18 The Case for Export Subsidies

In the code of international economic morality which has evolved since the end of the war and is embodied in our international economic institutions, export subsidies are regarded as especially naughty. Import restrictions are explicitly permitted for balance of payments and other reasons. Increases in tariffs are permitted in certain circumstances, such as when low-tariff countries join a customs union, as a defence against dumping and in some cases to protect infant industries. Devaluation is an entirely proper mode of behaviour if there is a fundamental disequilibrium. Only export subsidies are beyond the pale.

On reflection, this is odd. For there are clear merits of export subsidies which other measures, conventionally considered more legitimate, do not have. Part of the explanation may be found in the fact that, since countries are normally more specialised in their exports than in their imports, the impact of 'damage' inflicted by export subsidies will tend to be more concentrated. For a developing country in particular, the degree of concentration by products and destination is likely to be great, and opposition from entrenched interest groups in importing countries therefore strong.

While it is generally agreed that, on certain assumptions which need not be spelt out here, a uniform change in the exchange rates would give the optimum solution, we may assume that this is ruled out or, if a devaluation occurs, that it would be accompanied by other measures affecting trade.

1. In the first place, export subsidies increase the volume of world trade. International trade is generally regarded as 'a good thing' and one is sometimes even exhorted to 'maximise world trade'. If this exhortation were taken seriously, it would imply subsidies to all

1 I am indebted to Michael Lipton for helpful comments.
2 If, as recent UK and Indian experience suggest, the volume of imports is less responsive to devaluation than the volume of exports, devaluation operates like export subsidies, with the added advantage of a possible reduction in the (foreign) price of imports.
transportable domestic production, so that it could be sent abroad and swapped for all required purchases, to be imported from abroad. This would clearly produce a situation which is worse than no trade and, since restricted trade is better than no trade, a situation worse than restricted trade. Less extreme cases can easily be constructed to show that excessive subsidies are worse than restrictions. Clearly, subsidies can be too large. But as long as subsidies are kept within a critical limit, it is desirable that a country in balance of payments difficulties should correct its deficit by increasing trade and making fuller use of international specialisation, whereas a country resorting to import controls and tariffs would reduce international specialisation. Given the prevalence of restrictions on international trade, there is a presumption that measures designed to increase such trade are, ceteris paribus, likely to be beneficial.

2. Compared with devaluation which, of course, is similar to an ad valorem tariff on all imports and an ad valorem subsidy to all exports, export subsidies are more easily reversible. If the balance of payments difficulties are temporary, the subsidies could be removed later, whereas appreciation may prove difficult.

3. From the point of view of the country buying the subsidised exports, subsidies have the advantage of improving its terms of trade, whereas quantitative import restrictions and tariffs imposed by the exporting country will tend to worsen them. If it, therefore, has to accept the reduction of a given balance of payments surplus, this will be achieved with a bigger gain in its real income. From the point of view of the exporting country, while export subsidies worsen its terms of trade, the benefits from international specialisation will outweigh the losses from worsened terms of trade if trade restrictions were, initially, above those required for optimum tariff policy. In view of general foreign exchange shortages, this is often likely to be the case.

4. From the point of view of the subsidising country, export subsidies show up clearly the costs of protection. If they are imposed to protect an infant export industry, it will be clearly seen how much the nursing costs are. If they are imposed to correct the balance of payments, again costs will be apparent and can be compared with those of other measures. Not only the amount but also the locus will be open instead of concealed. It will also be easier to oppose vested interests when subsidies are reduced than when import restrictions are removed.

5. The fact that export subsidies normally involve the raising of additional revenue means that no country will resort to them lightly, as it might to imposing import restrictions. It will be forced to weigh more carefully the cost against the advantages expected from them.