

P R O T E C T I O N I S M

STATEMENT

by

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## P R O T E C T I O N I S M

Nostalgic references are nowadays being made to the liberal era of the 60's and the early 70's. It is claimed that the open international trading order has been slowly dis-integrating over the past five years or so. Protectionism has allegedly increased such that parallels are drawn with the early 30's.

All this is hardly justified. During the great depression trade contracted by over 25 % in a few years. The fall in world trade volume in 82-83 has been of the order of 2 %. World production has contracted much more. In the first half of this year world trade was again rising strongly.

In reality the "ideal trade conditions of the 60's" have never existed. The international economic system has always had numerous warts and blemishes. Balance of payments import restrictions and exchange controls have for long been the norm rather than the exception, and central planning widespread.

In the trade policy field, there have for several decades been restrictions and distortions in a number of areas; textiles and clothing since 1962; steel - eg. self-restraints by the E.E.C. and Japan vis-à-vis the U.S.A. from 1969 to 1974 and by Japan vis-à-vis the E.E.C. -; specialty steel quotas in the 70's; restrictions against Japanese cars; and shipbuilding subsidies.

Up to the end of 1967, before the beginning of the staged implementation of the Kennedy Round cuts, customs duties in most developed countries were comfortably high. To take a few simple examples : customs duties on passenger cars were 35 % in Japan, 22 % in the E.E.C., 6,5 % in the U.S.A. and 17,5 % in Canada. On polyethylene they were 20 % or over

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in all these countries.

in all these countries. On silk ties the corresponding figures were closer to 30 %. This in itself made it easier to dispense with non-tariff barriers. While trade liberalisation has made progress in the less important agricultural products and processed foodstuffs, trade in the major agricultural products of the temperate zone has largely escaped the liberalisation progress. In the developing countries trade policies have always been highly protectionist, with less than a handful of countries following liberal policies.

Today industrial countries have reduced tariffs to unprecedentedly low levels - indeed staged tariff cutting under the Tokyo Round continues until 1986 - and they have gone even further in the framework of the Generalised System of Preferences. A number of codes such as those on customs valuation and government procurement and subsidies and countervailing duties were negotiated in 1979 to supplement the rules of G.A.T.T. thereby tightening up the obligations of the signatories, and other provisions such as those dealing with dispute settlement, balance of payments difficulties and less developed countries have been clarified. In the regional context, free trade has been achieved in Western Europe in industrial products and the Community has gone a long way to grant full free access to the Lomé countries, and substantial tariff disarmament to practically all the Mediterranean nations.

The "great recession" and the behaviour of exchange rates have in recent years imposed enormous strains on the trading system. The world trading order has withstood the pressures surprisingly well. It has not disintegrated. Creeping protectionism has been eroding the progress achieved in some areas but modest liberalisation in other areas has worked the other way thereby compensating to a degree the regression elsewhere.

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Where has the slippage into protectionism occurred and what form has it taken ?

The picture of textiles and clothing needs to be carefully analysed. Total imports from the developing world into the industrial countries have continued to grow at a significant pace, and both the commodity coverage and, even more so, the exporting country coverage of the restrictions applied under the M.F.A. have expanded. On the other hand, for the major suppliers this meant that their room for expansion had been curtailed and growth had been lower. This double process corresponds to the broadening pattern of product lines and the rapid increase in the number of developing countries which have set up export industries in this area. If the major exporters now have less scope to switch to new unrestricted process lines, their process of upgrading will receive an additional stimulus. Some other suppliers might join in this process on certain products, once their quotas tend to be fully shipped. The result is that while there are admittedly more restrictions in this area, the volumes and patterns of developed countries imports have expanded considerably. Imports from the developing countries increased from 7.3 percent of apparent consumption in the developed countries in 1973, to 17.4 percent in 1981. The share of developing countries in world's exports of textiles went up from 30 % in 1963 to 34 % in 1982. The corresponding figures for clothing were respectively 15 % and 48 %.

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Steel is another trouble area

Steel is another trouble area with a wide and broadening variety of gimmicks interfering with the free flow of trade. A downward trend in steel consumption in the developed world combined with recession and new steel plants in a number of NICs - which for the time being, because of the recession, have export availabilities - is forcing painful contraction and modernization of the steel industry in the whole industrialized world. But world trade in steel is still rising, and production capacity in the developed world together with employment have been shrinking fast.

The shoe industry is another case of a shift in comparative advantage which has led to open and hidden protectionist measures. One might note, however, a number of cases where governments have refused extra protection to their producers. Here again trade continues to grow rapidly.

In/ the car sector, the restrictions are practically concentrated against exports by Japan. Disregarding inflation, exports of O.E.C.D. countries in passenger cars has risen from \$ 4.3 billion in 1965 to \$ 59 billion in 1982.

Finally there are a number of other sectors, inter alia in the consumer electronics area, where new restrictions have been introduced but not in as systematic a way as in textiles or clothing, nor in the same context as in steel. International trade is expanding by leaps and bounds.

In agriculture the picture has not really changed over the last decade. The degree of trade tensions in the area of temperate agriculture products fluctuates with the overall supply/demand situation.

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A meaningful quantification of all these restrictions is well-nigh impossible not so much because of the lack of transparency as is all too frequently asserted, but much more because of the very complex and diversified nature of the measures. It is clear, for example, that the amount of trade suppressed in the case of Japanese car exports is substantial but in other areas when the restraint involves so-called "weather forecasts" or other kinds of export restraint promises, the restrictiveness depends on the precise nature of the undertakings, the degree to which they are respected, trade conditions in the importing country, etc. Although voluntary exports restraints and organised marketing arrangements have multiplied in recent years they have mostly only slowed the progress of foreign penetration in the importing markets or altered its pattern; either other suppliers have taken the place of those directly affected or the penalized exporters have succeeded through selling upmarket products and gained in price terms a part of or all that they were losing on quantity. Considering further that export restraints tend to raise prices charged by exporters, the real burden of such limitations is falling to a considerable extent on the consumers of importing countries rather than on the exporters.

Contrary to the 30's, flows of trade have seldom been actually cut back from levels reached. The "Maginot lines" set up by importing countries have frequently been no more successful than the original, mostly not because the authorities of the importing countries did not realize that the protection was not watertight, but because the Government concerned considered that the degree of restraint thus introduced were enough to keep the domestic pressures they were subjected to at bay. Many measures have been a kind of placebo to operate

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on the psychology

on the psychology of the pressure groups. The criticism of those affected nevertheless remains valid, when one looks at the situation in terms of the "fair" trade that might have taken place in the absence of these measures but an objective analysis would hardly conclude that markets have been closed.

Many exporting countries, including a number suffering from great indebtedness problems, have hardly been affected by the recent protectionist trends, although several of them have been hard hit by a spate of stiff antidumping and countervailing duties to resist unfair trade practices. But claims about the terrible impact of new protectionism can frequently be attributed to the universal tendency of politicians to find external scapegoats for domestic ills. And there is also the understandable dramatisation of the recent trends by those responsible for maintaining liberal trade in order to heighten resistance to protectionism; in the words of Arthur Dunkel, Director General of G.A.T.T. "frightening people for their own good".

This analysis, that the recent drift into protectionist measures has not been so intense as is often claimed, seems to be supported by the fact that whilst no major liberalization measures have recently been taken /though one could merely mention in passing the application on 1/1/84 of the fifth of the eight cuts of Tokyo Round tariff reductions/ the volume of world trade in the first half of 1984 was running 9 percent above the first half of 1983, a rate of growth well above that of world output. As the 1984 G.A.T.T. report states, it was external demand which was the main, often the only stimulus to output in 1983 in industrial countries other than the U.S., Germany and the U.K., and in several developing countries.

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What has happened since world war II is that world trade has been growing much faster than the rate of growth of world G.N.P. The share of trade in the economies of almost all industrialized countries has doubled since 1973, the year of the launching of the Tokyo Round. This has been made possible by trade liberalization, falling transportation costs, improved communications which have lowered barriers and increased receptivity to foreign goods. Foreign trade has now become highly sensitive to changes in national and international economic conditions.

In sum, the trading environment has changed, from a persistent trend towards freer trade until the late 70's, to a situation of strong protectionist pressures and a number of protectionist measures, more particularly directed against Japan and, to a lesser extent, against some of the newly industrialising countries. Most of these countries maintain highly protectionist policies themselves, even in areas where their export performance is strong. In fact, international trade rules apply only to industrialized countries while all the others, regardless of their stage or rate of development remain substantially and, apparently, indefinitely free of international disciplines.

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What then are the causes of these heavy strains on commercial policies ?

Among the more general causes for this trend one can mention that in democracies Governments have today come to be regarded by their electorate as responsible for economic welfare. Indeed in recent years results of elections in democratic nations have increasingly been influenced by economic growth

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and employment performance.



and employment performance. This affects the behaviour of politicians and thus of Governments. High levels of unemployment are an extremely important source of protectionist pressures. The recent record levels of unemployment in the developed world have contributed greatly to new protection. In this respect, political muscle, i.e. voting power related to the number of jobs at stake, matters more than economic misery in winning protection. Unemployment, apart from its impact on the outcome of elections, also constrains budgetary policies, because of the heavy cost of unemployment allowances and the loss of taxation and social security income. The margin of manoeuvre of Government is considerably smaller when unemployment exceeds say 10 %.

The increasing openness of the economies of developed countries, further reduces the scope for effective macroeconomic demand management at the national level. Except in the U.S., general expansionary policies lead almost immediately to rapidly unsustainable current account deficits. This induces governments to prefer sectoral, regional and industrial policies to preserve growth and employment. Hence the deep-seated temptation to resort to state intervention and more specifically direct and indirect subsidization and measures at the border.

There is another development which complicates the handling of commercial policies. It has to do with the changing nature of "comparative advantage" where some quiet shifts have been taking place. No longer do endowments in land, mineral resources, labour and capital determine a nation's comparative advantage to the degree they once did. Even agriculture and fishery have become more "industrial". Rather it is the ability to adapt and use technology for the development of

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new products

new products and new methods of production of goods and services. Technology, scale of production and specialization increasingly influence international trade competitiveness. There is now a greater convergence in the potential structure of production in the more advanced countries so that natural factors are less successful in determining competitiveness and in insulating countries from foreign competition. Comparative advantage instead of being "natural" has mostly become "acquired". In a world where, for a broad range of products and services, allocation of comparative advantage has become more arbitrary and more rapidly shifting, the struggle for each country to maintain for its industries its share in world trade has heightened and the tendency to intervene has correspondingly increased.

In the last decade, disorderly behaviour of the exchange markets have become another, major source of protectionist pressures. Financial and monetary tensions have been putting great stresses on the world trading system. Major movements in real exchange rates, only partly or not at all related to, shifts in balances of payments, have changed radically the competitiveness of some countries' goods relative to those of other countries. At present it is the U.S. dollar which is seriously misaligned vis-à-vis European currencies and less so, in relation to the yen. During an electoral year, this misalignment, notwithstanding a robust recovery and an unexpected drop in unemployment, has given rise to a surge of protectionist pressures in the U.S. The value of the yen on the other hand remains relatively low, probably to a substantial extent because of considerable exports of capital.

Three or four years ago the situation was the other way round : the U.S. dollar exchange rate was undershooting, several

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European currencies

European currencies were extremely strong. Some countries particularly the United Kingdom and France experienced a rapid surge of imports from the U.S. in certain product areas such as that of man-made fibers and fabric. During those years, a number of firms in this sector went bankrupt because of the abnormal import flow. If some inefficient enterprises deserved to disappear, a number of others failed on account of the temporary aberrations of exchange rates.

The successive bouts of overshooting and undershooting change patterns of international trade in a manner that cannot be maintained in the long run. They have a ratchet effect because protectionist measures taken under pressure tend to last while the rollback pressures of undershooting exchange rates are not powerful enough to induce unilateral liberalization. While the present, unsustainable, level of the dollar is having strong positive growth effects in a number of countries, particularly in Canada, Japan and the Far East where the American market looms large in the geographical export pattern, this is less true in Europe where the share of exports going to the U.S. is much smaller (some 15 % for the E.E.C.). For us the level of the dollar adds to inflationary pressures (e.g. because of oil and commodity trading) and high real interest rates in the U.S. with consequent outflow of capital dampen the recovery.

Monetary flows nowadays dwarf trade and services flows and thereby affect exchange rates in decisive ways. Nothing much can be done about it, certainly not in the short term. Central Bank intervention can at the most slightly discourage the ardour of speculators. Capital controls or taxes such as interest equalization taxes on loans are not practicable.

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The difficulty

The difficulty in tackling this issue stems in part from the fact that trade and financial issues are addressed largely in isolation from each other, both within governments and at the international level. While institutions such as the I.M.F. and the World Bank feel free to prescribe "desirable" trade policies, the G.A.T.T. by and large has so far failed to grasp the crucial importance of exchange rate misalignments for trade policy. Obviously the solution to the trade distortions caused by exchange rate volatility does not lie in resort to trade protectionism. Rather it lies in general economic policies and importantly also in improvements in the monetary system where they are largely overdue.

There is in reality no monetary system. The world's exchange rate system ought to facilitate the expansion of world trade and investment. Today the non-system encourages the opposite as the international price mechanism sends out wrong signals for the international division of labour. There is simply an unstable non-system or at most a communication system between Ministers of Finance, Central Banks and international monetary institutions. The goal should be to avoid "incorrect rates" rather than to try to maintain "correct" rates.

Finally, pressure for protectionist relief also stems from the rising number of newly industrialized countries which have succeeded in developing export industries and in establishing themselves on world markets. Exceptionally rapid growth of exports of these countries, often in sensitive sectors, has continued unabated. To take the example of South Korea, Hong-Kong and Taiwan, expressed in U.S. dollars with base year 1975 = 100, the export index in value, disregarding inflation, in 1983 stood at 481 for South Korea, 368 for Hong-Kong and 471 for Taiwan.

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This is in itself evidence

This is in itself evidence that world markets are not as closed as too frequently asserted. What has happened is that along with the rising cost of labour associated with industrialization, the protectionist measures adopted against these countries have prompted them to diversify their exports.

In sum, the agitation about protectionism in trade, particularly as it is voiced by those responsible for monetary affairs and macroeconomic policies, is partly misdirecting the attention to a symptom, while failing to attack the malady itself.

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The real, rather more permanent, threat for the future lies not so much in the classical and not so classical measures such as export restraints. The danger comes from the temptation to use the increasing complexity of regulations imposed on safety, health, environmental and other justified grounds for protectionist purposes. This also applies to the services sector. Traditional regulation will make it difficult to deal with obstacles in this field. How does one distinguish between restrictions which are perfectly justified from those that are just there for protectionist reasons? Then, in addition to state-trading and state monopolies, which tend to remove trade from any internationally agreed rules, there is also the rapid growth in the size of government procurement, not only in the military area. Experience shows that genuine competition in this field requires not simply international regulation and disciplines, but more importantly a change in the behaviour of human beings. That is much more difficult.

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What has also characterized

What has also characterized the recent past is the proliferation of subsidies to support ailing firms. In Western Europe these mostly come straight from the State budget. In some other countries the subsidization has mostly been indirect through generous investment tax credits and in particular tax systems which permit money making firms to reduce their tax bill by taking over tax credits from money-losing firms, thereby allowing both to improve their financial situation. However subsidization is subject to constraints, and that for two reasons. First, with the present unsustainable budgetary deficits, public funds are running out in most countries and secondly, pressure against subsidies is building up from competing firms which do not benefit from the state aids. In subsidization, the worst is probably behind us.

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What are the specific macroeconomic problems which beset the European Community and which have added to the protectionist pressures ?

The present predicament of Europe, more particularly of the Community, mainly stems from wrong economic and budgetary policies in the 70's. Generous social security has made labour markets rigid to a degree that has contributed to high unemployment. The major fault was a general tendency to be too optimistic, to assume that the economic conditions of the previous decades would continue indefinitely. Interest rates were low or even negative, access to cheap capital was easy. Labour priced itself out of jobs. Investment and profits flows were sacrificed to the benefit of consumption.

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Budgets went astray.

In Europe there is excessive "cradle to grave security" whereas on the other hand, in the U.S. given its wealth there may be somewhat too much of a "hire and fire" mentality, which gives rise to social hardships for those that cannot stand the extreme contest of "survival of the fittest". In the Community certainly there has to be a better balance between the twin requirements of economic growth for society and economic security for individuals. Europe's recent modest economic recovery has taken place despite tight fiscal policies and the foreign account is in small surplus. America's take-off has depended partly on unsustainable growth of the federal budget deficit.

Painful restructuring or, more bluntly, contraction, of traditional industries has been going on. The steel, textile and clothing and shoe industries have been adjusting downwards. This has translated itself in frightening figures for unemployment - roughly 12 million or 11 % of the Community work force.

In textiles and clothing, employment has been falling between 1973 and 1982 by 39 % (textiles) and 37 % (clothing) respectively and this fall has continued in 1983 where textile employment dropped by a further 3 % and clothing production by another 2 % from 1982 levels. In absolute terms that means that textiles and clothing employment in the community fell from roughly 3 million employees to 1.8 million at the end of 1983. The Communities shoe industry too saw a significant decline in terms of employment at a rate of about 2 % a year. In steel the figure has been 6 to 7 % per annum. In shipbuilding there has been a contraction of about 50 % in 5 years. In agriculture the total loss between 70 and 83 was 33 %. The Community has not been going on, as has sometimes been said, with its merry ways.

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In the Community

In the Community, progress is being made to lay the foundations for sustained growth. Inflation and budget deficits are down. But we are not immune against the effects of policies of the others. Of particular concern at present are the excessive real interest rates which are directly affecting economic activity, producing distortions of exchange rates and capital flows and exacerbating indebtedness problems.

On the whole, the Community's performance in the matter of protectionism during the recession stands-up well. It is true that the particular problem in trade relations with Japan and the Community's enormous bilateral trade deficit with that country has necessitated certain corrective measures. The same kind of problem has, of course, arisen in the U.S. and some other countries. But apart from this there has been relatively little recourse to additional protection.

### Conclusion

There are no grounds to be complacent about success in opposing protectionism. Likewise there are no grounds for pessimism. The "rising tide" of world trade is far stronger than any "rising tide" of protectionist measures. I do not share the view, which the annual G.A.T.T. report seems to imply, that "trade policy discipline has deteriorated to a point at which protection becomes easily available to almost any industry anywhere". In the developed world at least, national administrations dealing with trade policy are generally composed of men who know what Ricardo said. Many of them, in the words of the Wall Street Journal, wear Adam Smith neckties. There is also a large basis of mutual trust between the major actors on the world trading scene which has and will continue to prevent disputes from escalating into trade wars.

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In recent years in the O.E.C.D., the Western Summits and other fora, there has been a long series of solemn communiqués and lofty commitments to a standstill on protectionist measures and to liberal trade. These declarations serve a useful purpose in that they can be quoted against protectionist lobbies. But it would be highly desirable that action be more compatible with the words - and if that is not possible then the advice should be to refrain from repeating so often aspirations that are in stark contrast to what is feasible and realistic. For not only is the credibility of those who subscribe to these statements at stake, but what is worse, the strengthened resistance to protectionist measures which is expected to result from such collective commitments fades away. The desirable and effective kinds of international undertakings are those which go somewhat further than Governments consider they can achieve so that they may influence behaviour. But commitments which go so much beyond what is realistic that they lack credibility and therefore efficacy should be avoided.

More important than statements is collective action in macroeconomic policy-making and systemic changes in the monetary and financial fields to support the recovery. That is a basic requirement for world trade to expand. Economic growth facilitates the adjustment process in the developed world. In turn, this helps the developing countries to expand their export receipts. Sustained growth will require protectionism to be kept under control and further efforts to be made to liberalize trade. The recent increase in "managed trade" may have been inevitable during the recession and even helpful sometimes to avoid more serious havoc to the trading system. But the time has come to counter protectionism by initiating the preparations of new trade negotiations - not necessarily one massive big round of the earlier kinds -

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but perhaps through other formulas.

but perhaps through other formulas. The process of multi-lateral negotiation being by its very nature complex and time consuming, the preparations should start so that when the world economy regains its health and strength and when the financial and monetary situation improves, negotiations are not delayed by the lack of preparation. Common efforts to liberalize trade will then provide a counterweight to protectionist pressures and should thus help to keep world markets open, contributing thereby to the convalescence of the patient. In such a new round a substantial input will be required on the part of the successful newly industrialized countries.

Finally, a broader consideration : free trade is not an end in itself but rather a means towards increased welfare - not only in material terms - all around. It is this objective which is fundamental and when deviations occur they should be kept at the minimum with the basic consideration of human welfare as a guideline.

This statement should not be construed as a defence of the recent trend to protectionism. It is merely an attempt to set the record straight. The resistance that has been offered to the pressures augurs well for the future. But this statement is intended to be a warning. If macroeconomic policies do not improve and exchange rates continue to behave in grossly distorted ways, the worst could still happen.