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# Restrictions on International Competition Through Government Measures

by Bettina S. Hüni, Neuchâtel\*

**The seventies can be seen as the decade where the ingenuity of the human mind knew no bounds to the invention of new non-tariff barriers, circumventing the original GATT rules. Where has this neoprotectionism led so far and what is the outlook for the future?**

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The term "neoprotectionism" refers to those measures which have the effect of protecting an industry against foreign competition as a substitute for an abolished tariff. Unfortunately, the protective effects of most non-tariff barriers (quotas, technicalities of origin rules, health protection standards, veterinary rules, hall-marking, quality tests, etc.) are by far more stringent and comprehensive than those of a tariff. Their domestic economic and social costs are also higher in terms of a misallocation of productive factors, slowing down adjustment and generally reducing the volume of world trade.

Neoprotectionism can also be defined as the "self-deception of the industrialized countries": they deceived themselves by thinking that liberalization could be divided up, so that "disrupting imports from developing countries could be controlled" in order to maintain the advantages of free trade among themselves.<sup>1</sup> The most common forms of neoprotectionism today are "orderly marketing arrangements" and "voluntary self-restraint agreements". Both these forms of selective discrimination are bilateral arrangements concluded by governments outside the GATT. They are imposed by an economically stronger importing country seeking to protect one domestic sector against an economically weaker exporting country. "Orderly marketing arrangements" determine a fixed market share for imports. As such they have the restrictive effects of quotas. If the efficiently produced imports from the selected country go above the limited market share, the government of the importing country takes further selective measures against that particular exporting country.<sup>2</sup> "Voluntary self-restraint agreements" are obligations taken by one country not to export more of a certain product into another country for fear of retaliatory measures. The question remains just how "voluntary"

they are. It is obvious that without government backing those "voluntary" self-restraint agreements could not be implemented.

It is equally obvious that orderly marketing arrangements as well as voluntary self-restraint agreements are serious restrictions on international competition directed against efficient producers, in the first place against Japan, but now also against some of the newly industrializing countries. The greatest danger they imply is that of *duration*: the longer they remain in force, the better protection is guaranteed, and the more seriously international competition is distorted. At present, such agreements have been concluded in most sensitive industries (automobiles, textiles, steel, electrical equipment, machinery, etc.). Investment insecurity for the individual industrialist has been increased, not decreased, by such measures, because even if some can take advantage of the prolonged period of adjustment due to protection, future developments are less predictable – which is a deterrent to trade and investment. In order to illustrate this point, it is worthwhile to look more closely at some case studies.

There are over 900 non-tariff barriers to trade notified to the GATT. It is impossible to give an account of all of them. A choice is made here, which shows two national schemes and one plurilateral scheme of restrictions on international competition. Individual cases, such as the much debated "steel pact" between the US and the EC will not be discussed, but rather complete systems of restrictions on international competition, because they show more clearly the philosophy, the fallacies and the risks inherent in official protectionist measures.

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<sup>1</sup> Jan Tumlir: Die Weltwirtschaftsordnung heute – eine kritische Bestandsaufnahme, Symposium VII, Ludwig-Erhard-Stiftung, Stuttgart 1981, p. 46 ff.

<sup>2</sup> Jan Tumlir: International Economic Order – Can the Trend be Reversed?, in: The World Economy, Quarterly Journal on International Economic Affairs, Vol. 5, No. 1, March 1982, p. 31 ff.

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All developed and the majority of developing countries have export promotion schemes<sup>3</sup>, some of which do *not* contain protectionist elements, which cause serious prejudice or material injury to other partners. Others, such as government subsidies for ship-building, have distorted international competition to the extent that trade flows depend on competitive subsidization rather than on demand. The span from relatively harmless to very protectionist schemes is therefore quite wide.

The GATT (Art. XVI) does not prohibit subsidies as such, but recognizes that export subsidies may cause injury. It imposes two obligations on governments:

- subsidies which are likely to increase exports or reduce imports have to be notified to the GATT;
- a partner suffering serious prejudice has a right to ask for bilateral consultations, and if they are not satisfactory, to introduce a complaints procedure.

Already in 1960, the developed countries in the GATT agreed on a "Declaration on Export Subsidies" prohibiting subsidies on industrial products which would lower their export price below their price in the domestic market. Yet a lot of leeway was left to governments for devising export promotion schemes still containing protectionist elements, as "domestic subsidies" were not prohibited. Many governments switched to direct production subsidies instead of export subsidies, which do however have exactly the same distorting effect on international competition. As a countermeasure, an injured partner may levy a "countervailing duty" (Art. VI of the GATT)<sup>4</sup>, which should however not go beyond the estimated value of the export subsidy. However, the imprecise definitions and methods for determining "serious prejudice" or the value of an export subsidy<sup>5</sup> greatly complicated the strict application of the GATT rules. In the seventies, new export promotion schemes appeared and the old ones were extended.

Official export credit schemes are another field where governments can give such favourable conditions to the clients of their domestic industries that international competition is distorted. The gravity of the rivalling export credit schemes is shown by the Arrangement

reached among the OECD countries in July 1982 on a uniform interest rate for export credits to various categories of client countries. The Arrangement was hard to arrive at and only remains in force until May 1st, 1983. It fully shows the economic and political problems connected with "graduation". "Graduation" procedures are the result of the split in the GATT system into one most-favoured nation treatment régime, valid among the developed countries, and the "special and more favourable, differentiated" treatment valid between them and the developing countries. The procedure of judging which countries have attained a level where they lose certain development privileges, will always be extremely difficult on the multilateral level and can hardly be entirely free of political or other subjective connotations. The Arrangement is the manifestation of the political will of the OECD countries not to give their industries unfair advantages in international competition. Yet, the text contains so many concessions to special positions and is valid for such a short period that the will to avoid the export credit terms race is weakened.

Other export promotion schemes distorting international competition are the different procedures of export risk guarantees and insurances granted by the governments. Due to the growing instability of the monetary system, export risk guarantee schemes were extended in the seventies. But again, according to the type of risk insured, the degree of coverage, the amounts available, the general conditions for these indirect export subsidies, the schemes show great differences. In other words, the export industries of those countries having an export risk guarantee scheme with greater or smaller public subsidization compete under different conditions in world trade.

In most market economies, public entities, i.e. national and local government authorities, are the largest single clients of industry. In France, public procurement amounts to over 15 % of GNP, in India to about 5 %. In most developing countries, public entities have an even larger freedom of action for their procurement. Most public entities have a "buy national" bias. At the beginning of the seventies, the US fully applied the "Buy American Act", which restricted or simply prohibited the procurement of foreign goods. On the small part of US public procurement *not* for defense (about 20 % of the total), the public entities allowed a 50 % price differential in favour of domestic bids.<sup>6</sup> In India a price differential of 15-25 % is valid in favour of

<sup>3</sup> For an overall view of the main schemes, cf. Bettina Hürni: Exportförderung in wichtigen Handelsstaaten, in: Aussenwirtschaft, HSG, Heft III, 1975, pp. 226-241.

<sup>4</sup> GATT: The Tokyo Round of Multilateral Trade Negotiations, Geneva, April 1978, pp. 53-60, 129-132.

<sup>5</sup> The problem of world trade *internalization* becomes evident here: the injured country has to determine the value of a subsidy in another country and relies on the protectionist government's information—or, if it starts the complaint procedure, already interferes with domestic economic interests of another country.

<sup>6</sup> US Senate, Sub-Committee on International Trade, Committee on Finance: Discriminatory Government Procurement Policy, Executive Branch, GATT Study No. 5, Washington DC, June 1973, p. 7.

domestic bids. Canada applied a 10 % preference margin on products with a high content of Canadian components. In Japan, there are no legislative requirements on public procurement. As the government is very closely linked to private industry, there is often no competition at all on public procurement, as public entities simply select their suppliers. In France, open tendering, which implies competitive bidding, is applied to only about 30 % of total public procurement.

The EC gives "national treatment" to their members' industries, which practically leaves the US out. The European Development Fund of the EC leaves a lot of room for selective tendering, where it invites bids without giving them general publicity. In EFTA, public procurement regulations are comparatively liberal and come closest to the new GATT Code on Public Procurement (see below).

As the developing countries depend more on imports, their share of open tendering in public procurement is usually larger than in the developed countries.

The degree to which public procurement becomes a non-tariff barrier depends on what percentage of it is made through open tendering.

But even under the assumption that public procurement would use open tendering only, the administrative procedures for the evaluation of bids can still constitute barriers to free competition. In order to bring more transparency into bidding procedures, the prescription of the technical specifications has to be precise, the conditions and qualifications for participation clearly stipulated, the information requested adequately defined.

#### The Multifibre Arrangement (MFA)

Whereas export promotion schemes and public procurement methods are typically fields where national governments can apply protectionist measures which distort international competition, the MFA is a collective effort in favour of an "orderly marketing arrangement". It came into force on January 1, 1974 for four years and has been extended twice for four years. The MFA III

(1982-1986) covers about 80 % of world trade in textiles valued at about \$ 80,000 million in 1981.

The original arrangement (MFA I) had left ample room for a gradual trade liberalization, without market disruption, through a "controlled" increase of imports into the developed countries. But the practical application of the MFA turned it into an instrument of selective protection for the industrialized countries. Up to the first extension (1978), the US had concluded 22 bilateral self-restraint agreements and eleven other consultation mechanisms for the unilateral imposition of "self-restraint". But the US textile industry was restructured and became relatively competitive again. In the first Protocol of extension, the protectionist element of the MFA (in general the safeguards against trade liberalization due to market disruption) was reinforced. Even so, the structural problems in the EC countries' textile industry remained unsolved. The MFA is a classic example of a protectionist scheme which is an *inefficient* instrument for solving structural adjustment problems. Up to the negotiations for the second Protocol of extension, the EC had concluded 25 bilateral export self-restraint agreements and seven informal arrangements with low-price exporting countries, a bilateral agreement with Bulgaria and one with China, as well as a protection mechanism against Taiwan – a total of 35 import restriction instruments.

The EC then declared that its acceptance of the second Protocol of extension depended on the successful conclusion of new bilateral restriction agreements with its about thirty textile trading partners during 1982. On the insistence of France and Great Britain, to a lesser extent of Belgium and Italy, the protectionist elements were to be reinforced in the following ways:<sup>7</sup>

- Quotas should be reduced for various countries (up to 12 % reduction).
- The "dominant suppliers" in EC terminology (also generally the most efficient ones, such as Hong Kong, South Korea, Macao, Taiwan) should reduce their

<sup>7</sup> Cf. E C : Lettre d'information du Bureau de Genève, Special Number MFA III, 15 January, 1982.

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exports into the EC by an average of 10 % (compared to the already unfavourable base year of reference 1981).

□ A “surge clause” should avoid a sudden full utilization of export quotas. (Exporters complain that they cannot fully use even the quotas allotted to them under the MFA II, due to the extreme splitting up of tariff nomenclature positions and other technical and administrative barriers to trade.)

The Federal Republic of Germany was successful in maintaining its relatively liberal textile trade by means of an EC regulation on textile processing, with liberal rules on processing abroad and origin rules for third country components. By the end of 1982 the EC had successfully concluded the bilateral agreements which were the *conditio sine qua non* for EC adherence to the MFA III.

Thus since 1974 the liberal clauses of the MFA have been weakened and the protectionist tendencies strengthened. This has neither made the “managed” world textile market “orderly” nor have the structural problems in the importing countries’ industries been solved. It has so far been the firmest manifestation of economic power policy in a special sector of world trade against newly industrializing and developing countries. The MFA III procedures have further weakened the “rules of the game” of the GATT, and therefore increased insecurity in world trade, especially for some of the weaker partners.

#### Code on Subsidies and Countervailing Duties

In the final analysis, the seventies have been a decade of growing protectionism through national, but also collective, plurilateral government measures implying restrictions on international competition. Towards the end of the decade, the same governments paradoxically became aware of the negative effects of a trade-reducing network of protectionist measures and reacted on a multilateral level against it. This reaction is most obvious in the late achievements of the Tokyo Round: even though the multilateral trade negotiations of the Tokyo Round officially started in 1973 – at the same time as the oil crisis – the major breakthrough and achievements came in 1978/1979.

The Tokyo Round Code on Subsidies and Countervailing Duties can be seen as a multilateral reaction against the various export subsidy schemes of the GATT contracting parties. Its official name is “Agreement on interpretation and application of Art. VI

(countervailing duties), Art. XVI (subsidies) and Art. XXIII (complaint procedures)”. It has been characterized as one of the “most confusing international agreements imaginable”.<sup>8</sup> Yet, the Code clearly stipulates three aims:

□ The avoidance of export and domestic subsidies for primary products, as well as for minerals and manufactured products, because they may cause material injury. The inclusion of “domestic” subsidies is new. Also new is the classification of minerals as manufactured products, so that stricter rules can be applied to them.

□ Countervailing duties, a kind of “tariff punishment” applied by the importing country on subsidized exports (e.g. the steel pact), should be in line with proved “material injury” caused to the domestic import-competing industries. Consequently, the countervailing duties’ value should not go over and above the value of the subsidy. An “injured” party may also take “other” countermeasures, which can be unilateral and binding from the beginning, whereas the countervailing duties first remain provisional for a certain period of time.

□ The transparency for the settlement of disputes *before* taking countermeasures should be increased. A committee should oversee the application of the agreement, and within fixed time limits a “panel” (the GATT special investigation and conciliation bodies) must be appointed, if no solution is found bilaterally. The committee may even authorize countermeasures. The novelty here is that the committee – not the full GATT Council, as formerly – has this right, and that the complaints procedure has been defined more precisely with the set time limits. The list of prohibited export subsidies on industrial goods established in the 1960 Declaration was extended and modernized. A party to the agreement is also entitled to ask for information on what it considers an “illegal subsidy” by another party. The latter is under the obligation to give this information. It was considered a major breakthrough that the US – for the first time – accepted the notion of “material injury”, which must be proved by precise investigations before a country has the right to take countermeasures against subsidized exports from another party.

However, the Code on Subsidies and Countervailing Duties leaves too much room for divergent interpretations of its main, basic notions and provisions, as the steel controversy between the US and the EC has shown. The notion of “subsidy” as such is not clear, the conciliation procedures remain rather cumbersome. In practice, subsidies on agricultural products are still allowed, even though their effect as restrictions on

<sup>8</sup> Richard Senti: Subventionen und Gegenmaßnahmen in der geltenden Welthandelsordnung, working paper 33/82, Center for Economic Research, Swiss Federal Institute of Technology, Zurich, June 1982, p. 6.

international competition may be just as negative as those for minerals and manufactured products. Export subsidies are forbidden, domestic subsidies are still allowed if they do not cause material injury to another party. Yet, the protectionist effect and the distortion of international competition is exactly the same.

### Code on Public Procurement

Rules on public procurement were new land for the GATT. On a multilateral level it was EFTA which started early to abolish discrimination in public procurement, with the Stockholm Convention of 1960. The "Lisbon Agreement" of 1966<sup>9</sup> and EFTA practice were preparatory material for the GATT Code, which is generally more detailed, and compulsory on some provisions.

The GATT Code establishes the principle of "national treatment" of foreign firms in public open and selective tendering. Each participant had to submit a list of public entities to which the Code applies. As a novelty, a minimum threshold value of SDR 150,000 (equivalent to \$ 196,000) is established for public procurement under the Code, so that smaller contracts do not fall under the Code. The risk of large contracts being "split up" in order not to reach the threshold value was foreseen and such "splitting up" is to be avoided. The Code applies to products only and leaves out exclusive service contracts. Services are included only as far as they are "incidental to the supply of products" and "do not exceed 50 % of the total value of the contract". The two questions of including service contracts and enlarging the lists of public entities covered are being debated as future extensions of the Code.

As in other agreements and arrangements of the Tokyo Round, "special and differentiated" (more favourable) treatment to developing countries was included in the Code, and open or selective tendering with as many participants as possible is recommended, whereas single tendering should be limited to exceptional cases. There are detailed rules on publication of qualifications needed by suppliers, tender documentation, awarding of contracts, ex-post information to unsuccessful bidders, a clause not contained in the EFTA rules. (It remains, however, debatable, whether such a rule restricts or promotes competition, and if it is in the interest of bidders at all.)

This code is the first substantial, worldwide agreement on non-discrimination in public procurement. As such, it can be considered as pio-

neering work. If it is successful, an important section of trade will become more liberalized. Yet the Code still leaves enough leeway for maintaining discriminatory practices.

### Self-sustaining Protectionism

Is neoprotectionism self-sustaining? There is a great risk that the answer would be yes. The example of the Multifibre Arrangement is a case in point: the argument in 1974 was that the textile industry needed a prolonged period for structural adjustment in the old industrialized countries, and that therefore certain protectionist measures had to be taken for a *limited* period of time. Yet, in 1982, those restrictive measures have not only been prolonged, but have become more stringent, whereas the liberal elements in the MFA have lost much of their significance. Experience shows that restrictions on international competition, once built up, do not disappear by themselves, but have a self-reinforcing effect until they turn to become permanent schemes cementing protection.

The outcome of the GATT Ministerial Meeting in November 1982 gives another illustration of self-sustaining protectionism: the agricultural policy of the EC has been harshly criticized inside the EC and measures of reform had been designed long before the open altercation about it with the US. It was well known that institutionalized agricultural protectionism has impeded structural change and has become an almost unbearable burden on the EC budget – and by the same token on that of the consumers and taxpayers inside the EC as well. Yet the common agricultural policy is about the only truly common element of European integration according to the "EC Customs Union model"!

On a worldwide level, a deliberate effort is necessary to break the self-sustaining and probably self-reinforcing cycle of neoprotectionism. The best instrument for this would be a *precise* interpretation of Article XIX of the GATT, already foreseen in the working programme following the Tokyo Round. This interpretation should preclude any unilateral and selective permanent prohibition of imports efficiently competing with domestic products. This would in other words slow down – or, at best, stop – the proliferation of bilateral, "voluntary self-restraint" and "orderly marketing" arrangements. But in view of the fierce opposition of the EC – and especially France – to such a non-discriminatory, multilateral, liberal interpretation of Article XIX, this will not take place tomorrow.

A further measure to impede self-sustaining protectionism is the on-going work in GATT, reaffirmed

<sup>9</sup> EFTA - Secretariat: The European Free Trade Association, 2nd edition, Geneva, June 1980, pp. 56-58.

by the Ministerial Meeting, on more efficient, multi-phased conciliation procedures by means of the aforementioned panels. These would guarantee a uniform application of the "rules of the game" and therefore create a stable framework for investment and trade security.

The EC's isolationist economic power policy at the Ministerial Meeting was rooted in the French fear of exposing their no longer competitive economy to international competition. It must not be forgotten that France has a long-standing tradition of commercial protectionism and mercantilist thinking, which is at odds with today's growing interdependence, even for an economy relatively self-sufficient like the French one. Yet the GATT remains a valid and valuable institution respected enough not only to initiate, but also to sustain the deliberate efforts of the great majority of its 88 members to break that cycle of neoprotectionism. In the present *political* context of EC integration, this remains a trial of patience for the time being. However, it cannot be repeated often enough, that the great majority of GATT members are *economically* best served in the long run if they succeed in that deliberate effort to break the cycle of self-sustaining protectionism.

### Fragmentation of World Economic Relations

International competition is indivisible: if each country protects its inefficient industries and only allows competition for its efficient producers, others will do the same, the comparative advantages will be falsified, the international division of labour fails, inevitably leading to such a fragmentation of world economic relations that the principle of "do ut des" no longer applies.

There is as yet no example of "managed trade" being more efficient than the market mechanism stimulating international competition. A case in point on the international level is the commodity agreements, which have either failed or do not work satisfactorily, despite their sophisticated mechanisms of buffer stocks, demand management, selective production subsidies, financial mechanisms in the Common Fund, etc. In order to come back to true multilateralism in world trade negotiations – with a much larger number of partners than when the GATT was originally framed – both institutions foreseen for promoting international competition, the GATT and the IMF, need to be strengthened so that they will again become the sole poles of decision-making. This means in other words that bilateral or exclusive, collective "orderly marketing" or "export self-restraint" arrangements should gradually be phased out, as they cannot simply be abolished at

once, because of domestic pressures on the main traders' governments. The two poles of decision-making will then be able to maintain and control the framework for international competition in such a way as to increase its solidity, its credibility, its reliability, its investment security – and thereby the belief that the economic framework, the "rules of the game" are efficient.

### Return to Reciprocity

As in the tariff-dismantling negotiations in the past, the international trading community will have to make a deliberate effort this time to abolish the non-tariff barriers to trade. But in this process, *reciprocity* of eliminating non-tariff barriers must be weighed, so that the governments can justify the reduction of domestic, protectionist measures.

The graduation procedure, as defined in the "enabling clause" of the GATT Tokyo Round Agreements and in the "framework for the conduct of international trade", has to lead to a growing number of developing countries no longer being under the régime of "special and differential treatment", but under the régime of reciprocity, making concessions judged equivalent to those given by their partners. The sooner a uniform reciprocity régime is reestablished, the sooner the developing countries can take advantage of non-discrimination.

Considering the external indebtedness of some developing countries, the return to reciprocity as defined in the GATT is even more urgent. Because if the industrialized countries fail to open their markets to the exports of those countries with the largest debts, the latter will have little or no chance to be able to serve their debt, let alone to pay it back. Of course, it is equally clear that other developing countries can also contribute towards this aim of promoting competition in international trade, so that financial imbalances can be offset.

In view of the worldwide potential for economic growth and the necessity, even urgency, of taking advantage of the benefits of international competition, the claim for zero growth is simply absurd – or nationalistically selfish, which is worse. This possible growth, for which the world has a large potential, depends however on a uniform, stable, predictable, creditable framework for truly multilateral trade relations. This framework has been weakened by the inconsistency of government measures restraining international competition. It is up to the present to again strengthen this framework so that it will be solid enough to hold for the economic challenges of the future.