A FAIR DEAL FOR FREE TRADE

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Mr. Chairman, thank you for your welcome and your words of introduction. I count it a great privilege to be able to talk to you today. I count it an even greater privilege to be able to talk to you about something which does not exist. Because free trade is like absolute zero in physics, a theoretical concept not encountered in the day to day world.

But this observation should not deflect us from realising how far we have been able to move to free trade in the years since the Second World War. The 1930s were marked not only by the Great Depression but by the Smoot-Hawley tariff in the United States, retaliation against this very high tariff from a whole range of other countries, a jungle of restrictions in the form of both high tariff quotas and distorting bilateral deals in Europe. Exporting unemployment was a fashionable slogan. Expanding world trade in these conditions was like swimming in a lake choked with weed.

The reforms in international finance and trade worked out at the end and immediately after the war and in which the United States played a major part laid the foundations for what was called the one world trading system. Under the aegis of the General Agreement on Tariffs and Trade tariffs and other restrictions were drastically cut in a series of major trade negotiations. The average tariff on industrial goods imported into the United States and the European Community is now only some 4½ percent. And not only were tariffs reduced they were also bound which means in the jargon of the trade that they cannot be increased without a negotiation seeking agreement on appropriate compensation. United States exports in 1982 to its biggest customer, the European Community, totalled some $48 billion. By far the greater part entered under tariff headings which were bound. This meant a degree of access stability and prosperity for American and other exporters undreamt of in the 1930s.

All this has meant since 1947 the greatest increase in prosperity the West has known in recorded history. World trade which had stagnated in the 1930s rose by an average of 8.5 percent a year in volume in 1963-72 and even in the oil shock years of the late 1970s was rising between rates of 5 and 6 percent.

It is I know argued that protectionism is rife and is stifling world trade. But these charges are exaggerated. With the exception of steel there are few restrictions on trade across the Atlantic. In the case of textiles, often instanced as an example of protectionism, some 40 percent of European Community imports come in from developed countries without quantitative restrictions - providing in particular a good market for American exporters. In the case of trade with Japan you are all here very familiar with the restrictions which have been introduced on automobiles in the United States and Europe. I shall return to this important point later.

Indeed the remarkable thing about the one world trading system is not that here and there there have been some minor inroads of protection but in the biggest recession since the 1930s the system has held.

Of all this general prosperity the United States has deservedly taken a fair slice. Not just in its exports to Europe. Between 1970 and 1980 the value of U.S. agricultural exports jumped from $7 billion to over $41 billion. The U.S. share in volume of world exports of agricultural goods rose from 25 to 39 percent. In 1980 the U.S. registered in its trade balance a surplus of just under $27 billion in the agricultural sector. If one looks at manufactured goods the United States share of world exports in manufactures rose from 17 percent in 1978 to 21 percent in 1981.

All this explains the dramatic rise in the proportion of American Gross National Product represented by foreign trade. For one hundred years after the Civil War this never rose above 3 to 4 percent. Then in the 70s and the early 80s it soared to a current 12 percent. And that is the background of the change in the American scene from the 1930s to the 1980s. I went to a meeting last fall shortly after

I got to Washington run by the Centre for Strategic and International Studies. And someone got up and asked the very distinguished panel presiding over the proceedings how he could explain to the General Secretary of the Garment Workers Union what the benefits were of free trade. This was a tough question and the panel understandably hesitated. That redoubtable character Robert Strauss seized the microphone and gave an answer. He said, "Take early retirement".

That is certainly a solution. But the sketch I have given is, I suggest, a pretty fair defence of what not absolute free trade but the one world trading system has brought to main street America in comparison with the memories of fifty years back of "Buddy can you spare a dime". Between 1938 and 1982 the Gross National Product of the United States rose in real terms five times. That is one answer to our questioner.

But hold it a number of you will say. That is fine and dandy as far as the general economic scene goes. But here in Detroit the automobile industry is in real difficulty. And Pollyanna lectures about general economics don't help us. What about the proposals for domestic content.

Anyone can see that the situation has not been without its difficulties As Mark Twain said of "Pilgrim's Progress", "the statements was interesting but tough".

Production in the United States of motor vehicles and parts fell between 1979 and 1982 by over 50 percent. Now they are rising but there is still a way to go. Employment and the domestic market have strengthened markedly. But worst of all has been the foreign trade balance. In 1981 you exported in this sector $16.2 billion and imported 26.2, a deficit of $10 billion, in 1982 the deficit reached 15½ billion, in 1983 exports fell further, imports rose further and for the first half of 1983 there is a deficit at an annual value of something like $21 billion.

So the argument seems persuasive. Whatever the general picture the case of the automobile industry is a special one. To protect jobs and plants imports should be restricted.

But here I have to say that we should learn something from history. President Hoover once said that if the Smoot-Hawley tariff were not approved by Congress grass would grow in American cities. Grass nearly did grow because the Smoot-Hawley tariff was approved by the Congress. And it started the great protectionist slide of the 1930s. The general lesson in Europe as well as the United States over the last fifty years has been that taking protective measures is like giving slugs of red eye to someone not notoriously on the wagon. The more you pour the more is demanded. The more uproarious the demands become. And the worse afterwards the patient feels.

But let me be more specific. Let me comment in turn on four aspects of the problem.

- Some of the causes and effects of increased competition and requests for protection.

- The question of our relationship with developing countries.
- The question of steel because here you are one of its biggest customers.
- Japan, which can never be far from your thoughts.

Let me try and deal in turn with some of the causes and effects of the problems of competition and associated requests for protection. In the first place high interest rates. These have come down markedly over the last two years. But are still historically very high. They pose questions about investment. Where is the eager or cunning soul who would risk his money in a speculative investment when sitting idly by he can earn nearly 9 percent on a money market account. And who is going to hold for wary prospective customers a huge stock of showroom automobiles with the same interest rates. The news that these are shading upwards is not over the next year going to stop the remarkable recovery which has shown itself in the United States. But it must cast a chill on many of you in the automobile business here. However, cutting imports is not going to bring down interest rates. That can probably only be done by reducing the budget deficit.

Then the strength of the dollar which is largely caused by high interest rates. One economic truth often forgotten is that a strong currency plays a large part in the encouragement of protectionism. Unemployment and low capacity utilisation of course call for measures of this kind. But they tend to be selective. Over-valuation of any currency tends to call for more general protectionist measures.

Let us look back on the 1970s. In the final phase of the breakdown of the Bretton Woods system the dollar was over-valued - it was generally held - by some 15 percent. The result was the Mills Bill in 1970 and the Burke-Hartke Bill. These would have limited virtually all U.S. imports. And these Bills very nearly got past the post. At the time the unemployment rate was at its twenty year low. In 1976/77 the dollar was again over-valued and again protectionist pressures rose. An IMF analysis of U.S. trade measures shows that the number of times anti-dumping or counter-vailing duties were imposed on the various escape clauses leading to quotas and/or market agreements were invoked was higher in 1976 and 1977 than the previous two years (16 actions in 1977 and 26 in 1976 against 5 in 1975 and 9 in 1974). 1974 was a year in which U.S. unemployment was historically high and real growth declined by over one percent for the first time since 1954. But Congress passed the Trade Act authorising the extensive liberalisation that took place in the Tokyo Round. The dollar and the current account were then in approximate equilibrium.

A year ago it was generally estimated that the dollar was over-valued by about 20 percent and the yen was under-valued by 20 percent. The situation is now marginally better. But you here have seen the results. Rising protectionism, the passage by the House of Representatives of a Domestic Content Bill, a Bill in clear violation both of the principles of the General Agreement of Tariffs and Trade, of the Ministerial Declaration at the GATT meeting a year ago and of the Williamsburg Declaration signed among others in June by the United States.

So the strength of the dollar has caused a good deal of damage. It cuts demand abroad for American exports for industrial and farm products alike and it makes imports more attractive. But what would be the effect on the strength of the dollar if you were to cut imports. The answer is that the trade deficit would shrink and the dollar would rise still further. And the problem would get worse.

Then there is the question of relations with developing countries. Often this is put in abstract terms. Let me here in Detroit put it in practical terms. United States exports of transport equipment to, for example, Latin America amounted in 1981 to \$5.4 billion, in 1982 to \$3.3 billion, in the first half of this year to \$1.07. And all this not because of unfair competition but simply because Latin America cannot import; they cannot finance their debt.

In 1982 just under \$120 billion of United States exports, some 42 percent of the total, went to developing countries. On these purchases of American goods some 6 million American jobs depend. How are these countries supplised to pay for what they buy from you? Few would argue that the American taxpayer should pay for them. But these countries need to earn foreign exchange. How can they do so if they are kept out of one of the biggest markets in the world? Then there is an economic factor. This country grew great on change. The United States not only recognised it.

It pioneered change. Think of the Bell telephone, the Model T, the B17 and colour television. But the world in which you are now year in year out much more heavily involved is changing too more rapidly than ever before. And there is no international statute that says that production of automobiles or the steel that you use for them should be limited to the North American or European continents. The developing world is getting in on the act, just as they got into textiles in the 50s and 60s and into radios in the 70. Can we, like King Canute, try and stop the tide? Or should we not employ the skill and the inventiveness of the peoples of North America and Europe to move into more technologically advanced production both in steel and elsewhere.

Let me say a word about steel since this is a very important part of automobile production. Just as with automobiles with American steel mills operating at well under 60 percent of capacity cutting imports can seem very attractive. But pause to think for a moment of the consequences. Let us assume that by some stroke of sinister magic all steel imports were eliminated. Would the problems of the American steel industry be solved? No. Without foreign competition they would be aggravated. Plant modernisation, already lagging behind that of competitor countries, would be further delayed. Only 34 percent of steel produced in the United States is by continuous casting, the most advanced steelmaking technique, compared with 82 percent in Japan and 56 percent in the European Community. The Chairman of a major U.S. steel firm estimated recently that one-third of the United States steelmaking facilities required modernisation. Without imports labour productivity would decline further and costs would increase. Already wage rates in the steel sector are well above the average for manufacturing industry. Prices would rise and the rise in prices would have an adverse effect well beyond the steel industry. All that wide range of domestic industries that use American steel, and I am today speaking to one of the biggest, would also lose competitiveness. And the great danger is that pressures for increased protection elsewhere increase. If they succeeded this would mean retaliation against American exports which would inflict grave damage on the American economy.

Then Japan:

The problems of the Community - and I may add the United States - with Japan are ascribed from time to time by Japanese commentators to workshy Europeans and Americans facing efficient Japanese competition, to sheer protectionism, to a reluctance to adjust. The picture in reality is a different one. The Community's problems with Japan stem from a combination of three factors. Each on its own would be of limited import. Taken together, like the chemicals in a dangerous combination, they can create an explosion.

The first is the size of our bilateral deficit with Japan. In 1963 the ten present Members of the European Community had a trivial 86 million dollar deficit with Japan. This rocketed to some 500 million in 1970, to 3.4 billion in 1975 and over 11 billion in 1982.

At the same time Japanese exports to Europe in certain highly sensitive areas like automobiles, colour television tubes and sets, and certain highly developed machine tools rose massively.

At the same time European business found it difficult year in year out to penetrate the Japanese market.

Taken in isolation, these factors are not all in themselves decisive. We run bilateral surpluses and deficits in turn with our trading partners. But taken together, a massive and increasing deficit, increasing inroads on our sensitive industries and a sense that our manufacturers cannot get into the Japanese market to the same extent as they can get into other industrialised countries of the world creates risks which can become dangerous.

Let me give just a few figures to support what I have said.

Total Japanese exports of manufactured goods in 1960 amounted to 3 billion dollars. In 1981 the figure had soared to 136 billion dollars. But Japanese imports of manufactures in 1960 at just under 1 billion dollars had risen in 1981 to only 28 billion dollars.

Again in 1980 the European Community imported manufactured products equal to just under 800 dollars per head. The figure for the United States was 547 dollars, the figure for Japan was 233. Thus Japan's imports of manufactured goods are about the same value as those of Switzerland, an economy one-tenth of that of Japan.

And in per capita terms Japan is next to last among Member States of the OECD. The percentage of total imports represented by manufactured goods is equally striking - 55 percent in the case of the United States, 46.5 percent in the case of the Community - only 22 percent in the case of Japan.

These figures demonstrate more clearly than any long argument the size of an imbalance which is putting a strain on the world trading system.

What therefore can be done? It seems to us in the Community that there are two courses of action. The first is short term. The second is long term and more essential. The first course lies in ensuring a certain moderation in exports from Japan where there is prospect of rapid growth and where there are political and industrial sensitivities in the United States and Europe. This is not to make the case for protectionism. But this is to say that it is compatible with the maintenance of the open world trading system if it is recognised from time to time in certain difficult areas that there are political and social limitations to the rapidity of adjustment. But this leads to another logical conclusion. I have mentioned adjustment. If adjustment does not take place, if fears for the speed of adjustment are used to block adjustment entirely then we could well have been producing here, at great cost to the American taxpayer, stagecoaches - rolling out every week in their hundreds at a cost to the federal government of thousands of dollars - stockpiled in some great graveyard somewhere and all a tribute to some remarkably energetic lobbyist. They flourish in all countries and of course particularly a country as energetic as the United States. So the rationale for a temporary limitation is that there is a restructuring and a genuine and purposeful restructuring. Otherwise whether it be the United States or Europe we are left inactive in the world market we depend on and increasingly dependent on forlorn attempts to sell stagecoaches to a world which will require jet propelled automobiles.

The second course of action which is essential is that Japan opens its market to the Western world for manufactured goods. And here I think we can both be glad to see that we have seen some progress. The administration of Mr. Nakasone is clearly making a genuine attempt to ensure that Japan assumes the international trading responsibilities commensurate with its sensational success as a world exporter. On the 1st of April 1983 a series of tariff and non-tariff measures were brought into effect. And on the 21st of October certain other measures were implemented. We need of course to see how these measures develop.

But recognition by our Japanese friends that they need to exercise some moderation in exports in certain sensitive sectors towards the United States and Europe, recognition I hope in these sectors in the United States and Europe that the justification for this moderation can only be restructuring and a move towards increased efficiencyon our side and a steady opening up of the Japanese market for manufactured goods.

These measures should begin to deal with one of the major problems in international trade which both of us have faced over the last fifteen years.

Mr. Chairman, I return at the end to where I began. Free trade as such does not exist. But the free world with substantial leadership from the United States has made over the last thirty-five years great strides towards it. This has meant the biggest increase in prosperity in the West in recorded history. It has changed the face of this country, of Europe and of the world. The siren voices of protectionism are seductive. But we need to remember the cost, the fact that just over fifty years ago with the Smoot-Hawley tariff and equivalent restrictions in Europe we saw the damage that protectionism can bring. For the protectionist bell does not toll simply for one industry. It tolls for us all. History will never forgive us if just as we were emerging from the worst recession for half a century our courage faltered and we plunged back again into the stifling restrictions and the poverty of the 1930s. Whatever arguments we may have across the Atlantic, the United States and Europe have to work in partnership to keep the one world trading system alive. So far we have managed it. I salute today the courage in this country and in our own Community which has made this possible. And I am sure that together we will continue to succeed.