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# GATT and the New Economic Order

by Dr Per Magnus Wijkman, Stockholm \*

**The developing countries are calling for a "New Economic Order" because they feel that the trading system discriminates against them. Whether GATT will emerge from the present negotiations better adapted to the needs of the Third World remains to be seen.**

A protectionist tide is rising in the developed market economies as GATT's members enter a new round of trade negotiations. This round was initiated early in 1972 after the Smithsonian currency realignments by declarations of intent by the governments of the US, the EC and of Japan. Three years later the Ford administration received its negotiating mandate from Congress through the Trade Reform Act. In the interval, the industrial market economies had experienced the deepest recession of the postwar period. Unemployment had risen to levels which evoked comparison with the Great Depression. Inflationary pressures due to excessive US spending towards the end of the 60s had spread to its main trading partners. They were increased by a *simultaneous* boom in the industrial countries, a series of harvest failures and the quadrupling of oil prices by OPEC.

Record rates of inflation, unemployment and current account deficits in the industrial countries do not create an atmosphere conducive to the pursuit of GATT's traditional goals of multilateral, non-discriminatory, and mutually beneficial freer trade. Payments problems encourage bilateralism and discriminatory trading arrangements, unemployment presents a formidable political obstacle to freer trade, uncertainty about foreign supplies of strategic raw materials gives a powerful fillip to autarchy. Probably never before has GATT negotiated long-term decisions in such crisis circumstances. A long view is necessary so that the formulation of the commercial policy of the next decade is not obscured by these dramatic but transitory problems.

## **New Institutional Framework**

In the long-run the postwar institutional framework for international economic transactions must be adapted to emerging new political relationships between the market economies and centrally planned economies and between the developed and developing countries. The existing framework was never international in scope. Founded by a few developed market economies and dominated by the victorious Western allies, the IMF and the GATT were poorly tailored to the needs of the

developing countries and not designed to include the centrally planned economies.

It is therefore natural that the policy developments during the postwar period have increasingly emphasized the restricted scope and the limitations of these organizations. First decolonization has meant a vast redistribution of political power from the developed industrial countries to the developing countries. The developing countries can now object when they feel that the trading system discriminates against them. They can make political "noise" and throw "sand" into the world's economic machinery through collective action. Their nuisance potential in international politics is difficult to disregard. They have exerted this political influence in the United Nations by setting up UNCTAD as a poorly disguised competitor of GATT and voting through resolutions calling for a vaguely defined new economic world order. The recent adoption by UNCTAD of a resolution defining a Code of Conduct for Liner Conferences shows the developing countries' political strength and that they are prepared to inflict heavy efficiency losses on the world transport system in order to transfer income to themselves.

## **Shifts in Political Power and in Trade Flows**

Second, détente between the major market and centrally planned economies means that ideological considerations will influence trade flows between them to a lesser extent in the future than in the past. In Europe and in Asia World War II and the Cold War interrupted trade flows based on comparative advantage between market and planned economies which may now be resumed. Japan's trade with planned economies in Asia has already increased dramatically during the 70s and Japan and Western Europe together are now more important sources of imports as well as markets for exports for centrally planned Asian economies than are Eastern Europe and the Soviet Union. Similarly, trade flows between Eastern and Western Europe have increased and the extension

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to the planned economies of most-favoured-nation treatment by the market economies is now being negotiated.

Although the détente is inspired by the developed planned economies' desire for technology and capital from the developed market economies, it also provides more trading alternatives for the developing countries in both economic systems. They can "play off" developed market and planned economies against each other to achieve better terms of trade and diversify their import and export markets. They face less risk of sanctions from the dominant economy in their market system than the People's Republic of China or Cuba were once confronted with. This keener competition for markets should increase the trade flows between the market and the planned economies. It may also increase trade flows between the developed and developing countries within the market economy system.

These shifts in political power through decolonization and détente have contributed to the present crises in the international trade and payment systems. Whether GATT and the IMF will emerge better adapted to the needs of the developing countries and to accommodate larger flows of East-West trade remains to be seen.

The collapse of the Bretton Woods system of pegged exchange rates has contributed to decentralizing control over economic policy. Pegged rates were supported by the use of the dollar as international reserve currency and by conditional access to collective credit facilities in the IMF, while changes in the rates had to be approved by international review mechanisms. When the system broke down, the United States ceased to play the role of international central banker and the power to control the world's money supply and rate of inflation was distributed among a large number of national central banks maintaining flexible exchange rates.

#### Moderate Success of GATT

Whether the present crisis in GATT will result in freer or more protected trade depends largely on the outcome of the present negotiations. These will therefore determine whether GATT becomes primarily an instrument of the OECD countries or of the members of the UN. GATT once established a number of rules designed to achieve multilateral, nondiscriminatory and mutually beneficial freer trade after the bilateral, discriminatory and beggar-thy-neighbour protectionist policies of the 1930s. Compared with the Hawley-Smoot American tariff of 60 p.c. in 1930, the average tariff rate of 10 p.c. on industrial goods in the industrial countries after the enactment of the tariff concessions of the Kennedy Round appears a strik-

ing achievement. However, GATT's success is modest when measured against its goals. Most striking is the limited degree to which GATT has actually achieved these goals and the gradual erosion of its rules.

Trade liberalization in GATT has been biased in a manner reflecting the composition of its original members, mainly all developed industrial economies. It has resulted in reduction of *tariffs* on the *industrial goods* traded between the major *industrial countries*. Other trade distortions than tariffs and other goods than industrial have been neglected and contraventions of GATT's rules in these cases have been disregarded. One reason for this development has been GATT's system of negotiations between principal suppliers aiming at balanced concessions (reciprocity). Negotiations have thereby focused on those distortions which are subject to quantitative comparisons (tariffs) and on goods of interest to the major trading nations (industrial goods). Trade has not been liberalized for those agricultural and industrial goods in the production of which the industrial countries have a comparative disadvantage relative to the developing countries. Furthermore, in spite of GATT's rules the developed countries have felt themselves free to use other distortions to trade than tariffs when it has suited their purposes.

#### Interest of the Developing Countries

GATT's rules have not prevented the developed market economies from forming discriminatory trading blocs. As these blocs increase in size, they assume an autarchic and protectionist posture blocking further trade liberalization. GATT's acceptance of the increased practice of bilateralism, preferential trading arrangements and other protectionist distortions than tariffs clearly conflicts with its preachings.

What demands will the international trading system place on the developed market economies if it should consider the interests of the developing countries? The primary producing countries have traditionally wished to protect their industrial sectors while demanding access to developed countries' markets for their industrial exports. They have consequently been opposed to GATT's principle of mutual tariff concessions which ceased to apply to them in 1966. Their traditional exports are primary products which face low income and price elasticities in developed markets and therefore invite collusive producer behaviour. There is a direct relation between the failure of the developing countries to obtain access to developed markets for their industrial exports and their attempts at monopolistic pricing of raw materials. Improved market access for exports of manu-

factures will therefore improve the prospects of stability in raw material markets.

The developing countries as a group have a large deficit in their trade in services with the developed market economies due to payments for foreign capital and technology. This deficit must inevitably be balanced by a surplus on trade account vis-à-vis the developed market economies. The developed countries must eventually import more goods from the developing countries than they export to them, if the latter are to continue to service their foreign debt and to import skill-intensive services. The prospect of dramatically increased cereal imports by the developing countries in the 80s makes improved access to the developed markets for simple manufactures extremely urgent. The agricultural and industrial goods which the developing countries have a comparative advantage in are intensive in unskilled labour. They threaten politically powerful low-wage unions and agricultural pressure groups in the developed market economies which reduces the latter's ability to adjust to increased imports in the absence of large-scale adjustment programmes. If the market economies are shaken by the large-scale bankruptcy of the development countries, it will be because the creditors did not allow the debtors to pay off their debt, and not because the debtors were unwilling to pay. If farm land lies fallow in North America while Indians starve, it will largely be due to protectionist industrial interests in the rich countries.

#### Implications of Long-term Trading Trends

Likewise in East-West trade, exports of skill-intensive technology to the centrally planned economies must be paid for by importing from these countries unsophisticated industrial and agricultural products intensive in unskilled labour. In short, the developed market economies must offer increased market access to the developing countries and the centrally planned economies if they wish to retain the underdeveloped market economies within the market system, if they are unprepared to write off their claims on these countries, if they wish to stave off mass starvation there, and if they wish to pursue the *détente* with the centrally planned economies. Protectionism in the industrial market economies is incompatible with these long-run aims.

These long-run trading trends have important implications for the present GATT negotiations. Foremost is the necessity to liberalize trade in agricultural products together with industrial products. If agriculture — or any other industry — is protected for national security or income parity reasons, methods must be devised which minimize

the burden which this domestic policy places on foreign producers and consumers. The burden must instead be placed where it belongs — at home on domestic taxpayers. Non-tariff barriers, which have a particularly heavy incidence on the competitive exports of the developing countries must be phased out. The industrial countries must commit themselves to meet the market disruptions caused by increased imports from the developing countries and from centrally-planned economies through long-run adjustment programmes rather than by trade distortions. Protection of moribund industries — like infant industries — lasts surprisingly long.

#### Bleak Prospects

The prospects are very bleak that the present GATT negotiations will result in progress in these two areas. The growing conflict between the major industrial market economies — the US and the EC — threatens to paralyze the negotiations. At the heart of this conflict lies the agricultural policy of the EC. The common industrial tariff and the common agricultural policy stand as symbols for the unity of a community threatened by disintegration after the failure of its plans for monetary union. The EC has little interest in reducing its common tariff since the preferences enjoyed by members would thereby be reduced and its cohesion weakened. The same applies to the common agricultural policy. The EC has unnecessarily complicated the matter by declaring the *instruments* rather than the *targets* of its agricultural policy to be non-negotiable.

On the other hand, the United States has made increased access for its agricultural products to the EC the price for reductions of the US industrial tariff. The high priority which it places on liberalizing trade in agricultural products repeats its negotiating position from the Kennedy Round. That time the US did not achieve concessions in agriculture which it felt were commensurate with its own industrial concessions. The American negotiators will have learned from this experience.

The developing countries have lost interest in tariff reductions by the industrial countries since these reduce the small preferential margins they now enjoy through the special systems of preferences. The developing countries main interest lies in eliminating the non-tariff barriers to their competitive exports.

Thus, the positions of the developing countries, the EC and the US suggest that the negotiations for tariff reductions will quickly reach a stalemate. Prospects for progress in removing non-tariff distortions to trade are hardly more encouraging. There are at least two reasons for this. First, the

United States, which has traditionally taken the initiative in trade negotiations, lacks a mandate to negotiate on this issue. The Trade Reform Act requires that concessions offered by the Ford Administration's negotiators be examined and approved by the House of Representatives, well-known for its protectionist sentiments. Second, the developing countries, who have been deprived of the benefits of most-favoured-nation concessions by the imposition of non-tariff barriers on their competitive exports, have the strongest interest in this issue, but the weakest negotiating power. Their strongest argument, apart from self-interest, is that the use of import quotas and voluntary export restraints enforced by the threat of import quotas are against the rules of GATT. However, GATT has actively participated in the formulation of these voluntary restraint programmes, which has greatly weakened its ability to insist in the future on consistency in the application of its rules.

If the current GATT negotiations fail to restore the movement towards multilateral, non-discriminatory trade between the market economies, and to increase trade between the planned and market economies, the tendencies today towards enlarged discriminatory trading blocs may be reinforced and difficult to reverse in the future.

#### Growth of Discriminatory Trading Areas

Preferential trading areas tend to be protectionist since they are averse to *general* trade liberalization, which reduces the preferential margins of the members, and prone to *selective* tariff concessions to particular outsiders. Some outsiders will always find benefits from a small trading area, which they do not have to share with others, preferable to benefits from a larger group of countries, which they have to share with competitors. Preferential trading areas, like clubs, guard their privileges jealously and confer them selectively on outsiders by electing them members or granting them special status. There is thus a tendency for discriminatory trading blocs to grow. But since privileges by definition cannot be enjoyed by all, some must be left out. These outsiders retaliate by forming discriminatory trading areas of their own.

The dynamics of discriminatory trading areas leads to a world consisting of a small number of large isolationist trading blocs. The history of the EC is a good example of this process. It has expanded from six to nine members; it has created a free trade area with the residual members of EFTA; it has associated with a large number of Mediterranean countries and recently signed the Lomé Treaty with the greater part of independent Black Africa. The EC has consequently erected a

vast discriminatory trading area encompassing most of Western Europe and Africa. Those industrial and developing countries discriminated against can be expected to seek compensation by entering discriminatory trading arrangements of their own. This could encircle the American Hemisphere or the Pacific Basin. It could encourage Japan to attempt to reestablish its prewar Asian Coprosperity Region.

If this happens, the world economy is well on its way to realizing George Orwell's vision of tri-continental world in his novel *1984*. The important consequences of such a development are political rather than economic. A small number of trading blocs, each encompassing developed as well as developing countries, may actually be preferable on economic grounds. The internal zero tariffs within each tariff protected bloc may involve freer trade and less distortions than non-discriminatory trade with non-zero tariffs. Yet important political disadvantages may result from the emergence of such trading blocs. First, the nuclei will consist of dominant industrial economies around which smaller and less developed countries cluster for protection. Trading blocs consequently increase the political dependence of small states on the great powers. Second, commercial policy between the trading blocs will be determined through oligopolistic negotiations. In such a situation negotiations are conducted in the form of package deals, with concessions in one field being traded for concessions in another as each negotiator plays his best bargaining card to obtain the best package deal. Commercial policy will increasingly become an instrument of foreign policy.

We are already well on the way to such a situation. Most-favoured-nation treatment is bartered for emigration rights for labour (cf. the Soviet Jews); sales of military equipment are combined with offers of direct investments in the purchasing country (cf. the recent NATO purchases of jet fighters); oil is bartered for wheat in negotiations between raw material cartels (cf. the pronouncements of Kissinger and of OPEC); and, finally, fishing rights are bartered for navigation rights for warship (cf. the UN Conference on the Law of the Sea). Once again, trade will follow the flag of the countries with the largest gunboats if this tendency to enlarged discriminatory trading areas and mixture of commercial and foreign policy continues.

The GATT negotiators should reread George Orwell's novel *1984* before sitting down at the negotiating table in Geneva. The issue at stake is whether the international economy will encompass One World or whether it will be divided into tri-continental trading blocs or into clubs for the rich and ghettos for the poor.