

SUMMARY OF THE INTERNATIONAL TRADING SYSTEM'S PROBLEMS

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The problems of the system of international trade may be said to be of two kinds. On the one hand there are those caused by exogenous shocks and stresses, like wars and large, autonomous changes in key commodity prices, as well as by cyclical movements. On the other hand there are the difficulties inherent in the system itself: the endogenous problems. For want of a better expression all of the former may be lumped together under the heading "conjunctural", while the latter may be referred to as "systemic". The two classes are by no means independent of each other, but the logical distinction is useful for purposes of exposition and also, to some extent, for policy formulation.

Conjunctural Problems

During the past ten or fifteen years the evolution of the world economy has been characterized by falling rates of growth of production and trade; by the secular expansion of unemployment (due to technological, social and political influences operating from the mid-1960s); by the growth of international liquidity and accelerating inflation from the later stages of the Vietnam war and the Smithsonian settlement to beyond the generalized floating of 1973; by the price shocks of 1973/74 and 1979/80, with the cyclical behaviour of (real) oil prices and employment between and after; by wide swings of current account balances and exchange rates; and by the responsive growth in OECD countries of monetarism and state intervention in industry and trade - the one being, among other things, a political counterpoise to the other. During this whole period the attempt has been made to uphold the principles of multi-lateralism and non-discrimination, and at the same time to press ahead with further liberalization of trade: but there were stronger counter-currents.

For the environment of world trade the chief consequence of the growth of secular and cyclical unemployment was the generalized increase in protection that came to be dubbed "the new protectionism". None of the technical devices employed in the trade protection of the 1970s was novel when viewed in isolation, but together they took on a new complexion in their scale, in their emphases (non-tariff, sectoral, bilateral) and in their rationale. This last had much to do with the wholesale nature of the destabilizing influences compared, for example, with the marginalist logic of GATT's Article XIX.

In the past ten years or so most major currencies have been subject to fluctuations whose effects on international trade flows have dwarfed those of the import duty tariffs - which had in any case been diminished and largely immobilized in GATT. For example, the pound sterling has moved within a range of over \$2.5 and under \$1.5¹/₂. It followed that there was difficulty for government in judging what would be competitive, on a comparative cost basis, in the long run, and what should be let go. Some enterprises that fail to break-even at the first rate of exchange can make profits on their exports at the second, and this could account for a good deal of the ambivalence of governments in the matter of industrial policy.

Positive adjustment is of course easier in concept and in hindsight than in practice, where the uncertainties of the future must be added to the uncertainties of the present. For some countries it was more than difficult enough to judge what the position would have been given free market conditions in others, without having to construct alternative scenarios based on assumed future price relativities. As practically all countries had price structures reflecting varying but substantial degrees of government intervention, this would to some extent have vitiated attempts at adjustment to free market conditions by any one of them. Moreover, as suggested above, the influence of expectations (i.e. the speculative element in exchange rates) and the alleged prevalence of "dirty floating" and exchange rate "overshooting" sometimes constituted a perverse element in the process of adjustment, and added to the difficulties of industrial policy.

Though the chain of causation was not at all one way, a consequence of these and many other distortions and uncertainties was resort by government on a large scale to short-term measures of market organization involving subsidy (open and concealed), local content rules, minimum price rules, fiscal devices, regional industrial policies, purchasing programmes, aid and export credit packages, administrative intervention and direct control of bilateral trade flows, all of which in varying degrees embodied elements that could be described as protectionist. The EEC, Japan and the United States tended to sort out their problems between themselves, partly because fully multilateral solutions would in all probability have eluded them elsewhere.

The growth of multinational enterprise and the close working relationship of business with government in a number of countries have greatly facilitated the management of international commerce outside the traditional norms - and this on the sides of both physical shipments and multilateral payments. As noted by the UNCTAD Secretariat, between 30 and 40 per cent of international trade transactions is between

related parties (i.e. intra-firm trade), and a further 30 per cent is likely to constitute transactions where at least one of the parties is either the state or an enterprise owned or controlled by it.^{2/} Some of the most characteristic modern forms of corporate control of trade flows have been activated in response to cyclical disturbances, and have themselves been facilitated by long-term changes in the institutional, financial and technological environment of business.

In the period 1973-81, when oil prices were high (notwithstanding their erosion in real terms by inflation between times), trade restructuring reflected the need for oil importing countries to pay more, in exports of merchandise (including arms) or services, for the oil. Capital-surplus oil exporting countries could place funds with the Euroloan market, which was increasingly tapped by developing countries. Collectively, developing countries were the "soft" markets, increased exports to which helped OECD countries to contain their current deficits and curtail the erosion of their monetary autonomy that would have resulted from an over-large growth of foreign claims on them: at the same time the anti-inflationary monetary policies pursued by OECD countries made theirs the "hard" markets. These characteristics are reflected in world trade patterns as follows.

Share of world merchandise trade, per cent

<u>Exports from/to</u>	<u>1973</u>	<u>1981</u>
Developed countries/developing countries	12.0	15.7 ^a
Developing countries/developing countries	3.9	7.2 ^b
Developing countries/developed countries	14.0	18.7 ^b
Developed countries/developed countries	51.2	40.9
Socialist countries/socialist countries	5.7	4.7
Others	<u>13.2</u>	<u>12.8</u>
	<u>100.0</u>	<u>100.0</u>

^a Growth in share mainly attributable to manufactures.

^b Growth in share largely due to oil.

Source: UNCTAD document TD/274, paragraph 15.

The changes depicted above are very large for so short a period, and would imply a considerable shift in the commodity pattern of world trade even had technology stood still. They called for an adjustment of industry that was

rendered all the more difficult by the pursuit of policies which, however necessary, brought the growth of world production and trade to a halt. The result was to hasten the erosion of GATT norms, and the declining relative role of GATT-type trade, by the organization and management of markets in the search for stability. "The degree of management is now very large and extends to all sectors and groups in all countries, regardless of their economic and social systems or levels of development."^{3/} The particular devices employed have of course varied, in accordance with detailed objectives, institutional structures, and in some cases international agreements. There is a growing realization that trade-as-industrial-policy remains largely outside the scope of GATT rules.

One form of trade management that has featured in the past - in the arms offset arrangements of the West, in investment-related trade arrangements with centrally planned countries, and in special deals like the rice-rubber pact of China and Sri Lanka - has now come to the fore as a means of ensuring supplies and stabilizing market outlets against the upheavals of disturbed trading conditions. This is counter-purchase^{4/} which, like so many other forms of managed trade, is not in direct conflict with the GATT but rather outside it. J.J. Walsh quotes recent OECD estimates of counter-trade covering 15-20 per cent of East-West trade and less than 10 per cent of intra-OECD trade, while an earlier estimate of developing country trade had put the coverage of counter-trade arrangements at about 40 per cent in the mid-1970s. The present ratio is said to be higher. "As the IMF recently noted, there has been a surge in bilateral trade arrangements since 1979. Most have been initiated by developing countries to correct payments deficits. Some developed countries use counter-trade arrangements to assure supplies of essential imports. All such arrangements are made in response to governmental policies and programmes."^{5/}

The GATT had been designed for a non-discriminatory, free-market system of fixed parities and marginal adjustments, in which the role of government was strictly limited. But experience suggests that the market system can only operate efficiently within a framework of basic stability of prices and wages, in the absence of which there is a seemingly inevitable drift towards state corporatism. GATT was thus not at all adapted to dealing with the trade implications of such gross macro-economic disturbances as have been experienced over the past ten years, and during this period the relevance, and hence the authority of GATT have suffered a severe decline.

Now the break in oil prices has revealed the weakness of a trade adjustment based to such an extent on debt. At the same time it may provide the opportunity for reorganising the debt structure of developing countries, and remove the occasion for some of the hastily imposed measures of industrial and trade protection, by concerted expansionist policies in OECD. These would make OECD markets softer, developing country markets harder, and support the revival of commodity prices and a new adjustment in the geographical pattern of trade. Some of these changes might prove temporary, however, if at the same time attention were not given to the long-standing need for a system of trade and payments legally and institutionally capable of ensuring adequate, and adequately co-ordinated, policy response both to conjunctural shocks and to secular change. The GATT has recently warned that if rates of recovery vary among different nations, current account imbalances would probably widen and could become a source of pressure for further protectionist measures.

Trade Systemics

The system of international trade relations has been defined as "the series of principles and norms which form the basis of the international consensus regarding the role of government in the conduct of international trade, the contractual rights and obligations of participants as regards the use of trade regulating devices, and the international agreements and institutions by means of which trade policies are implemented. The GATT clearly constitutes the basis of what might be called the 'multilateral' system of trade relations".^{6/}

On this definition it may be said that the chief problems of the system as such are threefold, arising from 1) the breakup of the international consensus on the role of government; 2) the perceived lack of balance in the rights and obligations as between contracting parties; and 3) the rigidity of GATT law and of the institutional procedures and negotiating modalities of GATT, which has retarded adaptation of the norms and the obligations to changing commercial and industrial realities. These three causes are closely interlinked in practice: together they weaken such consensus as exists in favour of the GATT system as a whole.

At the Davos Symposium of the European Management Forum, early 1983, the need was expressed for a package of initiatives to resolve linked problems of developing country indebtedness and protectionism. For this, it was said that there was a need to "strengthen" GATT, for which purpose the Contracting Parties should meet every two years at ministerial level. While it may be allowed that such meetings would heighten awareness of trade-linked problems and give political impetus to the work programme, it is difficult to envisage any real strengthening of the multi-lateral trade system without an agreed diagnosis of GATT's weaknesses. To "reaffirm" GATT would be insufficient. The fundamental weakness is that GATT has lost the consensus on which it was based.

The GATT is a balance of "interests" and if, in the passage of time, through the evolution of trade, industry, and government, this balance becomes distorted, the need is felt for a new balance. This can only come about by exchange of substantive interests (concessions). Without a balance of rights and obligations that is broadly seen to be fair and in the interests of all, the normal processes of consultation become increasingly sterile, and it is vain to expect conciliation and dispute settlement procedures to be effective. The law would have lost its sanction, which is mutual interest; and large numbers of countries would be tacitly ignoring the law. It is probably not too strong to say that this is what has been happening in trade in agricultural products. There may indeed be a need to strengthen GATT, but this can hardly go far enough to meet present needs without a new consensus among contracting parties i.e. between governments.

The plea for a new consensus based on an agreed diagnosis surfaced in the preparatory work for the GATT Ministerial in 1982, for which developing countries had been co-ordinating their positions elsewhere. However, the result of the Ministerial Session was a good deal less fundamental. It was a series of "reformist" measures, for which the GATT Council established procedural arrangements, mostly distributing the work among its existing organs and, where necessary, setting up new ones. This result should not have been unexpected, as it follows largely from the way GATT works. Indeed, the secretariats of UNCTAD and the UNCTAD/UNDP MTN project more than five years ago concluded that no fundamental change to the "framework" of world trade law would be likely to emerge from negotiating machinery set up in GATT.

Some reasons for the weakening official consensus among GATT's membership may be offered by way of example. In the first place, developments in trade and payments over the years have made parts of the Agreement obsolete, and

contribute to a felt lack of balance which has in turn been used in justification of non-adherence to some of its provisions. Some of these developments have been noted above, in the course of the discussion on the response to conjunctural shocks. But others, like the growth of trade in services, high technology, and trade-related investment, may be used to illustrate long-term trends that (whether or not related provisions should be written into the General Agreement) can seriously undermine the balance of national interests over a period of time.

Similarly, politico-economic developments of a rather fundamental kind can upset the balance. Such have been, for example, the resurgence of Western Europe in the shape of the EEC, and the growth of Japan, which have introduced tensions reflecting different industrial cultures, and a de facto division of power in GATT between these two and the United States. Also, the emergence of Third World countries as a politically coherent force, and their now dominant membership of GATT in terms of numbers, has highlighted a north/south divide on the concept and operative significance of "reciprocity" in GATT, and shown a need for the development of new negotiating modalities for these and other countries.

Then again, the increase in government involvement in trade is calling into question many of the presuppositions on which GATT was based. Giuseppe Porro argues that control of state aids is a necessary condition for the preservation of a system based on free trade. But, he says: "It seems inconceivable that, in the name of safeguarding free trade, states should refrain from intervening in order to restructure industry, preserve employment and permit the retraining of manpower, or assist depressed areas.⁷ For these and similar reasons it is now sometimes argued that the terms of GATT and its powers of multilateral surveillance should be extended to encompass not only trade but also investment and industrial policy - in a manner that calls to mind the charter of the stillborn International Trade Organization. Now, as then, this would create juridical as well as informational problems: as a senior US trade official recently observed, there is nothing so domestic as international trade. However, the difficulties should not be made an excuse for avoidance of necessary effort.

The problems do, indeed, go deep, and some are both technically complex and long-standing. In many contexts "comparative advantage" follows more the dynamics of industrial organization than the usual Ricardian, Heckscher-Ohlin or product-cycle logic; and when governments intervene in the market they are not necessarily failing to perceive that comparative advantage is there, but perhaps reacting to

realities that the model has assumed away. The world is not composed of the equal units implicit in the original one-world GATT view, but of very different kinds of economies, with different sorts of governments and different industrial policies. The theoretical benefits of free trade are generally admitted on all sides, but they abstract from the realities of market and political power. The concept of (completely) free trade (including, e.g. a unified rate structure and no subsidies on official export credits) implies free movement of capital and labour, which are always likely to be limited. These are the really difficult problems for government, the problems of degree in a world of economic imperfections. While the doctrine of comparative advantage is theoretically unassailed, its practical utility depends entirely on the validity in the real world of its ex ante assumptions.

There may be justifiable apprehension at a state of affairs in which most countries subscribe to a theoretical consensus while basing policy on its practical exceptions. With a sharper focus on the international allocation of savings and investment as the crucial welfare variable, governments would perhaps be able to acknowledge even to themselves what they are actually doing, and to tackle the consequences, notably those concerning the international order, in a less haphazard and contradictory manner. As it is, the great variety and scale of government intervention in the economic process, including the activities of state trading entities and the provision of subsidized export credit, have contributed to the present felt lack of balance in the rights and obligations of GATT. There is need for a new balance to be negotiated, for consensus to be re-established. The new balance would need to accommodate, inter alia, the smaller primary producing countries with their agricultural interests; the developing countries with their wide range of concerns, particularly about commodity production and trade, special and differential treatment, and negotiating modalities; as well as the advanced countries for which investment-related trade, and trade in services and high-technology goods, are becoming a major focus of attention.

The Way Ahead

There are two main schools of thought on the way to proceed. The first has been dubbed the "GATT or chaos" school, its adherents arguing that there is no chance of a new consensus. It is a choice of either GATT as it is, with reformist measures to try to make it work better, or breakup of the system. US trade officials have recently been floating ideas for "strengthening" GATT, one involving negotiations with developing countries, and one reviving a 1969 Atlantic Council proposal to create a sort of GATT-within-GATT consisting of the industrial countries and a few

advanced developing countries. As would be expected, these suggestions have evoked little enthusiasm, and indeed they would be regarded by many as themselves constituting breakdown of the system. An alternative scenario would see the EEC becoming selectively more protectionist in its attempt to preserve (and establish) free trade within its borders, while UNCTAD would promote South/South co-operation under its own auspices and within a separate legal framework. All of this, hypothetical as it is at this stage, would be analogous to the earlier breakdown of the par-value system of currencies, in as much as it would produce greater unilateral and group "freedom" of action but at the cost of greater uncertainty. It would hamper a return to greater stability of exchange rates.

The other view is persuasively argued by the UNCTAD Secretariat. "There is an urgent need for a new consensus to underline an improved international trading system."^{8/} In the view of its Secretary-General, as expressed to Ministers representing the GATT Contracting Parties in November 1982, while it was necessary to deal with immediate problems, it was necessary also to build an enduring structure for the future. It was important to recognize, he said, that the problems in the multilateral system had their roots in economic and social stresses arising from shifts in international competitiveness and conflicting national policies. In Mr. Corea's view these problems should first be addressed and analysed, so that any renegotiation of the rules and principles of the system would be based on a common understanding as to the objectives of such an exercise.

The "reformists", who held the centre of the stage at the GATT Ministerial, fear that such an exercise would merely highlight differences, and lead to a further erosion of credibility for GATT, without producing a new consensus. Against this it can be argued that differences are growing inevitably as a result of political and economic developments independent of GATT, and that to ignore them would not prevent the ultimate fragmentation of the system. In the words of the UNCTAD Secretariat^{9/}, "political vision and collective responsibility, and a willingness to go beyond negotiating postures and traditional attitudes, are urgently required". Unfortunately, wishing will not make it so, and it has to be recognized that a "new consensus", if it is to have any real meaning and effect, can only be arrived at by genuine compromise all round, by the cession of real or perceived national interests for the sake of larger national interests.

It is the magic of GATT that its negotiating processes are designed to make this possible. The problem now is that they no longer seem capable of doing so.

While being "good at" procedures leading to contractual arrangements, GATT is less successful with free-ranging policy discussions of a type capable of being held in some other organizations. For this reason, and because of its restricted mandate, GATT has some difficulty in addressing the larger issues, like protectionism in their totality. The industrial policy and monetary aspects are set aside, while present procedures for handling even the trade aspects are compartmentalized, tailored to the committee structure of GATT, and linked to the existing legal framework, i.e. the text of the General Agreement.

Among the important consequences of these procedural modalities in GATT is that it is made difficult for developing countries to evolve a coherent position in relation to their special interests. Another consequence is that an eclectic and creative approach to new problems emerging in world trade is inhibited, so that debate is stultified and the GATT legal framework itself becomes increasingly obsolescent. This applies in areas of overlap between international trade, finance and industrial policy, as well as overlap of internal GATT organs. On the other hand it must be frankly acknowledged that, while there exists the possibility in UNCTAD for wide-ranging debate on interlinked trade, industrial and financial issues, uninhibited by the legal GATT/IMF framework, the focus of that organization carries its own limitations for co-operation outside the North/South context. In like manner the OECD has its strengths and weaknesses.

Since the development of a new consensus out of existing organizations seems in the above ways to be fraught with difficulty, there may be a natural tendency to look for salvation in calls for a new globalism. But unlike the situation pertaining in 1944, the world no longer operates in an international juridical no-man's-land. If the way forward is not to be destructive of what has already been achieved, new arrangements would need to take into account existing commitments.

In the 1982 Commonwealth report "Protectionism", a way forward along these lines was suggested in the following terms:

"Joint machinery should be established linking GATT, UNCTAD and other international agencies, to discuss protectionism and structural adjustment, including the policy framework for

agricultural, industrial and other sectors; this could lead to, and facilitate, negotiation of specific rights and obligations in appropriate agencies."

(Protectionism: Threat to International Order, page 135.)

The institutions named or alluded to above, which may be assumed to include the IMF, are of course all creatures of government. The secretariats of these institutions could not be expected on their own to find a new consensus among governments. The recommendation of the Report may thus be interpreted to envisage joint machinery at the inter-governmental level - perhaps a type of C-20 mechanism with a much broader mandate, and serviced by a joint secretariat. A specific function of the UNCTAD Secretariat in this process could be to contribute ideas for the integration of developing countries into the international system on the basis of both equity and efficiency. But it would be governments that would need to make the running, at all stages of what would be a political process. And for the process to gather any momentum it would seem to be highly desirable, perhaps even essential, for the GATT Contracting Parties to meet at ministerial level much more frequently than hitherto.

If the first step may thus be visualized in terms of the creation of such a mechanism for co-ordination at the political level between institutions, the immediate goal of this process would be to reach an agree diagnosis, and accordingly to harmonize short-term policies for dealing with shocks to the system. Its longer-term objective, carried out with the important assistance of existing international secretariats, would be to search for a new consensus by staking new boundaries and defining interrelationships between domestic and international jurisdictions, between the trade and industrial aspects of the system of exchange, between North and South regarding the concepts of reciprocity and graduation, between manufactures and "commodities" as to the market and structuralist concepts of trade organization, as well as the boundaries of institutional competence.

To itemize the agenda in this way is to illustrate the formidable difficulties in the way of reaching a new consensus. It would be an arduous process, and a long process. Success could never be guaranteed. Without it, however, reformist efforts, necessary as they are, could hardly staunch the tendency to fragmentation, and a further loss of authority and effectiveness for international institutions could be expected. With it, the way would open for a preparatory conference, leading to negotiations on specific issues in appropriate agencies and a new balance of rights and obligations. This result would be a major

step towards the sort of "comprehensive" treatment of international commercial interchange envisaged in, for example, the Proposals for Consideration by an International Conference on Trade and Employment, issued at Washington towards the end of 1945.

The Proposals suggested the founding of an International Trade Organization of the United Nations, the members of which would undertake to conduct their commercial relations in accordance with rules laid down in the Charter of the organization. They affirmed the principle of unconditional most-favoured-nation treatment, and laid down for adoption rules intended to govern tariffs and preferences, quantitative trade restrictions, subsidies, state trading, exchange control, restrictive business practices and inter-governmental commodity agreements. General principles were formulated with respect to the maintenance of full employment and international co-operation in employment.

As is generally known, the Proposals were only very partially implemented, mainly because, in the view of the first Executive Secretary of GATT, there was a lack of consensus between those who were wedded to free trade and those who placed the emphasis on full employment on a national basis. The passage of time since then, and the development of new and potentially divisive elements, has only emphasised the need for a fresh effort to find a broad-based consensus. If this could be long-term and in the initial stages low-key it would help to get away from negotiating postures and traditional attitudes in order to address the real problems.

Footnotes

- 1/ "A depreciation which does no more than offset domestic inflation maintains the same conditions of trade as would obtain under a stable price level with a stable exchange rate." R. Blackhurst and J. Tumlrir: "Trade relations under flexible exchange rates". GATT Studies in International Trade, 1980. Writing on the influence of expectations on exchange rates, and the two main elements in these expectations, viz. inflation differentials and current account movements, the authors comment (op. cit., p. 39): "The current position of the pound sterling is a case in point. Despite a domestic inflation well in excess of the average among its trading partners, the United Kingdom's exchange rate has been quite strong. The principal explanation is the positive impact of North Sea petroleum (perhaps in conjunction with the current monetary restraint) on expectations regarding future trends in the current account balance." A similar type of observation could be made about the position obtaining early in 1983, when sterling came under pressure from apprehensions about the ability of OPEC to maintain some semblance of control in the market, in face of heavy discounting. If a conclusion of the GATT study could be the need for closer co-ordination of macro-economic policy among the leading countries, this in itself would not entirely overcome the anticipatory uncertainties and the after-effects of major "real" disturbances such as those that have surrounded the price of oil.
- 2/ "Protectionism, trade relations and structural adjustment"; UNCTAD Secretariat, January 1983, TD/274, paragraph 23.
- 3/ TD/274, paragraph 59.
- 4/ On the Indonesian counter-purchase policy of January 1982, see for example Far Eastern Economic Review, 27/1/83, and the London Financial Times, 24/2/83.
- 5/ Walsh, J.J.: "Countertrade: Not just for East-West any more?", Journal of World Trade Law, Jan/Feb 1983.
- 6/ UNCTAD document TD/274, paragraph 65.
- 7/ "Government Aids: the rules in EFTA, the EEC and GATT", published in EFTA Bulletin No.4, Vol.XXIII, October-December 1982.
- 8/ TD/274 paragraph 142.
- 9/ Loc cit.