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Urgency of Trade Reform over Trade Liberalisation

by Hugh Corbet, London *

The GATT system has in recent years revealed a number of dangerous weaknesses. Therefore there is reason for concern not only with the further liberalisation of trade within the accepted framework of GATT rules but with a reform of the rules as well.

As work began on the *communiqué* of the London economic summit, well before the leaders of the major industrialised countries had even gathered for the meeting at 10 Downing Street, it became evident that a renewed effort would have to be made to develop momentum behind the Tokyo Round of multilateral trade negotiations, if only because the United States and Japan were going to insist. Whether the European Community can pull itself together and play a constructive role in the negotiations remains to be seen. So far the Commission in Brussels has been satisfied that no deadlock or open rift has developed.

Increased Uncertainty

After much diplomatic manoeuvring¹, the seventh round of multilateral trade negotiations under the General Agreement on Tariffs and Trade (GATT), the instrument by which the commerce of the free-enterprise world has been governed since World War II, was formally launched in September 1973 at a ministerial meeting specially convened in the Japanese capital.

Hardly was the ink dry on the Tokyo Declaration², however, than the War of *Yom Kippur* broke out and the Organisation of Petroleum Exporting Countries (OPEC) precipitated the energy crisis that had long been expected — if not for another decade. The shock to the international system of trade and payments would have been greater if the stresses and strains of inflation had not already forced flexibility on rates of exchange between currencies³.

Still the Tokyo Round negotiations were not able to proceed — in spite of the increased risk of countries resorting to trade restrictions, or competitive devaluations, as a means of coping with the "oil payments" problems. Instead, the negotiations marked time until the Congress of the United States afforded the Administration an authority to negotiate, which it finally did in the Trade Act of 1974⁴, and until, shortly after, the Council of Ministers of the European Community agreed negotiating directives for the Commission.

Thus it was only in February 1975 that the discussions got down to business in Geneva where separate negotiating groups are covering tariffs; non-tariff measures; the sectoral approach to trade liberalisation; the "safeguard" provisions for emergency protection; temperate-zone agricultural trade problems; measures affecting imports of tropical products; and, since November 1976, the revision of the GATT rules⁵.

Confidence in the continued stability and expansion of the world economy was gravely shaken by the succession of economic crises which began in the late 1960s and culminated in the breakdown, in 1971, of the "Bretton Woods" framework of international monetary arrangements, based as it was on fixed rates of exchange between the main currencies⁶. But towards the end of 1973, with the quadrupling of oil prices, the economic implications of which were clearly far-reaching⁷, there was a quantum increase in the degree of uncertainty affecting the conduct and planning of corporate, sectoral and national affairs.

Weaknesses of the Trading System

From the outset it was vaguely realised that these crises demonstrated weaknesses which, if not corrected, could lead to increasing economic uncer-

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¹ See Hugh Corbet, *Commercial Diplomacy in an Era of Confrontation*, in: Hugh Corbet and Robert Jackson (eds.), *In Search of a New World Economic Order*, Croom Helm, for the Trade Policy Research Centre, London 1974.

² Reproduced in: GATT Secretariat, *GATT Activities in 1973*, Geneva 1974.

³ Harry G. Johnson, *Higher Oil Prices and the International Monetary System*, in: T. M. Rybczynski (ed.), *The Economics of the Oil Crisis*, Macmillan, for the Trade Policy Research Centre, London 1976, p. 151.

⁴ Public Law 93-618, 93rd Congress, H.R. 10710, signed by the President on January 3, 1975.

⁵ This last negotiating group on "the international framework for the conduct of world trade" was established by the Trade Negotiations Committee of the GATT on November 6, 1976. For a succinct analysis of its implications, see the *Neue Zürcher Zeitung* of November 12, 1976.

⁶ For a brief discussion of the situation at that time, see Hugh Corbet, *Global Challenge to Commercial Diplomacy*, Pacific Community, Tokyo, October 1971.

⁷ These implications are closely analysed in W. M. Corden and Peter Oppenheimer, *Economic Issues for the Oil-importing Countries*, and Jan Tumlir, *Oil Payments and Oil Debt and the Problem of Adjustment*, in: T. M. Rybczynski (ed.), *The Economics of the Oil Crisis*, op. cit.

tainty, undermining the international economic order that had been established after World War II through the GATT, the International Monetary Fund (IMF) and the World Bank.

What have those weaknesses been? They should not require spelling out. The following are some that come to mind:

☐ For a start, the principle of non-discrimination, the cornerstone of the GATT system, has been more honoured in the breach than in the observance.

☐ Second, temperate-zone agricultural products have been given a "special status", which has set them apart from the process of trade liberalisation pursued successfully in six rounds of GATT negotiations⁸.

☐ Third, the provisions in the GATT for emergency protection against "market disruption", in respect of sudden surges of imports of a particular product, have been inoperable, thereby obliging governments to go outside the GATT system to negotiate "voluntary export restraints"⁹.

☐ Fourth, as tariffs have been reduced so the significance of non-tariff distortions of international competition, and the inadequacy of the GATT in dealing with them, has been revealed.

☐ Fifth, the absence of an effective "complaints and arbitration" procedure has meant, inevitably, that small countries have little prospect of securing satisfaction in trade disputes, especially with large countries¹⁰.

Concern with the Rules

These and other weaknesses have been due, in part, to the inability of governmental institutions to respond to economic changes, which plainly have been taking place too quickly for democratic political processes to comprehend. When at last there was, at political level, a more conscious realisation of the dangers inherent in the erosion of the framework of multilateral cooperation, the major trading powers agreed in February 1973 to embark on a "comprehensive review of international economic relations" covering *inter alia* "all elements of trade, including measures which impede or distort agri-

cultural, raw material and industrial trade", with particular attention being given to the problems of developing countries¹¹.

What therefore needs to be understood about the Tokyo Round negotiations is that, unlike previous GATT rounds, they have not only been concerned with the further liberalisation of trade within an accepted framework of rules. They have been concerned, less explicitly at first and then more explicitly, with the rules as well. This is more important than is generally acknowledged, because when the market-oriented economies emerge from the Great Inflation and the recession that has gripped them during most of the 1970s it will not mean, as some appear to think, that there will be a return to the comparative calm of the 1960s. The world economy, already in considerable disarray, is likely to become a good deal more turbulent and difficult to manage.

The need for a new international economic order was in the forefront of serious policy discussion, at least in Washington and some other capitals, a fair while before it became a slogan of the Third World¹². What the developing countries have succeeded in doing, through the United Nations and its agencies, is to concentrate political attention in the developed countries on the questions involved, even if they are viewed from different perspectives¹³.

In the United States a fundamental review of the international trading system began, not only in the Administration and Congress, but also in business and academic circles, almost straight after the completion in mid-1967 of the marathon Kennedy Round negotiations. When the issues had become apparent, President Nixon appointed a Presidential Commission on International Trade and Investment Policy, the 394-page report of which was submitted to the White House in mid-1971¹⁴. Nothing like the Williams Report has been published, or not published, in any other major industrialised country. But the Secretary-General of the Organisation for Economic Cooperation and Development (OECD) appointed a High Level Group on Trade and Related Problems whose report was published in September 1972¹⁵.

⁸ See D. Gale Johnson, *World Agriculture in Disarray*, Macmillan, for the Trade Policy Research Centre, London 1973.

⁹ The issue is closely analysed in Jan Tumlir, *Emergency Protection against Sharp Increases in Imports*, in: Hugh Corbet and Robert Jackson (eds.), *In Search of a New World Economic Order*, op. cit.

¹⁰ This weakness is thoroughly analysed in Robert E. Hudec, *The GATT Legal System and World Trade Diplomacy*, Praeger, New York 1975.

¹¹ In two joint declarations, the United States and Japan, in one, and the United States and the European Community, in the other, sought to initiate on a tripartite basis a new round of multilateral trade negotiations. The declarations were lodged with the GATT Secretariat in Geneva on 9 and 10 February 1972 and in the ensuing months other countries associated themselves with the initiative.

¹² See the Declaration on the Establishment of a New International Economic Order, and the programme of action, drawn up at the sixth special session of the General Assembly of the United Nations, New York, April-May 1974.

¹³ The issues posed by the efforts of developing countries to engineer higher prices for primary commodities are discussed in Hugh Corbet, *Raw Materials: Beyond the Rhetoric of Commodity Power*, International Issues No. 1, Trade Policy Research Centre, London 1975.

¹⁴ Presidential Commission on International Trade and Investment Policy, *United States International Economic Policy in an Interdependent World* (Williams Report), US Government Printing Office, Washington 1971.

¹⁵ High Level Group on Trade and Related Problems, *Policy Perspectives on International Trade and Economic Relations* (Rey Report), OECD Secretariat, Paris 1972.

Following the presidential election in the United States, as well as the elections last year for the Bundestag in the Federal Republic of Germany and for the Diet in Japan (and the installation of a new Commission in Brussels), the major industrialised countries are better placed to get on with the multilateral trade negotiations, which in itself could help to counter the widespread feeling that the world economy is "drifting". Indeed, the negotiations could greatly assist the recovery from the recession, the prospects for which are being darkened by three sets of constraints.

First, the oil payments problem, which has not been resolved during the recession, is returning in harsher form than was the case when it appeared in 1974. Since then, the possibilities for recycling petro-dollars through lending and borrowing by private institutions are said to be nearly exhausted, the lending capacity of private institutions being limited by balance-sheet considerations. The scope for government-to-government lending also appears limited, given the political constraints imposed, in the industrialised countries, by already large budget deficits and by levels of taxation already deemed to be inhibiting business.

Unless they are prepared to accept unemployment in their export industries, the industrialised countries will have to finance the oil bills of the oil-importing developing countries, whose imports began to decline in 1976 in both money and real terms. If the industrialised countries are not prepared to provide such support, they will have to run down their export industries, and create employment in other industries, or expand the export opportunities for developing countries in their markets.

The second set of constraints impeding recovery is the problem of securing stability of access to supplies of raw materials from developing countries. But the problem here is not the threat of producer cartels aimed at engineering higher prices for particular commodities. Rather it is the recently proclaimed right of each country to nationalise its natural resources which has provided a powerful deterrent to the flow of investment into exploration and development. There is a danger of shortages resulting from insufficient investment. Overcoming this danger will depend to a large extent on multilateral commercial diplomacy. That task, though, will depend on the raw-material exporters of the Third World also attaining a satisfactory level of economic development.

The third set of constraints are those inhibiting domestic investment in the industrialised countries. In this respect there are two factors which have increased the risk of investment. Following

the great psychological disturbance of consumers caused by the events of the early 1970s, there is considerable uncertainty about the future pattern of demand, as exemplified by the erratic movements of demand for automobiles in the mid-1970s. Then there is the uncertainty caused by future monetary developments affecting rates of inflation, rates of interest and rates of exchange. In addition, there are two factors which, partly for other reasons, have decreased the rate of return on investment. There is the distributional struggle that can be witnessed in the industrialised countries, accentuated by the rise in oil prices. And traditional business accounting methods, not being appropriate for inflationary times, have resulted in a higher rate of taxation of real corporate income.

The GATT Plus Proposal

Such is the international economic situation in which the reform of the GATT system is being considered. The GATT framework of rules, of multilateral cooperation, is the only one we have. The times are not propitious for a fresh start. But that is not to say that a major overhaul of the system is out of the question. In the United States, an experienced group of experts put forward in 1975, under the aegis of the Atlantic Council, a private institute, an imaginative proposal for a code of liberalisation within the GATT framework that would be more rigorous than the articles of the General Agreement and would come to grips with the issues of concern to the industrialised countries¹⁶.

The GATT Plus proposal has been influenced by the changes in the composition of the signatories to the General Agreement: "Membership in the GATT has grown from fewer than 20, mostly industrialised, countries in 1948 to more than 80, mostly developing, countries in 1975. The concern of the developing countries with accelerated industrialisation has led to a series of special provisions in GATT rules giving them virtually a free hand to apply trade barriers to protect domestic industries and development programmes. The effect of the one-country-one-vote rules has been to give the controlling voice in all GATT decisions, even those affecting trade among the industrialised nations, to countries with a smaller volume of trade and a lesser ability, at their present stage of development, to assume new trade obligations. Under these circumstances the industrialised countries have tended to take their commitments in the GATT less and less seriously. An important goal in reform, therefore, should be that decision-making be responsive to the economic weight of the participants."

¹⁶ Atlantic Council of the United States, *GATT Plus: a Proposal for Trade Reform*, Washington 1975.

After arguing that the essential reforms in the decision-making machinery of the GATT system can be accomplished without depriving the developing countries either of benefits of the present GATT or of the prospects for improving the condition of their trade, the GATT Plus group, under John Leddy, a former senior official of the Department of State, go on to state: "Modernised trade rules to achieve a substantial further liberalisation of trade will require that more decisions be made on an international, rather than on a unilateral or bilateral, basis. And it is the industrialised nations who will have to carry out the reduction of tariffs and non-tariff barriers involved. There is no practical possibility of accomplishing the necessary restructuring through formal amendment of GATT, for example to establish a system of weighted voting for all its members. That would require the consent of two-thirds of GATT's memberships and would mean a sharp curtailment in the present voting influence of the developing countries."

Tighter Rules for Industrialised Countries

The GATT Plus group suggest that the way forward lies in another direction:

☐ The industrialised countries, acting within the framework of the GATT and in furtherance of its objectives, would conclude a supplementary agreement among themselves to liberalise trade in accordance with trade rules tighter than those of the GATT and to administer those rules themselves on a weighted-voting basis.

☐ The trade benefits of the new agreement among industrialised countries would be extended to all GATT countries as required by the most-favoured-nation clause.

☐ The agreement would be open to countries which accept common trade rules and would remain open for later accessions. Countries which are developing today could join when they have reached a stage of development where they are no longer in need of special privileges and when they acquire a more direct interest in shaping and contributing to a tighter trading system.

☐ Relations between the industrialised and developing members of the GATT would continue to be handled in accordance with present GATT procedures and voting arrangements and developing countries would retain all their rights under the GATT.

GATT Plus an Inadequate Approach

It is proposed that the GATT Plus code should be negotiated as part of the multilateral trade negotiations and there's the rub. The present *impasse* in the negotiations on a "new international economic order", as articulated through

United Nations resolutions, is only superficially due to a conflict of interest between the industrialised countries and the developing ones. It was not the appearance of the Third World as a political force in multilateral commercial diplomacy, but the increasing friction between the United States, Japan and the European Community, that reduced the post-war international economic order to its present disarray in which a demand for a "new order" appears justified.

The weaknesses in the international economic order referred to earlier are not the handiwork of developing countries. If they are the handiwork of any countries in particular, the United States and the European Community are largely responsible, but more objectively they are a reflection of unresolved problems among developed countries.

The rapid integration of the world economy since the 1950s has resulted in a high level of interdependence between the industrialised countries¹⁷. Economic interdependence, combined with the way governments have been assuming wider and wider responsibilities in domestic affairs, has meant that economic measures in one country are liable to affect economic conditions in other countries. Bluntly stated, governments in the industrialised countries are endeavouring to maintain as much freedom of action as possible, and that might be tritely said to be understandable, but in this day and age it is incompatible with the maintenance of international economic order¹⁸.

Problems among the developed countries are not more likely to be resolved in a GATT Plus negotiation than in the larger multilateral trade negotiations. What is the point, then, of the GATT Plus proposal if the latter succeed? And what is it if they fail?

Another question relates to the problem of how, in whatever course the developed countries take, OPEC power is to be addressed. The OPEC countries appear to have the power to intimidate the OECD countries, which means they could upset arrangements in a GATT Plus agreement as they could in a Tokyo Round agreement — the difference being that the developing countries could be made parties to a Tokyo Round agreement (if the developed countries were so minded).

¹⁷ As an indication of the interest that was developing in the United States in the mid-1960s in what the implications of the rapid integration of industrialised economies might be for international economic organisation, see Richard N. Cooper, *The Economics of Interdependence: Economic Policy in the Atlantic Community*, McGraw-Hill, for the Council on Foreign Relations, New York 1968.

¹⁸ About this there really should be no surprise, since the issues were thoroughly discussed back in the 1930s when the British economist, Lionel Robbins, argued (in *Economic Planning and International Order*, Macmillan, London 1937), that national economic planning and direction by democratically-elected governments would embroil them in cumulative and ultimately explosive international friction.