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TARIFFS AND PROTECTION

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TARIFFS AND PROTECTION.

In the previous paper Mr. Sydney has outlined the methods adopted and the problems encountered in evaluating the Ceramics Plant Project. In our preliminary discussions about this paper and in our presentation to this seminar we decided that it was also desirable to raise the broader issues associated with the relationship between Government trade policies and the development of industry. In the East African context the situation is complicated by the division of 'sovereignty' for many of these issues between National Governments and the East African Community. Yet in many industrial projects such as the one we have been discussing the need for protection against cheaper overseas imports, hopefully in the short run, arises.

The case for protection is one of deliberately encouraging an economic pattern involving less trade (i.e. imports of manufactured goods) and more local manufacturing at the expense of rural industry. In economic terms it means the diversion of resources away from a more 'efficient' towards a less 'efficient' form of production. Traditionally arguments in favour of protection include:

1) Protection improves the terms of trade or prevents its deterioration.
2) It has implications for the balance of payments in both the short and longer run.
3) It shifts income away from the rural sector towards the urban industrial sector.
4) It reduces the risks of the economy's dependence on a few volatile rural exports.
5) Protection represents a temporary loss for a future gain in that local manufactures are thought unlikely to require protection against cheaper overseas imports indefinitely.

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The main means of protection are as follows:-

1) Tariffs on cheaper overseas imports which, within the local context, are an East African Community decision.

2) Quantitative restrictions on trade which, within East Africa, are a national decision.

Other means of protection and/or preference for local manufacturers may include:-

1) A guaranteed local market for existing manufacturers through the Industry Licensing system.

2) A Government preferential purchasing policy in favour of local goods.

3) Subsidised input prices; for instance the provision of electricity to particular industries at less than marginal cost.

Assuming that we accept the case for protection against cheaper overseas imports, the cardinal issue becomes one of criteria. In developed countries protection against cheaper overseas imports is normally extended to firms and industries which are already established and there is an existing pattern of internal costs and prices and import competition to be considered. Inevitably there is a commitment to existing labour and management and fixed capital investment, in both private and public facilities. However, in a developing country like Uganda, protection against cheaper overseas imports may be requested at a very early stage of industrial development and there is relatively little data upon which to base policy decisions or established interests to protect. The question arises as to what criteria to base protection in such circumstances. The issues which must be considered should include:-

1) The comparative local costs of production against import prices of similar products. Assuming that some protection is agreed upon a basic issue is how much of

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the local market is to be 'given' to local producers and for how long? This involves consideration of both the necessary level of protection and also the comparability of the local product with the imported competitor. Plainly for such considerations there is a need for both an initial assessment and regular review procedure.

There is also a short run choice of:

a) a high tariff which allows the most efficient local firm to earn an abnormal profits anf for other local firms to survive, against overseas competitors.

b) a low tariff which allows the most efficient local firm to earn a normal profit (say 10% on capital employed) and puts other local firms in a 'devil take the hindermost position' against overseas competitors.

2) A related issue is of criteria for the desirable level of profit and return on capital employed. For instance how long is it necessary to allow for a firm or industry to recover its initial capital costs. Overseas investors often seek to return their capital to their country of origin within a period of 3 to 5 years.

3) The third point is the employment effect of the proposed tariff and related to this is how much the protected industry will contribute to local 'value adding' activity.

4) There is the question of balance of payment effects, both in short and longer run. For instance, if a protected company will require large numbers of skilled labour, and expensive capital equipment most of which will come from abroad, it may be that in the short run an industrial project will have a strong negative effect on balance of

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payments. Likewise the extent of the longer-run interest and dividend changes on capital borrowed overseas must also be considered.

5) A further issue is the 'multiplier effects' of input purchases for other local industries. Presumably the aim of protecting new industry will be to maxmise both local 'value adding' activity in the firm or industry receiving the protection and also, where possible, to maximise the local 'value adding' benefits among other local suppliers of inputs.

6) Finally there is the crucial issue of assessing managerial and technical efficiency. Under any system of protection the assessment of local cost disability is based on a scale of output which it is expected the firm or industry will reach, if it is given tariff protection. This raises the question of the optimum plant size which it is possible to operate, given the extent of the local market, local labour productivity, costs of capital and rates of return and other input prices, etc. Given these constraints it is desirable to consider how efficient this size of plant is likely to be compared to similar plants elsewhere in the world. This procedure is commonly accepted by the Australian Tariff Board.

When all is said and done the question remains how high should a particular tariff be and for how long should it be imposed? Alternatively how long is society willing to bear a temporary cost for a future gain, and what are the full extent of these costs and benefits likely to be? Moreover what shorterm Government revenue and other social implications are also likely to arise from the imposition of a new Tariff? The evaluation of such issues, in an objective and systematic way, is of prime importance for promoting industrial development through protective measures. It also highlights the need for a greater awareness of the relationship, both actual and potential, between industrial development strategy and protection and trade policies.

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