Declining Industries, 
Mechanisms of Structural Adjustment, 
and Trade Policy in Pacific Basin Economies

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The process of industrialization, and its spread to the developing economies, generates in its wake severe problems of structural adjustment for "declining" or "troubled" industries. These problems are of major policy significance for the Pacific Basin economies, though in somewhat different ways depending on the level of development (the advanced industrial countries, the newly industrialized economies, and currently industrializing nations). How inefficiencies are dealt with and resources reallocated is an important domestic economic and political problem. Moreover, it has even more important implications for the relationships of these economies with each other and with the world, not simply in terms of trade flows but of the rules and nature of the international trading system itself.

Countries can simply leave the adjustment process to the marketplace and to market forces. However, in many instances governments intervene to slow down or smooth out adjustment, and often unilaterally impose or maintain import restrictions as the policy instrument. There is a direct linkage between structural adjustment problems, market versus government mechanisms of adjustment, the multilateral trading system, and the ongoing Uruguay Round of GATT negotiations.

One practical as well as conceptual difficulty lies in distinguishing between declining industries and those in trouble. It is of course politically more attractive for representatives to portray their industry as troubled rather than declining in order to justify government assistance as only a "temporary" measure. Declining industries are those facing the loss of long-term competitiveness (comparative advantage), due to rising relative costs of labor, natural resources, land, or capital. The prototypical example is the decline in competitiveness in many textiles and apparel subsectors based on unskilled labor and relatively simple and standardized technologies, in all the advanced industrial nations and more recently in the Asian-Pacific newly industrialized economies as well.

Troubled industries have excess capacity or produce inefficiently for some sustained period but seemingly have not lost potential long-term competitiveness. Their difficulties may come about from sudden declines in world demand (shipbuilding in Japan and Korea), overvalued exchange rates (automobiles in the United States) or foreign import restrictions or export subsidies (the effect of European Community agricultural policies and United States
reactions on New Zealand and Australia). Moreover follower country governments which aggressively pursue industrial policies to create more skill, technology, and capital intensive industries sometimes make policy mistakes (automobile assembly in all the smaller Pacific Basin economies). It is unlikely that these "troubled" industries will become competitively efficient within a reasonable time frame.

The Pacific Basin Studies Program at Columbia University in 1987 initiated a project to investigate these issues in a comparative Pacific Basin context under the direction of Professor Hugh Patrick. The purpose has been to describe and evaluate the mechanisms of adjustment in each country, to determine their effectiveness and constraints on various policy choices, and to examine the implications for the country's trade policy. The five Pacific Basin advanced industrial nations -- Japan, the United States, Canada, Australia and New Zealand -- were obvious choices; each has well defined industries in decline or in trouble. Moreover, the four Asian-Pacific newly industrialized economies -- Korea, Taiwan, Hong Kong and Singapore -- are losing competitiveness in simple labor-intensive industries; and Korea faces severe problems of structural adjustments in certain troubled industries previously promoted by the government. Two countries earlier in the industrialization process -- Malaysia and Thailand -- were selected both because they have troubled industries (particularly automobiles) and because they represent problems of some possible decrease in competitive strength in certain agriculture processing industries. One economist from each country has prepared the basic country studies that form the core of this project; the group held two workshop meetings, in July 1988 and January 1989, to review issues and manuscripts.

The focus of the project has been on manufacturing industries; agriculture enters only peripherally. At the same time, it was well recognized that certain highly efficient land-resource producers in the Pacific Basin, notably of grains and other agricultural crops, are unable to exploit their cost and market advantages fully because of import barriers in Japan, Korea, and increasingly Taiwan, and even more importantly the European Community. Agriculture trade policy issues, while conceptually very similar by economic criteria, have a different political and institutional agenda, and are being handled separately, though not unrelatedly, in the current Uruguay Round of GATT negotiations.
Analytical Conclusions

I derive a number of analytical and policy conclusions from the project.

1. In every Pacific Basin economy analyzed, a great deal of adjustment has resulted through the marketplace despite substantial difference in the degree to which government policies attempted to inhibit or slow change. Market forces have simply been too strong at whatever level of protection. As firms lose sales and competitiveness, they reduce output, shift to new, higher value-added products, lay off workers, and adjust their physical capital. In every country there have been substantial declines in employment in specific manufacturing sectors; indeed this is one important measure of a declining industry.

2. Employment decreases in declining industries have been substantially greater in the five advanced industrial countries, reflecting greater loss of competitiveness. Most workers laid off found jobs elsewhere or retired; few ended up unemployed and apparently few benefited substantially from government retraining, relocation or similar government-based programs. In general, the higher the level of economic development (GNP/capita) the greater are the difficulties in adjustment. Human capital embodied in workers is both greater and more industry and/or firm specific (e.g., steel). Firms are larger, more capital-intensive, and their capital more specific in use. The political power of workers and firms in a declining industry is likely to be greater, and the are more likely to seek government help. However, national differences in institutions, policies, and behavior substantially determine an economy's flexibility, and hence its ability to rely on the market as the mechanism of adjustment (e.g., Singapore versus New Zealand).

3. It is incorrect to consider broadly-defined industries such as textiles or apparel as "dying," as likely to lose competitiveness altogether. Some segments are relatively capital and technology intensive (e.g., synthetic fibers); others maintain competitiveness through design, quick responses to changes in fashion, and nearness to market. Moreover, the process of sectoral decline is likely to be long-run; there is heterogeneity not only of product but of quality of producers. In textiles particularly many firms are small-scale, family-owned, and owners, workers, and machinery are aging. The opportunity cost of owner-workers and their physical
capital is low; it may well make economic sense for them to produce until retirement and exit, 
even with lower incomes. The policy issue is whether society should enhance their incomes. If 
so, the political reality is that support is likely to be by protection from import (or domestic) 
competition rather than by direct subsidy. One policy objective should be to keep such support 
low enough not to attract inefficient new entrants into the industry, if more direct programs of 
support are not politically feasible.

4. The macroeconomic environment and macro policies strongly affect both the 
adjustment process and the degree to which sectoral policies are utilized.

a) Rapid economic growth is the single most important factor easing the process of 
adjustment for declining industries. It creates new jobs and investment 
opportunities, and makes possible market-based adjustment. The best examples 
in the 1980s are Hong Kong, Korea, Singapore, and Taiwan, particularly in 
textiles, wigs, and other very labor-intensive declining sectors.

b) A substantially overvalued exchange rate for a sustained period creates troubled 
industries and exacerbates the difficulties of declining industries. The United 
States (automobiles), Australia, and New Zealand are important examples. In 
addition to reducing price competitiveness, the overvalued exchange rate 
increases trade and current account deficits, which create trade frictions and an 
environment making protectionist actions politically more palatable. The United 
States experience in the 1980s has become a major problem not only for it but 
for all nations. In contrast an undervalued currency retards the process of 
structural adjustment and results in excessive current account surpluses. Japan is 
by far the most important example, but the surpluses of Taiwan and Korea have 
also resulted in serious problems.

c) New Zealand currently represents a special and extreme case of comprehensive 
sectoral deregulation and reforms in an adverse macroeconomic environment. 
The comprehensive and boldness of this policy package is impressive. Its 
successful implementation requires strong political will and a relatively long-term 
time horizon.
5. In virtually all economies -- Hong Kong being the exception -- the government has intervened selectively to help its declining or troubled industries. The issues are those of degree, targeted group for assistance (workers, owners, financiers), and type of policy instruments used.

6. While most governments employ the rhetoric of market failure and/or infant industries as justification for intervention and policies usually are driven by some sense of efficiency in resource allocation, in practice the policy objectives are more redistributive in nature, primarily in favor of interest groups with political power in affected sectors. The economic reality is that where government interference slows (or stops) the market forces of adjustment, resources continue to be inefficiently allocated, in some instances at great costs to consumers and with considerable net (deadweight) losses to the economy as a whole. However, these costs frequently are hidden, in the form of high prices or low-interest-rate loans. The political reality is that powerful interest groups -- which differ from country to country -- are able to shape government policy to their advantage for sustained periods of time; in a second-best world they are able to stress social costs of adjustment (particularly unemployment). The policy battle in every country lies in tilting policies toward efficiency.

7. The advanced industrial countries -- the US, Canada, Australia, New Zealand, and Japan -- historically have provided assistance to both troubled and declining industries in one form or another. The major policy instrument was the de facto imposition of new import barriers, in new and increasingly pernicious forms of voluntary export restraints (VERs) and orderly marketing agreements (OMAs), as well as import quotas (textiles). While tariffs have in general been reduced, they remain higher than average in declining industries; and in many Pacific Basin countries (Australia, New Zealand, Korea, Taiwan, Malaysia, Thailand) tariff or quota barriers remain high.

8. Japan is an exception among the industrial countries in that it now relies far less than earlier on trade protection to assist troubled or declining industries. Given its strong economic and trade position since 1980, it is very difficult for Japan to impose new import barriers (though not impossible, as selected "voluntary" restraints on imports of silk and knitwear attest). Rather, Japan has engaged in a constructive series of government-industry joint
programs in selecting declining ("structurally depressed") industries, which have been especially effective in concentrated industries. There is some evidence of collusive market-sharing arrangements in a few highly-concentrated industrial products, which have not been challenged by the government. The government has also provided support for small manufacturers and their workers in depressed industries and regions. The modest amount of government resources actually being provided suggests these programs have been ameliorative and smoothing, to mitigate political problems and pressures emanating from basic reliance on market forces.

9. The governments of the newly industrialized economies -- Hong Kong, Korea, Singapore, and Taiwan -- have not provided significant new assistance for declining labor-intensive manufacturing sectors. However, Korea and Singapore have assisted troubled industries. Korea in particular, suffers from earlier policy mistakes which created today's troubled industries (shipping, shipbuilding). High tariff and other import barriers continue to protect Korean and Taiwan manufacturing. The policy problem, as earlier with Japan, is not the imposition of new protectionist support for (newly) declining or troubled industries, but the persistence of previously-established barriers which become increasingly effective as industries mature and begin to enter the process of decline.

10. Malaysia and Thailand are still in the early phase of their industrialization process; in general labor-intensive industries are expanding, not declining. Yet each has its troubled industries, due mainly to policy mistakes. Automobiles are a clear case of highly protected, inefficiently small, local assembly and local component production. There also have been mistakes in the excessive expansion of capacity in the processing of certain agricultural products - sugar mills in Thailand and palm oil mills in Malaysia.

11. As noted, government policies to intervene in the process of adjustment reflect both a mixture of efficiency in resource allocation and social objectives, and a political response to powerful interest groups. Organized labor in declining industries has been an important player in the United States, Canada, and Australia, much less so in other Pacific Basin economies. (The current New Zealand case is remarkable in that powerful labor interests have gone along with the Labor Government’s market-oriented reform program.) In most instances of intervention it appears the government has particularly sought to help owners and managers;
in some instances major creditors (Japan, Korea) apparently have been the objective, or at least the beneficiaries, of government assistance to the industry. Immigrant labor has been a beneficiary in some instances (Australia, Canada, the United States); in contrast in Singapore the further utilization of foreign visiting workers has been deliberately restricted to prevent the pace of adjustment (textiles, shipbuilding) from slowing down.

12. In Taiwan (plywood), Korea (textiles) and Japan (aluminum, perhaps textiles) the government has provided some incentives for firms in declining industries to invest abroad in lower-cost countries. While this has not been studied carefully, it appears that the purposes are mainly ameliorative and political. To the extent that firms in declining industries invest abroad and import back to their home, utilizing their existing domestic marketing and distribution systems, it undermines the ability of the firms in the industry to unite to seek government protection from imports.

13. The political and economic realities of declining and troubled industries have been and are vexing problems for the GATT-based international trading system. While positive economic policies of domestic rationalization without using protectionist instruments has been widely touted (by the OECD, for instance), in practice almost all countries have relied primarily upon import restriction policy instruments. The main exceptions are Hong Kong and Singapore which have systematically maintained free trade policies; and Japan in the past decade, which has been virtually precluded from using import restrictions to provide new assistance to declining or troubled industries by reason of its high trade surplus and strong U.S. and other foreign pressure. The major example of the bypassing (and undermining) of the GATT international trading system is the Multi-Fiber Agreement (MFA) which enables industrial countries to impose comprehensive bilateral quotas on textile imports from developing countries.

14. In practice, the GATT system has not been effective in preventing industrial countries from raising import barriers unilaterally (Australian quotas on automobiles or textiles) or bilaterally (U.S.-Japan "voluntary export restraints" on automobiles, U.S. steel import arrangements with Japan, Canada, Korea, Taiwan). Existing GATT institutions, mechanisms and powers do not provide an adequate basis in practice for restraining the intervention of national governments in assisting their declining/troubled industries by import restriction measures.
15. The declining and troubled industries problems of structural adjustment, and the proclivity of most governments to intervene by raising or maintaining import barriers, may well represent the key issues of the global trading system today: how to prevent official low trade barrier countries (U.S., Japan, Canada) from raising new barriers; how to cause high official import barrier countries (Australia, Korea, Taiwan, Malaysia, Thailand, and to some extent still New Zealand) to reduce those barriers; and how to delimit and restructure existing barriers, such as the textile MFA, into more market-oriented systems amenable to gradual liberalization.

**Policy Conclusions**

Several policy conclusions are suggested by these studies.

1. Since reduction in employment and output in industries having lost comparative advantage is inevitable and inevitably carries with it social and political as well as economic costs, generally it is less costly to allow the process of adjustment to take place sooner rather than later to reduce the cumulative inefficiencies and costs to consumers not only of delay but also of ever-higher protectionist barriers.

2. It is important to get the macroeconomic policies right: generation of employment and investment opportunities, and an exchange rate that is neither overvalued nor undervalued are central.

3. The decision that the government intervene, to what degree, and particularly in what form is quintessentially political and ideological. Nonetheless, it can and should be guided by objectives of economic efficiency and consumer welfare. It is the task of economists and government policy makers to make clear the economic choices and associated costs to political leaders.

4. While labor adjustment seems to occur mainly through the marketplace, in slower-growing, advanced industrial economies governments could and probably should do more to develop constructive programs of retraining and relocation to minimize individual and social costs of job loss. However, the danger is that such programs in practice may simply become nothing more than schemes for additional income compensation; even so, they may be a
politically-attractive, second-best ameliorative technique preferable to continued or enhanced protection.

5. The GATT-based international trading system needs to be strengthened, and GATT itself provided with more powerful set of institutional structures, powers, and procedures to monitor individual country trade policy performance, and to press for domestically-based positive policies of adjustment rather than imposition of import restrictions under whatever guise ("voluntary" systems, orderly marketing arrangements, new quotas or tariffs).

6. The textile MFA is a pernicious and inefficient model of import restriction and managed trade. It should not be applied to other sectors.

7. Rather, textile trade arrangements should be gradually liberalized. A pragmatic sequence is first to move from country-by-country import quotas to global quotas; and then from quotas to equivalent tariffs; and then to a process of multilaterally negotiated binding tariff reductions.