reductions in unviable lines of production. In cases where adjustment assistance to traditional industries has led to productivity improvements in market segments which compete with imports from lower-cost countries, competition has increased for these countries. On the other hand, productivity improvements have often been accompanied by shifts into high-value product ranges.

71. In this context, developing countries have expressed concern that assistance with the development of process innovations which improve productivity through the substitution of capital for labour might entail a loss of their comparative advantage in labour-intensive industries. Evidence suggests that process innovations have not resulted in "reversals" of comparative advantage. Rather, cost advantages due to process innovations have tended to be short-lived.

72. Some traditional industries (e.g. clothing, footwear) do not lend themselves easily to a high degree of automation and have remained relatively labour-intensive. In textiles, technological progress in spinning and weaving operations has improved productivity and increased capital intensity, but the new technologies have spread rapidly to many developing countries. Although their labour cost advantage narrowed, they were able to maintain their competitive edge in standardized mass products, as increasing import penetration in developed-country markets indicates.

73. By contrast, the application of defensive subsidies which simply served to maintain uncompetitive lines of production in traditional industries have denied new market opportunities to competitive suppliers from developing countries and economies in transition, as did the institution of border protection and the use of anti-dumping, countervailing and grey area measures as protectionist devices against import competition.

74. Governments recognize that reductions of uncompetitive production capacities need to be determined to a greater extent by market forces. The Treaty on European Union, for instance, stresses the need to speed up structural change "within open and competitive markets" (art. 130). However, political and social constraints, in particular high levels of unemployment render a rapid exposure to the full impact of import competition difficult.

75. Unless governments show greater resistance to pressures from interest groups for subsidization, structural adjustment will be further retarded and its costs raised even more. Assistance with the social cost of plant closures may be considered to a greater extent in cases where industries are regionally concentrated so that the risk of social disruptions is particularly high.

76. A growing number of developing countries are, for their part, moving their export supply capabilities into industries which produce skill- and technology-intensive goods. The experience of developed countries shows that there is a large potential for intra-industry specialization in trade and production of these goods, and new market opportunities can be expected to emerge for developing countries through intra-industry specialization based in particular on product differentiation and the relative importance of market proximity. 13/ However, liberal market access in developed countries is a crucial prerequisite for such specialization.

77. A careful examination by governments of the compatibility of support measures with GATT rules and, more specifically, with the Uruguay Round Agreement on Subsidies and Countervailing Measures will help ensure that market opportunities of trading partners are not adversely affected. Sector-specific measures are actionable under the Agreement if they cause "adverse effects" (e.g. injury, serious prejudice) to the interests of other countries. Horizontal measures fall outside the purview of the Agreement and can be applied freely under GATT rules. Assistance with R & D, both horizontal and sector-specific, is permitted within broadly defined limitations.

78. In agriculture, structural adjustment policies are unlikely to make a significant contribution to opening up new market opportunities for developing countries and economies in transition, unless such policies are strengthened considerably. Moreover, the impact of adjustment assistance on agriculture will be dampened substantially until adjustment pressures on farmers increase as a result of liberalization policies which eliminate the current high levels of support and protection. However, the effects of the liberalization process set in motion by the Uruguay Round will only be felt in a medium- to longer-term perspective.

79. While adjustment assistance in agriculture needs to be strengthened, such assistance has to be in conformity with the relevant provisions of the Uruguay Round Agreement on Agriculture. According to annex 2 of the Agreement, investment aid to assist in financial or physical restructuring of farming operations must respond to "objectively demonstrated structural disadvantages", although the Agreement gives governments a relatively free

hand in the interpretation of what constitutes a structural disadvantage. Moreover, investment aid may require farmers not to produce a particular product. This provision can prove to be an effective safeguard to ensure that investment aid is not provided in support of output in respect of which producers have no longer a cost advantage and for which there may be considerable surplus production. Assistance to R & D which benefits the agricultural sector comes within the purview of the Agreement on Subsidies and Countervailing Measures.

Chapter III

POLICIES OF ADJUSTMENT "BEYOND NATIONAL BOUNDARIES" AND IMPLICATIONS

A. Structural adjustment through regional integration

80. A number of developed countries view regional integration as a tool to promote structural adjustment in their economies. Economic integration is intended to increase international competitiveness through a more efficient allocation of resources on a wider regional scale, lower production and transaction costs, and induce greater investments and more efficient corporate structures.

81. The European Union considers the single market as a major avenue to improve international competitiveness of its high-tech industries and to reduce the technological gap resulting from a segmented European market *vis-à-vis* major world market competitors. The European Union has complemented traditional methods of trade liberalization and integration with a number of specific policy actions including joint research and development programmes to advance towards this goal. However, there is not as yet evidence that the relative competitive position of European skill- and technology-intensive industries has effectively improved to the extent expected.

82. Likewise, NAFTA is frequently considered as a means to promote the structural adjustment of the Mexican economy and safeguard economic reforms already achieved. Higher investments and technology transfers should bring about such effects. In turn, NAFTA provides industries of the developed member States with a close-by, low-cost production platform and, hence, with further possibilities to improve their international competitiveness. Closer integration between the European Union and Eastern European countries and recent proposals to enter into free-trade area agreements with Mediterranean countries may also be expected to enlarge the options for the structural adjustment of European industries.

83. Nevertheless, regional economic integration groupings often limit the influence of external pressures on the process of adjustment in certain production sectors by keeping border protection high or maintaining stringent rules of origin. This hampers the development of linkages with more competitive external suppliers and prevents the best possible use being made of global opportunities for a rational allocation of resources.

B. Support for global enterprise relocation strategies

84. In many instances, enterprises in developed countries have relocated production, which had become uncompetitive, to new sites in developing countries where it would enjoy a comparative advantage. Relocation in economies in transition has so far taken place on a much smaller scale, but is expected to grow.

85. Vehicles of relocation have been foreign direct investment (FDI), including joint ventures, and other forms of production cooperation such as subcontracting or licensing arrangements. In part, relocation has taken the form of the transfer of labour-intensive stages of production. Such "outward

processing" has, to a large extent, taken advantage of export processing zones, in-bond industries and special customs and import licensing facilities in developing countries.

86. Relocations to developing countries are, to some extent, embedded in regional or global production and distribution networks of transnational corporations (TNCs). Such networks allow the use of production factors, materials and technology inputs from a wide variety of sources, enable firms to reduce costs and ensure a simultaneous presence in major markets with locally adapted products. TNCs are also revising their investment strategies to incorporate possible locations in economies in transition. Moreover, medium-sized enterprises increasingly extend their operations to regional or global levels.

87. Major beneficiaries among the developing countries of production networks that stretch beyond national borders have been a number of fast-growing developing economies in the Asian region. Moreover, some of these developing countries are, for their part, increasingly pursuing strategies of relocation to lower-cost economies, mainly within the region. Among the economies in transition, a few countries in Central Europe, which have made progress with economic reforms, concluded association agreements with the European Union and are geographically close to its market, are prime candidates for growing inter-linkages with production structures of Western Europe.

88. Many developed countries have implemented programmes which provide support for foreign direct investment (FDI) by their enterprises. 14/ Some schemes are specifically designed to favour investment in developing countries; others are applicable on a general basis. Almost half of the OECD’s member countries have public development finance agencies which serve as vehicles for channelling FDI to developing economies. The policies of the Overseas Private Investment Corporation (OPIC) of the United States accord preference to FDI in low-income developing countries. Schemes dovetailed to supporting FDI in economies in transition are still largely missing in developed countries.

89. Governments have also facilitated the relocation of labour-intensive stages of production in cases where the assembled products are re-exported to the input-supplying country. Under "off-shore assembly" and "outward-processing trade" provisions, many governments levy no duties on imports to the extent that the imported products incorporate inputs (e.g. fabrics, components) provided by suppliers in the importing developed country. Furthermore, preferential market access under GSP schemes may have provided some incentive for the relocation of traditional production sectors to beneficiary countries with comparative advantage. Still, quota restrictions and rules of origin have mitigated considerably adjustment pressures due to import competition from GSP products.

90. The objectives of government support for FDI in developing countries are general in their policy orientation. Thus, governments require that their support has a favourable impact on the economic development of the developing country (e.g. employment creation, raising human skills, technology transfer), but brings also economic advantages to the developed country (e.g. securing employment, export expansion). On the other hand, the investment’s potential

in generating export opportunities for developing countries is rarely a consideration of support programmes. Rather, such potential may be regarded to be inconsistent with the developed country's balance of payments and employment objectives. Data on FDI flows which benefited from government support, therefore, grossly overstate the contribution of FDI support programmes to structural adjustment in developed countries.

91. Japan may be considered an exception as the country has, in large part, linked its support for FDI to objectives of structural adjustment. Much more so than other countries, Japan has tackled the challenge of declining industries consistently through industrial shedding in the form of overseas transplantation in developing economies. Japanese FDI in developing countries, which is heavily concentrated in the Asian region, has clearly served as a "house-cleaning-and-renovating vehicle" 15/ and facilitated the industrial up-grading of the domestic economy in line with shifts in competitive positions in international trade.

92. The country's industry entered a new phase of relocation in the Asian region in the mid-1980s when the sharp revaluation of the yen impelled Japanese enterprises to move offshore on a much larger scale than in the past. Japanese investment in developing Asia increased more than sixfold between 1985 and 1990. According to some estimates, about 10 per cent of Japanese manufacturing were relocated during this period, creating over 700,000 new jobs in Asia. 16/ Investments have taken place both in light industries (e.g. consumer electronics, TV sets, household appliances, textiles and clothing) and in other sectors (e.g. general and electrical machinery, transport equipment, precision equipment), and were in large part export-oriented, with some proportion of re-exports to Japan. Investments of this kind have slowed down since the early 1990s, indicating that this phase of restructuring is approaching its limits.

93. The strategy of relocating declining lines of production in developing Asia has been implemented in close consultation with the Government and has benefited from financial support. 17/ The approach has been broad-based, rigorously weeding out those industrial activities in which Japan could no longer exploit competitive advantages at home. The relocation strategy has not only helped the restructuring of the Japanese economy, but has at the same time contributed to the development of the host economies. Similar broad-based strategies are still missing in other major developed countries. Some advanced developing countries in the Asian region are following Japan's approach - a phenomenon often referred to as the "flying wild geese pattern".

94. Investment support schemes of developed countries have apparently contributed little to reducing the marked concentration of FDI in a few developing countries and integrating a greater number of them at all stages of economic development into adjustment strategies of developed economies. In 1985-1990, some 10 developing countries, of which 6 in Asia, accounted for three quarters of all FDI in developing economies. Moreover, eligibility requirements (such as adequate political stability of host economies), which provide for discretion in the application of investment support schemes have often resulted in the exclusion of low-income and least developed countries as

well as highly indebted economies. In the same vein, relocation through "outward processing" has in certain sectors, mainly textiles and clothing, been constrained by import quotas.

95. A dynamic process of structural adjustment in production and trade "beyond national boundaries" on a truly global scale is crucially important to integrate all developing countries and economies in transition into an international division of labour which generates gains for all trading partners. Schemes of developed countries in support of FDI could serve to a much greater extent to facilitate the relocation of those of their production activities which have irrevocably lost competitiveness.

96. Further analysis would be required to develop a more comprehensive policy framework, which mobilizes both enterprises and adjustment assistance for industrial relocations of uncompetitive lines of production. A closer examination of the Japanese experience could prove to be helpful.

Chapter IV

NEED FOR FURTHER POLICY ANALYSIS

97. The UNCTAD Ad Hoc Working Group on Trading Opportunities in the New International Trading Context will, inter alia, examine to what extent Uruguay Round commitments to liberalize trade will create new market opportunities for developing countries and economies in transition in the developed countries.

98. Structural adjustment policies of the developed countries can assist industries in accommodating new pressures to adjust. Policy makers in these countries may, therefore, pay greater attention to the contribution of structural adjustment policies to positive adjustment in industries in which liberalization in fulfilment of Uruguay Round commitments is likely to lead to stronger competitive pressures due to increased imports from developing countries and economies in transition. Important cases in point are agriculture, textiles and clothing, which have become subject to a gradual process of liberalization.

99. For these and other major sectors which will be faced with increased import competition, policy makers may: (i) identify enterprise strategies which have adjusted production to changes in competitive positions and, thereby, helped opening up new market opportunities for lower-cost foreign suppliers; (ii) examine whether and to what extent structural adjustment policies have facilitated (or induced) these enterprise strategies; and (iii) identify how structural adjustment policies can be strengthened so as to provide more effective support to such strategies.

100. The analysis of the effectiveness of structural adjustment policies in particular sectors can be complex, especially in cases where industries and enterprises have benefited from several adjustment assistance measures in support of a mix of adjustment strategies. Industries have often combined several strategies to meet increased pressures of competition (e.g. plant closures, productivity improvements, moves into more skill- and technology-intensive lines of output, diversification into other sectors, relocation in developing countries).

101. Particular attention may be given to an evaluation of the effectiveness of incentives and support measures for the relocation of uncompetitive lines of protection to lower-cost countries with comparative advantage, in order to ensure a global perspective of the policy approach.

102. In agriculture, textiles and clothing, which are being liberalized progressively over longer transition periods, structural adjustment policies may to a greater extent aim to stimulate adjustments ahead of the build up of new import competition. In agriculture, structural adjustment policies would very likely need considerable redesign and strengthening.

Notes

1/ See Policies for Adjustment: Some General Considerations, Council Communiqué of 15 June 1978 [C(78)96 (Final) Annex II].

2/ See OECD, Industrial Support Policies in OECD Countries, 1986-1989, Paris, 1992 (OCDE/GD(92)126), table 1.

3/ See "Industrial policy in an open and competitive environment - guidelines for a Community approach", COM(90) 556 in Bulletin of the European Communities, Supplement 3/91.

4/ See MITI, Trends and Future Tasks in Japanese Industrial Technology, White Paper, Tokyo, 1988, quoted in C. Watanabe and Y. Honda, "Japanese industrial science and technology policy in the 1990s", in Japan and the World Economy, Vol. 4, No. 1 (October 1992).

5/ See "Law on Temporary Measures for Stabilization of Specified Depressed Industries", enacted in 1978. In 1983, this law was amended, extended for another five years and renamed "Law on Temporary Measures for the Structural Adjustment of Specified Industries".

6/ See "The role of industrial policy in the post World War II economic development in Japan", country presentation submitted by Japan, UNCTAD TD/B/WG.4/Misc.17.

7/ See S. Sekiguchi and T. Horiuchi, "Myth and reality of Japan's industrial policies", The World Economy, Vol. 5, No. 4 (December 1985); and the same authors, "Trade and adjustment assistance", in: R. Komiya, Okuno, and K. Suzumura, Industrial Policy of Japan (Tokyo, San Diego, London: Acadamic Press, 1987).

8/ MITI, The Sub-Committee for Long-Range Issues of the Industrial Structure Council Interim Recommendations, Tokyo, February 1994.

9/ See R.Z. Lawrence, "A depressed view of policies for depressed industries". In: R.M. Stern (ed.), Trade and Investment Relations Among the United States, Canada, and Japan (Chicago: The University of Chicago Press, 1989).

10/ See R.Z. Lawrence, "A depressed view of policies for depressed industries", op. cit.

11/ See Bulletin of the European Union, No.1/2, 1994 and COM(94)49; furthermore P. Buigues and A. Sapir, "Community industrial policies". In: P. Nicolaides (ed.), Industrial Policy in the European Community: A Necessary response to Economic Integration? (Dordrecht, Boston, London: Martinus Nijhoff Publishers, 1993).

12/ See "Market opportunities (environmental measures, structural adjustment policies, RPBs)", report by the UNCTAD secretariat (TD/B/WG.4/6).

13/ See W. Gerstenberger, "Strukturwandel in den führenden Industrieländern: Setzen sie alle auf die gleichen Pferde?", ifo-Schnelldienst, 5-6/89.

14/ Incentives provided may be broadly grouped into five categories: (a) Investment information services and investment promotion activities, in particular the financing of pre-investment surveys and feasibility studies; (b) Investment guarantee schemes covering non-commercial risks (e.g. war, expropriation and transfer risks); (c) Fiscal incentives; (d) Financial aid (e.g. preferential loans to firms wishing to invest in developing countries); and (e) Establishment of government-sponsored investment corporations providing equity and loan capital for joint ventures. Export credit and export credit insurance programmes which facilitate equipment exports have in many cases also been decisive factors in the financing of a private foreign investment.

15/ T. Ozawa, "Japan in a new phase of multinationalism and industrial upgrading: functional integration of trade, growth and FDI", in Journal of World Trade, Vol. 25, No. 1 (February 1991).

16/ See K. Furuya, "High-level manpower and Japan's foreign aid", paper prepared for Conference on International Manpower Flows and Foreign Investment in Asia, Tokyo, 9-12 September 1991, quoted in Pang Eng Fong, Regionalization in labour flows in Pacific Asia, OECD Development Centre (Paris, 1993).

17/ Besides the provision of credits by the Export-Import Bank of Japan, credits have been extended to enterprises moving offshore by the Overseas Economic Cooperation Fund (OECF) and the Japan International Cooperation Agency (JICA). Both institutions aim to promote economic development in developing countries.
