

Harkort, Günther

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# A Concept for an Open World Economy

by Dr Günther Harkort, Bonn

**One of the many new publications dealing with the reform of the international trade system is the report of the Trade Policy Research Centre "Towards an Open World Economy". The following article analyses and criticises the main proposals of the report.**

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In September 1971, soon after the OECD had published the Rey Report<sup>1</sup>, the Trade Policy Research Centre, a private organisation set up in London in 1968, brought out a report by a study group with the title: "Towards an Open World Economy"<sup>2</sup>. Frank McFadzean was the chairman of the group and Sir Alec Cairncross, Sidney Golt, Professor James Meade and the American Professor Harry G. Johnson — all of them well known for excellent practical or theoretical work in the field of international trade — were among its members<sup>3</sup>.

## Basically Liberal Approach

The report contains evidence of considerable expertise, as was indeed to be expected from a group of such high standing. It shows everywhere the signs of perfect knowledge of the subject. That is true also of the background papers. Forming a smaller and more homogenous group, the authors found it easier than the Rey group to reach common conclusions. The report is written in a fluent, succinct and readable style — which one would hesitate to say of the Rey report.

<sup>1</sup> Policy Perspectives for International Trade and Economic Relations, Report by the High Level Group on Trade and Related Problems to the Secretary-General of OECD, OECD Paris 1972, 168 p.

<sup>2</sup> Frank McFadzean et al.: Towards an Open World Economy, London (MacMillan, for the Trade Policy Research Centre) 1972, 198 p., bibl. The Report is being published in North America by St. Martins Press, New York, and distributed in Japan by Maruzen, Tokyo.

<sup>3</sup> The book comprises the report proper, "Proposals for Future Trade Strategy" (40 p.), eight chapters dealing with individual problems and described as background papers (120 p.) and a selective bibliography. Responsibility for the background papers rests with their respective authors; the papers contain further explanations for the proposals in the Report.

The very useful bibliographical appendix (11 p.) refers to books and articles — mostly of recent date — on the topical problems of international trade. The publication was brought out in London and therefore mentions only writings in the English language. More than half the titles are by American authors; the others are by British, Canadian and Japanese writers and by the German Professor Pribe. Europeans have only themselves to blame for this lack of balance; they took more interest in the establishment and enlargement of the EEC. Besides, they are not quite as dissatisfied with the world trade system as are — at present — the Americans; discontent is known to stimulate literary activity.

The basic approach is emphatically liberal, as may be inferred from the title, but it is not utopian. Or it is at least not more utopian than specialised experts — whether working in the sphere of education, urban planning, development aid or foreign trade policy — are apt to be when they join forces to supply the public, governments or other specialists with good reasons for whatever action is absolutely necessary in their own sphere and deserves being given priority over everything else.

The aim of liberal trade policy — and who among them is not liberal in principle? — is the free exchange across the frontiers of goods, services and capital under competitive conditions, undistorted by government intervention, whether intentional or unintentional. However, what is modern economic policy if not growing intervention by the state? This is not something which trade policy can change though it is bound to demand that intervention must not be practised in a way which debases international competition; often this means that acts of intervention on the national level should be coordinated internationally, and this raises vexed questions, both of substance and of method, for the governments. One can only hope with some trepidation that the governments will be willing and able to do what is objectively required under trade policy aspects.

## Europe

This is what the authors of this report do. They share the fate of all who have spoken or written about this subject, the authors of the Rey Report included: They have not come up with something entirely new, something nobody else has been thinking of. That cannot surprise and is no cause for complaint. The field of international trade has been turned over and over for scores of years;

the problems, the causes of disruption, the options for a solution, the possible modes of procedure are well known to the experts. For this reason new proposals for a future trade strategy can be novel only insofar as they involve a convincing and realistic appraisal of the problems to be solved and a convincing and realistic programme of practicable solutions. Logic and consistency will always convince, and they are to be found in this report. But they are not by themselves convincing enough. An inherent part of any concept which covers the trade policy in its entirety is the political point of view from which it arises; and whether it convinces the individual reader depends on his sympathy for this political point of view.

And so the "European" reader will ask: What does the report make of the EEC? Well, it does not care for it. Essentially, it fails to focus on the facts. Nowhere is it made clear that the EEC has been launched by a legal instrument containing important articles which will for some time have to be left essentially unchanged if the existence of the EEC is not to be put at risk. That fact must be taken account of in any trade policy which is conceived with proper regard for reality. Our American friends tend to overlook this at present; the report shows the same tendency. On the two main points at issue between the United States and the EEC — the EEC's agricultural policy and the preference agreements — this British report is indeed leaning towards the US side. Similarly, the plan for a monetary union with fixed rates of exchange inside the EEC is dismissed tersely — too tersely — as being at present unattainable. The subjects are more or less the same as in the Rey Report, the missing chapter on monetary policy is replaced by Professor Johnson's contribution on Commercial Policy and the Monetary Crisis of 1971. The space available does not permit to analyse all suggestions. Only a few of them are dealt with.

#### **No Import Duties on Industrial Goods**

As regards industrial goods the report comes out against a more liberal trade and in support of free trade. The industrial tariffs should be completely abolished between the industrialised countries through progressive, linear and automatic reductions over a period of 5 — 10 years (while the developing countries are to enjoy the same advantages on a non-reciprocal basis). Exceptions are to be allowed only on grounds of "national security" or "national interest". To enable the governments to engage in such a more or less total removal of tariffs, the system of escape clauses to counter abrupt market disruptions would have to be improved.

The negotiations could not be given the necessary political impetus without such an ambitious and plausible objective. For a number of reasons other possible negotiating techniques — the Kennedy Round method, harmonisation of tariff levels, sector-by-sector approach — could not be expected to yield any great results. The method of automatic tariff cuts down to zero would meet the need for reciprocity, by itself solve the problem of tariff harmonisation and — a point not made by the authors but certainly in line with their aims — do away with all forms of discrimination involved in the EEC association and preference agreements.

Looked at objectively, the industrial tariffs of the industrialised states could certainly be removed to everybody's advantage. That however applies to many things on this planet which nevertheless are allowed to continue. Where is the country in which the belief in the advantages of free trade is held with such wide-spread and firm conviction that the government, supported by it, can disregard non-economic aims and overcome all opposition by vested interests? Nothing but harm would come from paying lip service to free trade in the fond belief that the reluctance of other partners will prevent the worst — namely, zero point being reached: such negotiations would be dishonest.

The experience of recent years has shown of what ingenuity governments are capable when they want to make up for reduced tariff protection by other defence and support measures. When they take such action, a perceptible, quantifiable and comparable protective device — the customs duty — is replaced by others which lack all these attributes. Anybody who knows of the, hardly encouraging, discussion about non-tariff barriers will be aware into what a quagmire this can lead.

Tariff negotiations aiming at zero duties would as a matter of course, one is tempted to say, generate a vast growth of the exemption lists; "national interests" ruling out zero tariffs could easily be found anywhere.

Besides, if tariffs were reduced to zero, would they not release a tidal wave in the use of escape clauses? The report says that escape clauses to counter market disruption must in any case be expected to play a bigger role in future than they do at present; of the relevant Article XIX of GATT virtually no use is being made now. The report wants this article to be amended, to be worded more precisely and to be enforced more firmly. But even if this were done, would such a tidal

wave be better for international trade than the continuing existence of moderate tariffs? There will be even more reason to ask this question if — as does not seem impossible — “discriminatory” escape clauses are permitted which are directed against the “disruptive” country alone and no longer — as stipulated by Article XIX — against all countries. On this difficult problem of discriminatory escape clauses the authors have not expressed an opinion.

In view of this it is worth considering whether it would not be more realistic and judicious to set the coming negotiations a more modest target than zero tariffs — for instance, a substantial linear reduction combined with heavier cuts for the highest duties and special attention for the effective, as well as the nominal, tariff rates.

### **Agriculture: The Problem Child**

The pages devoted to agriculture present a special problem in any publication dealing with trade policy. The report contains in its Summary of Recommendations only a guarded proposal about how to proceed. A high-level working group is to be formed by representatives of countries exporting or importing temperate-zone farm products. This group is to study whether the existing agricultural support systems achieve the desired impact on agricultural incomes, what disruptive effects they have on world trade, and what alternatives exist for attainment of the social objectives in a socially more effective way which is “possibly less disruptive for world trade” and at the same time politically acceptable.

The words put in quotation marks are rather moderate but also especially appropriate. The section on “Agricultural Trade” and the background paper by T. E. Josling show what the authors would suggest if they sat on the proposed high-level committee. But this and other sensible proposals for agricultural policy leave a question open: What can they contribute to the coming trade negotiations?

Two things are certain: the round of trade negotiations due to open soon will have to cover the trade in agricultural commodities. And: the EEC’s agricultural policy is in urgent need of reform. These correct premises however must not lead to the mistaken conclusion that the agrarian reform called for will make progress in the trade round any easier by opening the EEC market to a substantial degree to agricultural imports from third countries. The situation in the agricultural industry of the EEC is not such that this — certainly desirable — outcome can be expected in the foreseeable future. Certain improvements for

third countries are possible; the authors of the Rey Report reached agreement on a list of measures which would provide some alleviations. But they did not come anywhere near the expectations of the Americans and other third countries which export agricultural commodities.

### **Grains as an Example**

Among major commodities which the EEC is supposed to admit in larger quantities are grains. What the chances are in this field can be shown by a simple statistical calculation of which only the end result can be given here. Assuming that the Americans would regard it as a substantial improvement if extra grain shipments to the EEC (of the Six) resulted in a one-per-cent rise of their total exports and, further, that they kept their share of total grain imports by the Six intact, the production of grains in the six original EEC countries would, to go by the 1970 figures, have had to be nearly one quarter lower than it was in fact if room was to be left for the additional imports. The reality is different. The production of grain by the Six is rising substantially; by 1980, it is estimated, production will be almost one-third higher than it was in 1966/69, and net-import requirements will by then be much smaller. Meanwhile the number of persons employed in agriculture is declining rapidly — by one third between 1960 and 1969 — and this is a continuing process. Who can imagine an agrarian reform disrupting this firm trend in the foreseeable future and forcing a change drastic enough to allow such large extra shipments from the grain exporting countries as to make a difference to their balances of trade?

One waits for a report to say clearly: the thorough-going reform of the EEC’s agricultural policy needed for many other reasons cannot be a major topic of international trade policy at this time because it cannot yield substantial benefits from the point of view of trade policy.

### **Conditional Most-Favoured-Nation Treatment**

The GATT system is based on the principle of unconditional most-favoured-nation treatment: any tariff rate negotiated by country A with country B must be applied to all other GATT members no matter whether they make tariff concessions in turn or not. The principal exemptions are for customs unions and free trade zones according to Article XXIV. This principle has not the aim and effect of applying equal tariff rates to all members but of applying existing tariffs equally to all partners and thereby putting all on the same competitive footing. GATT negotiations have hitherto been conducted on the basis of this principle.

The report is emphatically in favour of a different mode of procedure: negotiations on the basis of conditional instead of unconditional most-favoured-nation treatment. This is perhaps its most striking proposal. The Rey-group had not even discussed, let alone recommended, conditional most-favoured-nation treatment.

Conditional most-favoured-nation treatment means that tariff concessions are granted to those partners only who make equivalent tariff concessions on their side. This runs counter to GATT unless covered by the sole exemption allowed for industrialised countries — Article XXIV. It is therefore suggested that the trade round should be treated as one of negotiations about an industrial free trade zone, a zone to which every country willing to subscribe to its conditions would have free access.

Several advantages are claimed for this method of negotiation: it is in keeping with the new situation in which everything depends essentially on two or three large parties; the pace is set, not by the most hesitant, but by the most liberal bidder; nobody obtains advantages paid for by others by the simple expedient of waiting for what the most-favoured-nation clause will put in his hands; the GATT's present sanctions system is ineffective whereas under the free trade zone agreement a member failing to honour his obligations could be subjected to penalties including even expulsion.

There is room here only for a few critical notes. First, the proposed procedure could clearly be applied only if — as recommended in the report — a progressive and automatic reduction of tariffs to zero is aimed at for the industrial sector; otherwise Article XXIV (which deals with free trade zones) could not be used.

The proposal does not dispose of the main difficulty to be faced in the coming negotiations. If the USA were to offer to the EEC its consent to an industrial free trade zone provided the European agricultural market were opened wide, the EEC would have to reject such an offer. Conversely, the EEC could not join such a formidable partner in a free trade zone without insisting on moves for the harmonisation of economic policies which would not be acceptable either to the US Congress or to American public opinion.

If free trade zones were offered by the EEC and the USA without an agreement being reached between these two parties, the result could well be the emergence of several preference areas, which is the opposite of what the report wants. The EEC being reputed to be politically relatively harmless, its clientele, already fairly large, would

increase more than the USA's. Japan would also inevitably have to set about establishing a preference zone. Countries which for one reason or another do not wish to join either of the free trade zones would find themselves in quite a difficult position.

It is certainly not desirable that countries which are out to profit from negotiations on the basis of the unconditional most-favoured-nation principle without making concessions of their own are given a "free ride". But it is better to put up with this evil than to select a negotiating principle which — in fact if not in theory — adds to the grave danger of total ruin for the multilateral trade system. In any case, the authors' hope that the political relations of the USA with the European Community and the rest of the world, together with the philosophy which has evolved around GATT, will make conditional most-favoured-nation treatment a lever for progress appears to be unduly vague and ill-founded.

### **Problem of Sanctions**

Moreover, there is no good reason why a system of conditional most-favoured-nation treatment should make it easier for the members of the free trade zone to impose sanctions. GATT only provides for an authorisation by the contracting parties which enables the injured country to take appropriate retaliatory measures against the country causing the injury; the contracting parties not directly concerned must continue to grant most-favoured-nation treatment to the latter country as long as they do not feel themselves to have been injured and have not invoked Article XXIII. A different procedure could be conceivable: Fines for countries failing to live up to their obligations; temporary suspension of the treaty tariffs by all contracting states; expulsion from GATT. Hugh Corbet, who follows Gerard and Victoria Curzon in this respect, considers such strict action in his contribution as a possible instrument under an international trade treaty on the basis of conditional most-favoured-nation treatment. Why only on this basis?

In reality a system of collective sanctions would be unattainable on either basis. States are not prepared to expose themselves to the risk of such sanctions, nor are they ready to commit themselves to taking part in the operation of sanctions. Their reason is cogent: any major action in trade policy is coincidentally an act of foreign policy. Hence such decisions cannot be taken according to considerations of trade policy alone; they must be taken in the framework of foreign policy as a whole. Those who forget this can build beautiful castles. But they are castles in the air.