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Article — Digitized Version

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Intereconomics

Suggested Citation: Schachter, G.; Tryon, R. (1978) : Protectionism in EC-US trade relations, Intereconomics, ISSN 0020-5346, Verlag Weltarchiv, Hamburg, Vol. 13, Iss. 5/6, pp. 123-127, <https://doi.org/10.1007/BF02929178>

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Protectionism in EC – US Trade Relations

by G. Schachter and R. Tryon, Boston *

During the 1950s and early 1960s the trading interests of the US and the EC generally coincided, with the result that tariff negotiations could be held successfully. Since that time the interests of the US and the EC have diverged somewhat, and pressures for increased protection have arisen.

The nineteenth century belief was that free trade signified freedom. This worked well for the growing industrial empires. The world system collapsed when less freedom of trade and less freedom in general prevailed in the aftermath of World War I. The debacle of the 1930s was reinforced by public policies aiming to isolate the nation state from the vagaries of international markets; World War II was partly a consequence of these autarchic policies. For a while thereafter, international mechanisms – IMF, GATT – have been devised to maintain a smooth flow of international trade and until the early 1970s worked well enough.

In the wake of the floating of the dollar and the OPEC oil embargo have come calls for a new economic order, and there is an autarchic movement in the making. The vision of continuing expansion has been replaced by an introspective fright. Fortunately, the fear of retaliation, rather than a belief in free trade, is strong enough to thwart autarchic trends in the USA, EC and Japan, the main traders of the world.

Whatever the theoretical merits of free trade, the realities of the current economic situation do not permit a government to allow foreigners unlimited access to domestic markets or to refrain from subsidizing domestic industries which sell abroad. Pressures are building that might turn the world toward increasingly protectionist policies, perhaps leading to trade wars reminiscent of the 1930s.

The Boston Globe expressed this in editorial form: "The root problem remains jobs. The danger of rising unemployment throughout the industrial world is one with which none of the major countries has been fully able to cope. Right now we are enjoying the benefits of modest recovery

from the last recession, partly in the form of reduced joblessness. But the next recession – and there will be one – could produce a far harsher look everywhere at trade and protectionism. The task then will be to prevent concern from turning into panic." (April 23, 1978.)

Pressures for Protection

Since the depression of the 1930s the US has generally pursued a liberal trade policy, seeking lower tariffs and expanded world trade. This policy supports US economic and political interests: the gains from trade not only raised incomes in the US but also strengthened US trading partners across the world, particularly in Western Europe. During the 1950s and early '60s the trading interests of the US and Western Europe generally coincided, with the result that tariff reductions could be negotiated successfully. Both parties desired to expand trade as a vehicle for growth, and relatively high tariff levels presented an easy target to attack. Since that time the interests of the US and the EC have diverged somewhat, and pressures for increased protection have arisen. These seem to be somewhat stronger in the EC, but are evident on both sides of the Atlantic.

The basic cause of these pressures is unemployment, both in exporting and import-substituting industries, generated largely by the 1974–75 recession. What is different about this unemployment and previous years' is that the pressure for economic growth seems diminished. Various groups in society are more interested in preserving their share of the pie than in making sacrifices to increase the size of the pie. The adjustments required by a dynamic free trade policy,

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the retraining of labor and the reallocation of investment goods, are becoming increasingly difficult to make as workers and management are content to defend gains already made. Governments are no longer under great pressure to raise living standards, so they are much more reluctant to place adjustment burdens on any given industry.

The result is that domestic industries are defended more willingly against imports, and exports are subsidized more readily; the burden of inefficiency or misallocation is spread over all taxpayers and consumers rather than being absorbed by one industry. This phenomenon has arisen both in the United States and in the Common Market countries, but appears to be stronger in Europe owing presumably to a difference in political philosophy: in the US, government intervention to aid failing industries is still the exception rather than the rule. For example, the layoffs in the US steel industry last fall would probably not have been tolerated by most EC governments.

Different Views

A difference in trading patterns and foreign policy has also contributed to this divergence. The United States still has a global outlook and wishes to preserve its links with nations all across the world, while the EC takes a more regional view. Thus last July the EC formed a full free trade area including the former members of EFTA, but continues to regulate trade with other regions.

The current system of floating exchange rates may be contributing to an increase in non-tariff barriers to trade. An appreciation in a nation's currency makes imports cheaper regardless of the tariff level; in recent months the dollar has fallen enough to offset many EC tariffs. (Except, of course, where variable levies are imposed to keep the domestic price of imports constant.) To the extent that new import quotas are simply replacing tariffs that are no longer effective, the increase in protectionism is more apparent than real.

The present oil situation, in combination with domestic conditions, has caused serious balance of payments difficulties for many countries, some of whom are turning to trade policy as a tool for attacking these adjustment problems. In August 1971, the US imposed an emergency tariff surcharge to ease pressure on the dollar, and the current discussions with Japan are probably motivated as much by balance of payments considerations as by hardship caused to US industry.

In 1974, the US Congress passed trade legislation enabling the President to negotiate further

tariff reductions within the GATT framework and to take other steps with respect to trade policy. The bill set conditions for the imposition of import quotas and tariffs to protect domestic industry, retaliate against dumping, and to help control balance of payments problems. The bill also provided for the extension of most favored nation status to Soviet-bloc countries.

It is this bill that provides the basis for US participation in the current round of GATT talks. At the time of its passage many feared that the bill signaled a basic shift away from free trade in US policy. Examination of events since 1974 suggests, however, that this has not been the case, because US interests still lie in the expansion of trade.

Current US Trade Policy

The Carter administration continues to hold to a free trade philosophy. Secretary of State Cyrus Vance recently stated that "we must resist the temptation to insulate ourselves from international economic competition, for we are a country that thrives on world trade". He succinctly stated the US's trade position: "One out of every eight manufacturing jobs in the United States depends on exports. For every one of those jobs, another one — in a supporting industry — is created. Every third acre of US farmland produces for export. Each dollar of those agricultural exports stimulates more than a dollar's worth of output in a food-related industry. Today, one out of every three dollars of US corporate profits is derived from international activities. Exports of our goods and services now contribute nearly \$ 200 billion to our gross national product. Two-thirds of our imports are essential raw materials, or goods we cannot readily produce. From automobiles to newspapers, from jet aircraft to household appliances, many of our industries depend upon imported materials."¹

But of course policy is also determined by the influence of various special interest groups. The major force in the US supporting free trade is organized agriculture; America has a substantial comparative advantage in agriculture. In the continuing trade discussions with Japan much of the focus was on agricultural problems. US multinationals also support free trade, so they can import foreign-made goods into the US.

Organized labor in the US has reversed its traditional support of free trade and has been the most vigorous force behind increased protection in the 1970s. The reason for this presumably lies in the fact that organized labor derives most of

¹ The Secretary of State, speech before the National Governors' Association, in: The Secretary of State, February 27, 1978, Washington, D.C.

its strength from the heavy industrial sector, which for years supplied the bulk of US exports. Now that the comparative advantage has swung in favor of agriculture and high technology products, which are less organized, labor has begun to resist the loss of jobs to foreign business.

At the last congress of the AFL-CIO, labor demanded several legislative measures which would severely impede trade: regulation of imports through quotas and other controls, bilateral textile agreements, approval by Congress of all GATT tariff cuts, and new anti-dumping laws. Labor is also concerned about US investment abroad, asking for reform of the tax on overseas corporate profits and for the cessation of public insurance for private ventures abroad.

The role of consumers in the formation of trade policy is hard to evaluate. The US has seen only occasional consumer lobbying for lower tariffs. However, both the Ford and the Carter administrations have aimed to hold down tariffs to ease inflationary pressures, largely in response to popular opinion.

These forces have tended to counteract each other, so that despite a considerable increase in the level of protectionist rhetoric, US trade policy has not substantially changed over the course of the '70s. Successful claims of injury are rare, and the government has been reluctant to grant tariff relief. In the shoe industry, for example, in spite of a clear case of injury the government denied assistance because of its concern with inflation. In the early '70s the administration raised beef import quotas in order to hold down prices.

Of course, there have been exceptions. In 1969, the US pressured Japan and other countries into accepting voluntary restrictions on textile imports to the United States. Voluntary agreements were also used in clothing imports, and more recently, quotas were set for specialty steel imports from the Common Market.

But the bulk of trade policy has involved cases of alleged dumping in the US, and the administration has been at some pains to confine the remedy to raising prices to cost, and not to respond to pleas for further protection. In a case of particular importance to US-EC trade, US steel companies claimed that the VAT rebate given to EC steel exporters amounted to an illegal subsidy under GATT and entitled them to compensation. The US Treasury vigorously disputed this interpretation and took the case to the US Supreme Court, where it was decided in favor of the government.

While both the US and EC are philosophically committed to free trade, differences between the

two arise in the sensitivity of each to unemployment. Germany is committed to a liberal trade policy but last year had to give in to its EC partners that are plagued by unemployment problems, and insist that trade policies should be a function of domestic conditions. Indeed, within the EC, domestic pressures are greater by far than in the US for regulation of trade.

The EC and the US do not see eye to eye on many trade issues. Tariff levels have always been a sore point. On industrial goods the US tariffs are higher than those in the EC, while the reverse is true for agricultural products. Further, while EC industrial tariffs are generally uniformly low, there is considerable variation in the US tariffs. The chemical industry, for example, enjoys substantial protection, in part due to the American Selling Price method of customs valuation. This greatly complicates the task of equalizing concessions within the GATT negotiating format, and also provides certain industries in the US with a powerful vested interest in continued protection.

In agriculture, the US has had a comparative advantage for a long time and therefore American

Englisches Handels- und Wirtschaftsrecht

Von Rechtsanwalt und Barrister-at-Law

Dr. Volker Triebel

1978, 264 Seiten, Kt. DM 74,— ISBN 3-8005-6198-0

Schriftenreihe Recht der Internationalen Wirtschaft, Band 15.

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farmers need little protection. In Europe, farming is much less efficient (average farm size in the EC is 17 hectares, compared with 159 in the US), but since farmers hold substantial political power governments are obliged to protect farm incomes. Accordingly, the EC Common Agricultural Policy (CAP) holds up the price of many agricultural commodities well above the world levels, reducing the scope for imports. For example, the CAP prices of wheat and beef are presently twice the market price.

It is true that in spite of these restrictive measures the EC imports large amounts of food from the US, and it is further true that the domestic political pressures which require such a policy are well understood in this country. Thus the CAP is a good subject for scoring debating points, but does not represent a serious source of tension between the US and the EC².

Two other points might be made about the CAP. There are, of course, much more efficient ways of redistributing income than accumulating mountains of butter and dried milk. And if surpluses are to be stockpiled, they should not be then dumped on world markets at the expense of other exporters, but rather given in aid (or sold below cost) to countries who cannot afford to buy food at world prices.

The Problem of Dumping

In certain industries both the US and the EC suffer from the same problem: outdated technology, high labor costs, and excess capacity. However, the responses are different. The US relies on somewhat higher tariffs and a moderate program of adjustment assistance, and tolerates a higher level of unemployment than would be acceptable in most EC countries, where export subsidies and government aid are more frequently used. This has resulted in occasional charges of dumping in the US, and a growing feeling that markets are becoming sufficiently uncompetitive that import restrictions are necessary even where dumping has not occurred.

Steel and textiles provide the major dumping case and "voluntary" agreements to restrict trade. For several years the world steel industry has had substantial excess capacity and the problem has been compounded in the US and Western Europe by obsolescing technology. The slump in demand for new tankers has left the more efficient Japanese industry looking for markets. The result has been charges of dumping on all sides, and substantial layoffs in the US.

² The same is not true of Japanese agricultural policy with respect to beef and citrus products, which is seen in the US as a completely gratuitous piece of protection which does not help farmers and hurts both consumers and US exporters.

In response to this the US and the EC have revised their anti-dumping procedures. Instead of requiring an industry to make a case that it has been injured by dumping after the fact, the new "trigger price" mechanism sets a minimum price for imported steel. An imported steel sold below this price is presumed to have been dumped unless it can be proven otherwise. In the US, an effort is being made, at least, to have the trigger price set at the true foreign wholesale price — time will tell whether the administration can resist pressures to raise it closer to the American selling price.

The EC has undertaken negotiations to limit textiles, clothing, and fiber imports from the Far East, largely under pressures from the French. Dumping cases are becoming increasingly frequent; a recent issue of the *Economist* (2/25/78) estimated that 1978 would see a doubling of the 12 non-steel cases in the EC in 1977.

Even where actual dumping does not occur, international differences in the relations between government and business, particularly in the nationalized industry, are starting to concern the Americans. An example is the sale of 23 A-300 aircraft to Eastern Airlines by Airbus Industrie of France which was announced this month. The sale is worth some \$ 778 mn (including the engines, which are made in the US), and was preceded by a four month lease of four aircraft by Eastern at no cost, the planes being supplied by Airbus essentially on a free basis. American aircraft manufacturers see this as a bad precedent, because they cannot afford this sort of sales practice.

In response the EC points out that the US industry is continuously subsidized by government expenditure on research and development. Government R & D is meant for military but the results are found in connected export industries, at no cost to exporting firms. Also regional subsidies are a sore issue both for the EC countries and the US. These subsidies mean low cost of capital and therefore lower export prices that so far could not be untangled in the EC-US negotiations.

The US readiness to rely on competition stems largely, of course, from a feeling that there lies the US strength, and that in any competitive battle the US firms would not be the ones to go under. Such an attitude underlies, for example, the position taken by the US in negotiations with the British and others over air traffic rights. The US consistently argues for more competition and less regulation, while the British have sought restrictions on the number of airlines flying on a given route and the number of planes used on that route, in an attempt to maintain their share of the market.

Safety and environmental regulations, as well as food and drug standards, provide another area in which differing governmental policies can inhibit trade. On the one hand, strict US standards for consumer goods (auto safety and emissions regulation, drug testing requirements) may provide some protection against EC and other exporters who are unfamiliar with the rules and are trying to break into the US market. On the other hand, US manufacturers often complain that EC and other foreign producers who do not have to meet the US pollution and work safety standards receive an unfair cost advantage.

Conclusions

Petra Schelinski in *Deutsche Zeitung* (24/3/78) maintains that "Protectionism is now without doubt part and parcel of EC policy. It is now spreading like a malignant tumor". In January 1978 alone, the Commission received from member states 29 applications for some form of import cuts and the Commission accepted all except for four.

And in the US, according to Paul A. Voleke, President of the Federal Reserve Bank of New York, "a week hardly passes when the case is not put that foreign competition has contributed to the

closing of a plant or sizable layoffs. The causation often seems direct and certainly visible, even when the underlying situation is clouded by other factors"³.

And so we ask, is the world becoming more protectionist? The answer seems clearly to be yes. But this does not mean we are headed for a resumption of the trade wars of the 1930s. By and large economic policy makers recognize that gains from trade do exist, and they consciously sacrifice them, just as efficiency in the domestic market is sometimes sacrificed, to reach some other policy goal.

The problems economic policy is trying to deal with have become more complex in the past decade — we are not just concerned with maximizing incomes, or the growth rate. Distributional questions have risen to the fore, and trade policy can be seen as part of a broader incomes policy. This is not to say that import quotas are the best way to pursue these goals; the neoclassical results still hold, and a tax-transfer system is always preferred. But political expediency does not always permit this, even as it will not permit trade to break down entirely.

³ Federal Reserve Bank of New York, Quarterly Review, Winter 1977-78, p. 5.

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ISBN 3-87895-157-4

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