

Gatzke, Wilfried

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Wilfried Gatzke*

Is There an Alternative to Voluntary Export Restraint Arrangements?

Against the background of the increasing proliferation of voluntary export restraint arrangements, a proposal put forward by the American economist C. F. Bergsten recommending an alternative system of auction quotas is currently the subject of international discussion. Our article gives a critical examination of this potential new instrument of international trade policy.

Until and right into the 1970s, world trade was characterized by high rates of growth and increasing liberation from the barriers ranged against it by tariffs. A large part in this trend was played by the General Agreement on Tariffs and Trade (GATT) with its rounds of customs duty reductions. The sixth and seventh rounds, known as the Kennedy and Tokyo Rounds, were particularly successful in bringing down tariff levels. However, the world economic recession which followed the oil crises and accelerating international structural change have led to an about-face in the liberalization trends in world trade since the beginning of the 1970s. Nowadays discussions on international trade policy are dominated worldwide by the expression "New Protectionism".¹ The qualifier "new" does not refer to the fact that protectionist tendencies are regaining momentum, for that in itself is nothing unusual during phases of recession,² but the term is justified because of the instruments now being used to practise that protectionism.

The characteristic feature of the "New Protectionism" is that tariffs have given way to ever more subtle forms of non-tariff barriers to trade which are difficult to see through and can be used in a discriminatory way. The latter include, for example, minimum price arrangements, anti-dumping and compensatory tariffs, administrative and technical impediments or voluntary export restraint agreements. This list could be continued indefinitely. All these instruments are a violation of the intent and the substance of the GATT agreements.

There is one particular instrument, though, which appears particularly liable to contravene the GATT agreements – which, when all is said and done, have 96 signatory countries – and that is the voluntary export restraint agreements, which are known as "grey area" policies to GATT representatives.³

The question with which we are faced today is how the increasingly widespread tendency towards bilateral agreements in the shape of voluntary export restraints can be brought to a halt. A proposal by the American economist C. F. Bergsten recommending the alternative of an auction quota system is now being discussed internationally. The aim of this article is to elaborate on whether auction quotas do really represent an alternative to voluntary export restraint arrangements. Before that, however, a closer look will be taken at the characteristics of voluntary export restraints themselves. Bergsten's proposal will then be extensively discussed, with a description of what shape an auction quota system might take in practice. The article concludes with a critical assessment of this potential new instrument of international trade policy.

¹ Cf. H. Giersch (ed.): *Free Trade in the World Economy: Towards an Opening of Markets*, Tübingen 1987; D. Salvatore (ed.): *The New Protectionist Threat to World Welfare*, New York/Amsterdam/London 1987.

² Cf. K. Borchardt: *Protektionismus im historischen Rückblick*, in: A. Gutowski (ed.): *Der Neue Protektionismus*, Hamburg 1984, p. 40.

³ Cf. E. U. Petersmann: *Grey Area Policy and the Rule of Law*, in: *Journal of World Trade*, Vol. 22, No. 2, 1988, pp. 23-44; M. Kosticki: *Export-restraint Arrangements and Trade Liberalization*, in: *The World Economy*, Vol. 10, No. 4, 1987, pp. 425-453.

* Ludwig-Maximilians University, Munich, West Germany.

A reliable impression of trends in voluntary export restraint agreements is provided by GATT's "Review of Developments in the Trading System" which has been published semi-annually in Geneva since the beginning of 1988.⁴ The very fact that the review now includes a separate section on the subject is a good indication that this instrument of trade policy is becoming ever more significant. The last edition of the review mentioned 220 such agreements, most of which protected the markets of the European Community and the United States. The product areas affected include textiles and clothing, steel and steel products, electronic products, automobiles, footwear, machine tools and agricultural products. The countries particularly affected by the arrangements are Japan and the South-East Asian NICs, which have constraints imposed on their export opportunities. According to estimates made by M. Kostecki,⁵ even as early as 1984 approximately 10% of total world trade and 12% of non-fuel trade were covered by voluntary export restraints.

Characteristics of Voluntary Export Restraints

To begin with, how can voluntary export restraints be defined? The definition used by Gaab and Gieseck is as follows: "Voluntary export restraints (VERs) are understood to be bilateral or multilateral agreements for a set period of time concerning restrictions – either in value or in volume terms – on the exports of a country or countries, or of particular industries in a country or countries, as a result of usually intense pressure from the importing countries."⁶ Their definition shows that three aspects are especially characteristic of voluntary export restraint agreements. Firstly, they restrict the supply on the world market; secondly, they are applied selectively, and, thirdly, they are only negotiated for a given period of time. This means that voluntary export restraints fall outside the ambit of the GATT, and this in itself is a possible explanation for their growing popularity. Another point which needs to be made is that such agreements are not in truth voluntarily entered into by the exporting countries, but generally as a result of the threat of more drastic measures by importing countries in the event that exports are not curtailed.

Another argument for the growing popularity of the arrangements which is frequently mentioned in the literature is that the exporting countries are willing to agree to them because they are able to cream off the economic rent.⁷ Because supply is restricted, the price of the product affected will rise in the importing country. Since the exporting countries are assured of being able to place a given quantity of goods on the market, they will be able to sell that quantity at higher prices. The difference between the new price and the previous price is the economic rent accruing to the exporting countries as a result of the voluntary export restraint agreement. This can also be deduced using the partial analysis methods of economic theory. This economic rent has become the object of recent discussions in the USA, where it has been suggested that the rent which accrues to the exporting country should be diverted to the domestic economy via the auctioning of export licences by the US government.

Bergsten's Proposal

The Director of the Institute for International Economics, C.F. Bergsten, made a proposal to the US House of Representatives' Ways and Means Subcommittee on International Trade on 27th February, 1987 that all existing voluntary export restraint agreements be transformed into auction quotas.⁸ Bergsten based this proposal on a study conducted by his institute in which it was estimated that more than \$5 billion in auction proceeds could be raised if all US import quotas and all export quotas agreed in conjunction with voluntary export restraint arrangements were to be converted into auction quotas (cf. Table 1).⁹

As a rule, export quotas have so far normally been administered officially within the exporting countries. Apart from systems in which licences are awarded in proportion to earlier market shares, some are also granted on a "first-come-first-served" basis. It is not generally permitted to trade in such licences.¹⁰ The economic rent always accrues to those in possession of the export licences, which then further improves their competitiveness. Bergsten's idea is that the auctioning

⁴ Cf. GATT: Review of Developments in the Trading System, Geneva 1988 ff.

⁵ Cf. M. Kostecki, op. cit., p. 429.

⁶ W. Gaab, A. Gieseck: Freiwillige Exportselbstbeschränkungsabkommen, in: Das Wirtschaftsstudium, No. 8/9, 1988, p. 486.

⁷ Cf., among others, C. Hamilton: Economic Aspects of Voluntary Export Restraints, in: D. Greenaway: Current Issues in International Trade, London 1985, pp. 99-117; K. Jones: The Political Economy of Voluntary Export Restraint Agreements, in: Kyklos, Vol. 37, 1984, pp. 82-101.

⁸ C. F. Bergsten: Reform Trade Policy with Auction Quotas, in: Challenge, May/June 1987, Vol. 30, No. 2, p. 10.

⁹ C. F. Bergsten et al.: Auction Quotas and United States Trade Policy, Washington, D.C., 1987, p. 49.

¹⁰ Cf. W. Takacz: Economic Aspects of Quota License Auctions, in: Journal of World Trade, Vol. 2, No. 6, 1988, p. 39; C. Hamilton: ASEAN Systems for Allocation of Export Licences under VERs, in: C. Findlay, R. Garnout: The Political Economy of Manufacturing Protection: Experiences of ASEAN and Australia, Winchester, Mass., 1986, pp. 235-247.

of export licences by the American government should generate increased revenues for the state which should then be used to finance adjustment programmes for industries damaged by import competition.

Organization of the Auction Quota System

The question as to what practical shape the auction quota system should take¹¹ is one of crucial importance for the system's success. The auction quota system's period of operation needs to be limited, for the objective must remain one of reducing trade barriers, recognizing the spirit of the General Agreement on Tariffs and Trade. The prime objective ought to be one of restoring the international competitiveness of the industries protected. However, those industries will only make an increased effort if they know that the protectionist measure taken will lapse after a given period of time. It would also seem appropriate to reduce the protection provided by the auction quota system progressively. The exporting countries will do their best to resist the conversion of export quotas into auction quotas. If the intention is to persuade them that the ultimate aim is to have completely open access to the market, that market access ought to be successively improved even during the period in which the auction quota system is in effect. The loss of the economic rent would then be compensated for by an increase in export opportunities. Another important point in this regard is that the government should not grow accustomed to treating the revenues from this system as a permanent source of income. This consideration is reflected in the idea of a limited duration alongside the wish to restore the international competitiveness of the industries concerned.

What, then, ought to be the shape of the individual elements of an auction quota system? To begin with, a decision has to be made as to the form of the auctions themselves. On the one hand, these may be conducted orally or, on the other, tenders may be submitted in secret. The volume and frequency of the quota auctions which would be necessary suggest that the latter alternative would be preferable. This would also make collusion amongst the tendering parties less likely. In a secret auction, each participant submits a written tender before a definite deadline. Once this has passed, the licences are awarded to the parties which submitted the highest offers. Eligibility to participate in the auctions should be kept as open as possible in order to increase competition among the tendering parties. The auctions should be conducted regularly and frequently. This would mean, firstly, that those who had submitted unsuccessful tenders would not be excluded from the market for too long, and, secondly, that there would be

frequent opportunities to take account of the latest market information in the offers placed. A further advantage is that panic buying would be avoided. The licences awarded should only have a limited period of validity, to avoid market structures becoming unduly rigid, and definite limits should be placed on the number of licences any one tendering party is permitted to acquire. This would prevent a small number of tendering parties creating oligopolistic, or in extreme cases monopolistic, market structures by buying up as many licences as possible.

A further consideration of crucial significance is the method of establishing the auction price, for this determines the economic rent which previously went to the exporting country and is now intended to accrue to the importing country. In a sealed written tender procedure, the price ought to be set at the level of the highest unsuccessful tender as the quota is used up. This follows proposals on auction procedures made by Vickrey¹², offering the advantage that all tenders submitted potentially influence the price ultimately arrived at, and that the price paid is not the same as the price tendered, but is less than the party concerned would have been prepared to pay. This makes it the more likely that the offers submitted will reflect the real economic rent involved.

A final question which has to be settled is whether tendering parties ought to be allowed to resell licences they have acquired. There is no reason why this should not be allowed, provided that licences are not all bought up by a small number of auction participants. Here again, a limit would be necessary on the number of licences it would be possible to acquire, and this ought to be monitored by a state regulatory authority.

Criticism of the Auction Quota System

Bergsten's proposal has by now given rise to considerable discussion among academics and practitioners alike as to its applicability.¹³ The only places where any experience has been gained with auction quotas to date are Australia and New Zealand. Both countries have auctioned an increasing proportion of their import licences since 1981. There has been no

¹¹ Cf. C. F. Bergsten et al., op. cit., ch. 8; W. E. Takacz, op. cit., pp. 47-50.

¹² Cf. W. Vickrey: Counterspeculation, Auctions, and Competitive Sealed Tenders, in: *Journal of Finance*, Vol. 61, No. 1, 1961, pp. 8-37.

¹³ Cf. L. M. Baughman: Auctioning of Quotas: Lots of Pain for Little Gain, in: *The World Economy*, Vol. 11, No. 3, 1988, pp. 397-415; E. J. Milosh: Auctioning of World Trade, in: *Journal of Commerce*, 6th February, 1987, p. 15A; B. Stokes: Selling Quotas, in: *National Journal*, 14th February, 1987, pp. 370-73; W. E. Takacz, op. cit., pp. 40-42.

practical experience as yet of converting voluntary export restraint agreements into auction quotas.

The first great problem in putting the auction quota system into practice would probably be converting export quotas agreed as part of bilateral voluntary export restraint arrangements into global import quotas. Unless this is done, any application of the auction quota system does not appear possible. It seems unrealistic to assume that exporters in NICs would be in a position to submit tenders for entitlements to market access in industrial countries. For one thing, the amount of market information available is too small and, for another, the administrative expense is too high. This being the case, it would appear more sensible to award the licences to domestic importers. The question then is whether the exporting countries which have resolved to exercise voluntary export restraint would be prepared to accept that. The very reason exporting countries have been prepared to exercise such restraint is that they wish to preempt tougher measures such as import quotas. Moreover, any conversion of voluntary export restraint agreements into import quotas will hit all suppliers together. Third countries which have previously had unimpeded access to markets will now be forced to await the outcome of importer auctions if they wish to maintain their market shares. This could lead to concerted action being taken against the importing countries through the GATT, for import quotas are in contravention of the General Agreement on Tariffs and Trade. Only if it is faced with serious balance-of-payments difficulties is a member country allowed to breach the principled prohibition on quantitative barriers to trade.

Yet even if it does prove possible to introduce the auction quota system, there are still several more serious questions which remain open. Will auction quotas really be such a success as the Institute for International Economics' estimates suggest? If the system is set up as proposed, it is not certain that it really

will be possible to draw off the maximum economic rent. Both importers and foreign producers will do their best to resist this. Before introducing such a system, it will always be necessary to look into the market structure on the supply side. The number of producers in the automobile sector, for example, is readily visible. This means collusion would be possible even if auctions are carried out using written sealed bids. Bergsten himself rejects the use of the auction quota system for the automobile industry.

In addition, the government would have to meet high launch and administrative costs. Even though the auctions in New Zealand are conducted by a small team of people, high costs can be expected to arise for large importing nations such as the USA or the Western European countries. After all, the auction quota system would amount to a radical reshaping of trade policy as it has been practised to date. The present system has its own costs, of course, but the auction quota system would entail introducing a new and large administrative machinery.

Bergsten has interpreted his proposal to imply that the introduction of the auction quota system is a way towards greater trade liberalization.¹⁴ The intention is to progressively reduce the level of protection provided. Yet one can hardly expect branches of industry which have benefited from protectionist support for years to allow such reductions to occur. The steel industries in both the USA and the EC bear this out, for they have managed to resist competitive pressure from NICs for many years by demanding that protectionist measures be taken.

The problem would seem to be considerably more serious in the textile and clothing industry. The 1973 Multi-Fibre Arrangement, which has now been extended three times, is an arrangement which was multilaterally negotiated. It would be impossible for individual countries around the world to withdraw from the arrangement, which would breach the terms not only of the agreement but also of the GATT.

Auction quotas, then, involve the inherent risk that they will turn into a new instrument of trade restriction for the longer term. This fear is reinforced by the fact that politicians could use the government revenues generated by quota auctions as a means of bolstering the government budget. This appears to be a problem in the USA in particular.

As with other forms of protectionism, the ultimate cost will have to be borne by the consumer. If trade policy is

Table 1
Potential Auction Revenues
(US \$ billion)

Sector	Revenue
Textiles and apparel	3.00
Carbon steel	1.27
Machine tools	0.32
Sugar	0.30
Dairy products	0.20
Specialty steel	0.06

Source: C. F. Bergsten et al.: Auction Quotas and the United States Trade Policy, Washington D.C., 1987, p. 49.

¹⁴ See C. F. Bergsten, op. cit., p. 7.

reformed with the aid of auction quotas, the prices paid by consumers will not fall, for the supply on the market will always be below that which would be possible under free market conditions. Consumers will go on having to pay higher prices, and the only difference will be that part of the money which would otherwise have gone abroad will now flow into the coffers of the domestic government.

Conclusions

Bergsten's proposal is undoubtedly an interesting alternative to the trade-policy instruments traditionally used as far as importing countries are concerned because of the revenue prospects it raises. However, can the auction quota system really be seen as an alternative to voluntary restraint agreements? The main problem in converting such agreements into auction quotas is likely to be the resistance of the exporting countries. The very reason that voluntary export restraint agreements are concluded is to avoid tougher measures and to achieve a certain gain in the shape of the economic rent. If the auction quota system were to be introduced this would lead to new complaints at the GATT in Geneva, causing disruption to the relations between exporting and importing countries.

¹⁵ Cf. E. U. Petersmann, op. cit., p. 35.

One point auction quotas do have in their favour is that they would again make protectionism more transparent and would hold in check the current tendencies towards discrimination.¹⁵ This would again allow restricted market access to become the object of international negotiations. Given the manner in which voluntary export restraints are currently practised, these agreements are most unlikely to generate complaints before the GATT. Yet the Uruguay Round negotiations would undoubtedly be simpler if precise figures were available on the extent to which trade is being restricted by such "voluntary" export restraints.

Auction quotas should only ever be used if it is certain that they are a true step towards the liberalization of world trade. This is something the exporting countries need to be convinced of, but it must equally be brought home to domestic, import-competing industries. If this were to be achieved, consumers too would ultimately benefit, for after a period of time goods really would be produced where the comparative advantage is greatest. But has this Heckscher-Ohlin world ever really existed? If looked at in this light Bergsten's proposal also needs to be treated with scepticism. Free trade still is, as it has always been, a concept which graces the textbooks on foreign trade theory but is rarely encountered in practice.

Uwe Corsepius*

Liberalisation of the Capital Markets in Developing Countries

The domestic capital markets of developing countries are typically subject to serious inefficiencies. This article shows how these inefficiencies can be eliminated without necessarily provoking an adjustment crisis and indicates the measures on which emphasis must be placed in the context of structural adjustment assistance in order to mobilise a large volume of savings and achieve a better allocation of resources.

Financing a volume of investment that will generate rapid and self-sustaining economic growth is a serious problem for most developing countries, and all the more so for the heavily indebted countries that must finance economic growth largely by their own efforts because little new external money is available. An efficient domestic capital market is therefore essential if

new productive capacity and jobs are to be created quickly. To facilitate this, credit institutions must be able to mobilise domestic savings to finance investment by tailoring the yield and liquidity characteristics of their deposit instruments to suit savers' requirements. In addition, the underlying economic conditions must give the banks an incentive to transform the savings they have gathered into loans and to distribute them among investors in a way that ensures efficient use of the

* Institut für Weltwirtschaft, Kiel, West Germany.