European Communities Commission
Background Report

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RETREAT FROM FREE TRADE?

The Community and the world recession

Summary

Economic recession is tending to erode the pristine principle of free trade in the Western world. The problem is made worse because fall in demand in industrial countries has coincided with increasing competition in sensitive sectors from the developing world and the state trading countries. The European Community as the world's biggest trade negotiating body, has heavy responsibilities in this sphere.

The Community has already, in the Multi-Fibre Arrangement under GATT, introduced restrictions and, in some cases, a quota system on the import of textiles from developing countries; the Commission has proposed ordered restructuring of the steel and shipbuilding industries to meet the fall in demand. The footwear industry is suffering from low-cost imports and contracting markets for its own exports. Japanese penetration of the Community market has led to Community/Japanese talks on the Community's distorted balance of trade with Japan, and to voluntary Japanese restrictions in certain key industrial sectors. This note looks in more detail at current developments.

The Commission's aims

Pressure towards protectionism arises not only in the Community but in the USA. The international situation, therefore, is very different from that when the GATT Tokyo Round began with the Declaration of 1973.

The Commission's aim, in these difficult circumstances, has been to persuade member countries to adhere to the basic principles of the Treaty of Rome - fair and free competition - and not adopt protectionist, beggar-my-neighbour policies that could destroy the Community. Rather it has sought to regulate the flow of trade, so that in a contracting market available outlets are, as far as possible, equitably shared. This policy has broadly been adopted by the Community in such international forums as the GATT and OECD; internally, however, Commission proposals for structured contraction of certain industries still lie on the table.

Textiles

The first Multi-Fibre Arrangement (MFA) came into effect on January 1, 1974 and was designed to expand trade in the textile industry, reduce barriers and encourage the progressive liberalization of world trade in an orderly and equitable way, thus avoiding disruption of individual markets and individual lines of production in both importing and exporting countries.

By the time the first MFA expired at the end of 1977, an unprecedented upsurge in textile and clothing imports from developing countries, combined with economic recession in the Community, created not only balance of trade difficulties, but began to threaten the existence of the Community's own textile and clothing industries, particularly in Britain and France.

The Community made it plain that it would only adhere to the new MFA if it could get bilateral agreements with major textile suppliers to restrict the flow of imports. By the end of 1977 most exporters had agreed, and the Community accepted the extension of the MFA for another four years.

The major objective of the negotiations as set out in EC Regulation 3019/77 (OJ No L 357, 31 December 1977) was to seek immediate restraints on all significant suppliers of any textile product considered at all sensitive, either in the Community as a whole or in a particular member state. For the eight most sensitive products, where import penetration in the EC is highest, the negotiations sought to restrain all low-cost suppliers within an overall ceiling. In addition, in the case of new suppliers, the Commission has power to insist on strict consultation so that immediate action can be taken to introduce new restraints on particular products not subject to restraint through bilateral agreement.

These restraints take the form of quotas, ceilings on imports, and a flexible basket arrangement for less sensitive textile products.

The earlier MFA stipulated a minimum annual growth rate for imports of 6 per cent. Under the new Arrangement the Commission has authority to negotiate much lower growth rates, in some cases as low as 0.5 per cent or nil growth for certain products. For further details see BR ISEC/B33/78, April 27 1978.

Footwear

Though the problem is less acute, the number of shoes imported into the Community from third countries is also causing alarm, particularly in Ireland.

From 1973 to 1975 imports remained fairly steady at around 180 million pairs of shoes a year; by 1977 this figure had risen to 300 million pairs a year, the bulk of the increase coming from Hong Kong, Taiwan and South Korea.

These three countries have been particularly hard hit by recent restrictions imposed on shoe imports by the USA, Canada, Australia and Japan. The Commission estimates that these restrictions have released a potential 50 - 100 million pairs of shoes on the market from low cost countries. In addition, US import restrictions have badly affected Italian shoe exports, normally 47 million pairs of shoes for the American market.

Under Article 135 of the Act of Accession, Ireland has been authorised to adopt protective measures for her footwear industry against a general list of suppliers. More recently the Irish have requested the introduction of quantitative restrictions on imports into Ireland of certain categories of footwear. The Council has agreed that the Commission should continue talks with main supplier countries, and the request will be re-examined in the light of the outcome of the talks.

In October 1977 the Commission decided to set up a Joint Committee for the footwear industry. Its duties are to assist the Commission in studying the social and economic problems arising in the footwear industry.

The 38 members of the committee are equally divided between worker and employer representatives at European level. This is the first time official contacts have been established between the two sides of an industry for which the Treaty does not specifically prescribe a common policy.

For statistical purposes the Commission has been operating since May this year a prior automatic licence surveillance system on the import of shoes into the Community. This, however, is a temporary measure, and, subject to approval by the Council in July, will be replaced from October 1 by a more flexible system which will not require the use of prior automatic licences. The present system applies to imports from Brazil, Hong Kong, South Korea, Malaysia, Pakistan, Spain, Taiwan, Czechoslovakia, Poland and Romania.

Steel

The Community steel industry has been badly affected by economic recession, and Commission policy has been mainly concerned to maintain an economic price for steel products in order to encourage further investment and restructuring; to avoid low-cost dumping by third countries, and to ward off restrictions on steel imports contemplated by the USA.

At present the steel industry is working at only 60 per cent of capacity. Temporary price support measures, introduced in 1977 and extended into 1978, have helped the industry avoid further collapse. These support measures take two forms: (i) the invocation of anti-dumping procedures against cut-price imports, and (ii) extension of the system of minimum prices and guide prices for steel produced within the Community.

At the end of April 1978 the Commission sent the Council of Ministers a draft decision on state aid and subsidies in favour of the steel industry.

The decision, which will require the unanimous consent of the Council, is based on the same lines as the fourth directive relating to aids for shipbuilding. It will apply to all aid and subsidies whatever their form of origin, namely, general and regional aids, funds put at the disposal of public undertakings, and aids and subsidies granted by local or regional authorities.

The anti-dumping measures, originally intended to operate for 3 months from 1 January 1978, imposed an anti-dumping duty on low priced steel imports, designed to bring them up to a reasonable minimum. Meanwhile the Commission has been negotiating with non-EC supplier countries to impose voluntary limitations on imports. Commission negotiations along these lines have already been successful with a number of third country steel exporters (see also BR ISEC/B1/78).

Meanwhile there have been consultations between the USA, Japan and the EC to produce a new 'world steel agreement'. The aim is both to prevent price cutting and to put some order into the 'chaos' of the world steel industry.

Shipping and shipbuilding

The Community's cargo-carrying trade is increasingly threatened by competition from the state-trading countries. The Comecon group (mainly the Soviet Union and Poland) now have a virtual monopoly in their bilateral trade with Community countries, and have already obtained about a fifth of the shipping trade on other lucrative routes, such as the North Atlantic and the Mediterranean.

At its meeting on June 12 the Council considered a Commission proposal aimed at providing a framework in which efficient Community shipping companies could compete with the state trading countries and which would empower the Community to place certain restrictions on cargoes carried from Community ports in state-trading vessels. (See BR ISEC/B37/78). The Council did not adopt the proposal, but agreed to set up a general monitoring system which, from next year will provide information on Comecon shipping and freight rates in Community ports.

The shipbuilding industry is also in crisis. During 1976 orders in Community shipyards (as in third country yards) fell by 40 per cent, and by a further 20 per cent in 1977. Orders estimated for 1978 appear to be about half that of 1976 production, and are unlikely to exceed 60 per cent of the 1976 figure even in 1980.

The Community yards tend to be uncompetitive with yards in third countries and particularly in the Far East. This has led Viscount Davignon, the Commissioner responsible, to urge that output from EC yards should fall from a 1975 peak of 4.4m compensated gross registered tons to 2.4m cgrt by 1980.

The Council is at present considering a Commission proposal for reorganising the shipbuilding industry[1], and recently adopted a directive (78/338/EC) on co-ordination of aid to shipbuilding.[2] In the Commission's view short-term national efforts to prolong the life of inefficient yards or continue production of unwanted vessels can only lead to further deterioration of the industry. Instead, a medium-term Community strategy is required to make the yards competitive in the world market, coupled with adequate social provision and the creation of new jobs for those affected adversely by new techniques and change. (For details see BR ISEC/B11/78).

So far member countries, particularly Britain and Italy, have not taken kindly to the idea of regulated contraction of their yards under Community auspices.

Externally the Community has sought cooperation from third country shipbuilders in cutting production and sharing orders in a regulated way. Within the OECD the Community participated in the preparation of the general guidelines, approved on 4 May 1976, which provide that, in order to remedy the serious structural disequilibrium existing in the industry, efforts are needed in all shipbuilding countries in order that the inevitable reduction in world shipbuilding capacity may be achieved in the least damaging and most equitable way possible.

The Community has also requested the Japanese government to make special efforts because of the swift expansion of the Japanese shipbuilding industry in recent years. The Japanese government agreed to advise its shipbuilders to increase prices by 5 per cent so as partially to reduce the gap between EC and Japanese prices, estimated to average 40 per cent, and to reduce hours worked in Japanese shipyards by 30 per cent in 1978. At an April OECD meeting in Paris, however, the Japanese were complaining that they had been 'conned' into cutting capacity and raising prices while Community shipbuilders were kept afloat by more and more subsidies.

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(1) COM(77)542 final, 6 December 1977

(2) OJ No L 98 of 11 April 1978

Challenges to other industries

The man-made fibre industry, whose output represents nearly 50 per cent of all textile fibre consumption, is also passing through a particularly serious crisis because its production capacity is far in excess of market demand.

In July 1977 the Commission asked the member countries to refrain until 1980 from granting any assistance whose effect would be to increase existing man-made fibre production capacity. Since then, following consultations with the industry, it has become clear that it is operating at over 20 per cent capacity for market demand and that, as with steel and shipbuilding, it requires a strategy of orderly contraction. A reduction of imports from low-cost countries was included in the bilateral agreements on textiles under the MFA (see above) and the Commission is at present examining the legal foundations for a possible rationalization of the industry. In a speech on May 28 1978 Mr. Davignon indicated that the man-made fibre and steel industries had much in common: production over-capacities and decline in demand, combined with investment to increase capacities, price reductions and considerable financial losses.

The Commission also notes that, while at present retaining its dynamism the petro-chemical industry is vulnerable to a number of threats, and these must be kept under watch in case they create difficulties that may become permanent. The plastics industry is another case in point.

To meet some of these problems the Commission is considering legislation that would permit the establishment of crisis cartels for certain hard hit industries - a significant departure from the free trade principles that have hitherto been the basis of the Community's competition policy. The cartels would be exempt from the provisions of the Treaty against restrictive practices.

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