

# Don't Move or I'll Blow My Brains Out<sup>1</sup>

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## Introduction

History shows that sentiment turns toward protectionism when adverse national economic conditions prevail. That there have been enormous gains from the progressive liberalisation of international trade since the disastrous Smoot-Hawley Act of 1930 is undeniable. Yet despite these gains there has been a reversion to protectionist policies at a unilateral level on a scale alarming to those who understand that world social welfare can only be maximised through free international trade in all commodities, tangible and intangible.

In this paper, the rise of unilateralism since 1980 at the expense of the multilateral approach of the General Agreement on Trade and Tariffs (GATT) will be examined. The approach will be as follows. The first section will examine what will be argued to be the root causes of this reversion - the combined effects of a declining US manufacturing sector and the fast progressing unification of

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<sup>1</sup> This title, alas, is not original, being taken from Oxley (1990, p66). The author wishes to thank Professor Dermot McAleese for helpful comments on an earlier draft. Thanks also to a fellow student, Alan Kelly, for some ideas and sources.

Europe. The second section will then cast the issue in terms of the GATT negotiations. This section will encompass a brief discussion of new theories of trade. The third section will, in conclusion, assess the implications for the world trading system.

The paper will concentrate on US and EC trade policy. The US has dominated world trade-policy making since the turn of the century, and has been the major force for trade liberalisation, especially since Roosevelt sought an export-led recovery from the pre-WWII depression. The EC, continuing its efforts towards unification, faces major internal restructuring. It will be argued that it is principally internal US pressure for unilateral action, combined with EC internal adjustment processes, that have been responsible for the reversion to protectionism since 1980. The major question appears to be why, when economic liberalism seems to be winning everywhere, does this victory not extend to international trade?

## The Declining Giant and the New Kids on the Block

### *The USA - Paradise Lost?*

Despite the fact that the International Trade Organisation was stillborn due to US Congressional opposition to

ceding what they saw as vital national interest to a non accountable body, the 'stop-gap GATT' has been an enduring success. That success is mainly due to the fact that the US has been the driving force behind the negotiations. In the GATT's first thirty years, the average tariff on manufactured goods fell from 40% (1947) to 5%.

World trade, over the same period, has grown by 500%, set against growth in global output of 220%. The reason for the US's drive for free trade over this period is exactly the same as was Britain's in the late 19th Century - the US has been the world's leading manufacturing nation. However, prior to 1980, the US had a trade surplus, which allowed the administration to point to the benefits accruing to the country from free trade, or at least a steady progression towards it, and thus resist calls for protection.

What has changed in the US is its trade balance. From a current account surplus of \$2Bn in 1980, the US has developed a current account deficit of alarming proportions during the 1980s (\$126Bn in 1988), led principally by an increasingly poor trade performance.

It is at this point that political economy becomes relevant. Much of this trade deficit is with Japan and its neighbours. The US had balanced trade with the EC in 1989 (\$89Bn), but ran a deficit of \$95Bn with the Asian/Pacific Rim countries from a total trade deficit of \$115Bn. Economic theory dictates that a current account deficit must be matched by a capital account surplus if reserves are to be maintained. Such has been the case, but it has been particularly galling for the average US citizen to

see much foreign investment being made by Japanese money, especially in highly visible areas such as car manufacture. The US administration is finding it increasingly difficult to maintain resistance to GATT-illegal protection in the face of these developments.

### *Enter Fortress Europe - The Rise of Regionalisation?*

The progress towards economic and ultimately political unification of Europe continues apace. Major steps were taken at the December 1991 Maastricht Summit towards Monetary Union, and a true free trade customs union is due for completion by the end of 1992. It is, perhaps, ironic that the initiative for the EC's formation came from the USA, in order to lessen the probability of a future war in Europe, and bind what was left of Germany into free trade democracy after WWII. The completion of the single market will see the EC12 emerge as the world's largest single free trade bloc. Also, an agreement with the mainly Scandinavian and non-EC western European countries of EFTA will provide for an enlarged tariff-free market. Finally, the collapse of the managed economies of the European east provides room for further expansion and a desperate need for western investment.

Problems arise because such upheaval in twelve developed economies creates major structural adjustment issues. The most famous, of course, is that of agriculture. The CAP is funded centrally, and accounts

for in excess of 70% of the EC budget - that for a sector whose contribution to EC GNP is of the order of 4%, and 7% of civilian employment. The farmers, clearly, have a political influence which far outweighs their economic contribution. Agricultural protection has been a major source of conflict with the USA, itself no stranger to protecting its farmers, who represent 2% of US GNP, a trade war over US losses in agricultural exports to Spain and Portugal on their entry into the EC having been avoided only by the EC agreeing to pay ECU200M compensation annually to the US, an agreement which was due to expire in 1990, but was extended for two years.

In addition to agriculture, the European Commission, responsible for European trade policy, finds it easier in the short term at least to protect many European industries from outside EC competition while they come to terms with a true free market at home and adjust accordingly. It may well be that Europe feels it has enough on its hands striving to secure the projected 2.5% - 6.5% once-and-for-all gain in GNP projected by the Cecchini Report without managing simultaneously a clamour for free trade from the rest of the world.

It should not be forgotten that the EC12 are not a political unit as is the USA. Quite often, though the EC commission has the power to negotiate at the GATT on behalf of the twelve national interests are judged by the nations involved to be at risk. Witness Irish, French and German reaction to the Cairns group and USA's demand for 75% cuts in EC farm support over

five years set against Britain's tacit support for such demands.

It is, no doubt, US fears of an emerging protected European market that has led impetus to negotiations on the North American FTA comprising Mexico, Canada and the US. Such agreements, like the EC - EFTA agreement, are not GATT illegal, so long as falling tariffs and Non Tariff Barriers (NTBs) apply to a wide range of goods, not just a selected few, and barriers are not raised against the rest of the world as a result. The extent to which the possibility of protected trade blocs becoming prevalent represents a threat to the world trading system, or a set of leverage devices at the current round of GATT talks is moot. If it is a game, it is a dangerous one.

The possibility of a reversion to protected trading blocs must surely be in question given the interlinkages between the developed and developing countries. Third World debt reached crisis proportions in the early 1980s, as their ability to service debt deteriorated with the world recession, the situation being salvaged only by prompt if overdue action by the World Bank and the IMF. Part of this rescue has involved an acceptance on the part of the developed world that the developing nations be allowed to trade out of their debt. This will involve allowing access for textiles, currently governed by many bilateral multi-fibre arrangements (MFAs), and agricultural produce, to OECD markets. A major source of unilateralism, Article 18 of GATT, is being abandoned by many developing countries willingly (and by some at the prompting of the World Bank), pointing

to the experience of those countries who do not use it, among them Kenya and the ASEAN bloc, in comparison to those who do, among them India, much of South America, and much of black Africa as justification.

### **The Retreat From Free Trade**

This section will examine the reversion to unilateralism, encompassing both GATT-legal and GATT-illegal measures. Before proceeding it may be helpful to outline briefly the underlying principles of the GATT before considering these issues.

#### *GATT - The Administrative Arm of Economic Common Sense*

The following are the guiding principles of the GATT:

**\* Reciprocity**

A market-opening measure is regarded, alas, as a concession, for which reciprocal measures are expected. Because this variety of reciprocity aims to match reductions in protection (threats to raise tariffs are not allowed), not levels of protection, it is termed 'first difference reciprocity'. The principle is based exclusively on bargains on lower tariffs all round.

**\* Non-discrimination.**

The 'Most Favoured Nation clause' requires that every country is treated as favourably as the most favoured.

**\* Transparency.**

GATT urges that NTBs be replaced by tariff barriers, combined with a commitment (Binding Agreement) not to raise them further.

The GATT also incorporates a complaints conciliation service,

whereby accusations of unfair practice by member countries can be adjudicated upon, and recommendations issued.

#### *The Rise of Protectionism*

Since the mid-1970s, the volume of world trade has continued to grow, but at a slower rate in relation to global output growth. It is reasonable to suggest that the proliferation of new varieties of NTBs are a major contributing factor. Some of these devices are GATT-legal, i.e. they conform to, or are not incorporated in, the articles of the GATT. Others are GATT-illegal, or form part of the grey area.

Voluntary Export Restraint (VER), a favourite policy instrument of the USA, and also widely used by the EC, is a GATT-legal measure (because of its 'voluntary' nature) which threatens another country, under pain of retaliation to restrict exports of the good in question. Throughout the 1980s, the use of VERs spread from textiles and clothing to steel, cars, machinery, consumer electronics, and more. The GATT secretariat has enumerated around 300 VERs, mostly protecting the US and the EC. 50 affect exports from Japan, 35 affect exports from South Korea. Because they are 'voluntary', they are difficult to monitor, and there are no reliable estimates of their impact on trade.

By far the most famous of the unilateral measures in use is the GATT illegal Section 301 of the US Trade act (1974) which requires the President to retaliate unilaterally against foreign trade practices that unfairly discourage US exports. The law is vague, and the

US decides what constitutes "unfairness". From 1974-1985, there were 27 cases; from 1986-1988 11 cases covering \$4Bn. What the US is looking for in response is a Voluntary Import Restraint (VIE) - US trade policy in the 1980s has broadened from concern at a high level of imports to a more aggressive concern over low export levels.

Section 301 was strengthened by the Omnibus Trade and Competitiveness Act (1988) which has been dubbed Super - 301 (or the crowbar) allowing complaint about a whole range of practices adjudged to be restrictive. 'Named' countries have 12-18 months to comply. Japan, India and Brazil<sup>2</sup> were named in 1989, though Japan and Brazil have since been removed from the list. Through the use of Super-301, the US negotiated the 1990 Structural Impediments Initiative with Japan.

The GATT contains rules

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<sup>2</sup> India and Brazil were accused of breaching international intellectual property laws, especially in the field of pharmaceuticals. Intellectual property, like services, are not included under the GATT, though the US and EC want them included in this round.

<sup>3</sup> It is perhaps worth noting that VERs are a particularly brainless way of dissuading foreign competition. With the use of a tariff, some revenue is generated for government. VERs cede this revenue to either the importer or the exporting country. From a purely national point of view, tariffs are always more economically efficient than quotas.

preventing predatory action on foreign markets, usually referred to as 'dumping'. These rules allow tariffs to be placed on under-priced or over-subsidised products. They are more widely used than Section-301, accounting for 77% of all trade actions from 1979-1988 (under-pricing) with countervailing (duties on goods adjudged to be over-subsidised) accounting for 18%. The US and EC are regularly accused of misusing this provision for the blatant protection of uncompetitive industries.

On average, anti-dumping duties are four times higher than the average tariff on manufactured goods. Such action often leads to VERs - 66% of VERs from 1980-1987 had this source<sup>3</sup>.

## Conclusion

The first section set the scene for an examination of the extent of the increase in unilateral protection in the 1980s. Two main arguments were made. Firstly, the US's competitive advantage in some manufacturing industries appears to be slipping away, and this combined with a visibly successful Japan, is placing increasing pressure on the US administration for protectionist policies. Secondly, the continuing unification of Europe, complicated by the collapse of COMECON may be a major force for retreat from free trade. Set against this, however, was a 'pessimistic' prediction of the future of aggressive regionalisation given the truly global nature of international finance.

The second section went on to

examine the extent of unilateralism in the late 1980s. It was concluded that there is abundant evidence of the use of GATT-legal, GATT-illegal, and non-GATT measures for unilateral purposes. Some of the impetus comes, for the first time in the modern era, from the economics profession itself. It was argued, however, that should the Uruguay round succeed in encompassing intellectual property and services under the authority of the GATT, and further succeed in strengthening the GATT's powers of conciliation and enforcement, then many of the reasons for unilateral action will disappear.

A significant black cloud remains. Unless the US recognises the transient nature of competitive advantage and engages in progressive restructuring of the economy, and further succeeds in having services included under GATT, rather than choosing the politically attractive, but dangerous option of unilateral action, then, to use a classic free trade phrase, everyone will suffer.

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