

Chapter 3

International Trade Frictions and the New GATT Round: A European View

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INTRODUCTION

THE open multilateral trading system has, since World War II, become a key component of international relations. Trade in goods and services between countries has expanded to a point where it is now a mainstay of the world economy. Large and small countries alike depend on international trade—hence, the importance that attaches to the multilateral trading system and the need for trade policy to contribute in its own sphere to the revival of the world economy.

Subjected in recent years to a lot of stress and strain resulting from the various disequilibria that have affected the world economy, the trading system now needs not only to be strengthened and given a new impetus, but also—and perhaps more importantly—to be adapted to the new conditions of world trade. This has led the three pillars of the system—the U.S., Japan, and the EC—to call for a new round of multilateral trade negotiations in the GATT.

The launching of such negotiations will not, however, have the expected beneficial effects on the trading system if we cannot, at the same time, overcome the serious tensions that plague relations between the EC and U.S. and correct the destabilising factor that constitutes the enormous and increasing Japanese trade surplus. Both

problems are indeed a serious threat to the operation of the trading system and to the success of the new round designed to strengthen it.

INTERNATIONAL TRADE FRICTIONS

EC/Japan

The scale of the problem Japan poses for its partners can be summed up in a few figures. Its trade surplus with the rest of the world rose from \$7.6 billion in 1979 to \$46 billion in 1985. Over the same period its surplus with the EC rose from \$5.1 billion to \$11.1 billion; with the United States it was up from \$6.0 billion to \$39.5 billion. In balance of payment terms, Japan can certainly argue that a massive outward flow of capital (mainly to the United States) more than compensates for these surpluses, since the Japanese balance of payments showed a deficit of \$2 billion in 1981 and \$12 billion in 1985. Nevertheless, the Japanese current account (goods plus transfers and services) is well in the black, up from \$4.7 billion in 1981 to \$49 billion in 1985, which means that the services account deficit is shrinking fast; so fast that the OECD forecasts a current account surplus of \$58 billion for 1986.

The EC's structural trade deficit with Japan has not stopped rising since the early 1970s (0.5 billion ECU in 1970, 8.7 billion ECU in 1980, 17 billion ECU in 1985), although admittedly, it has grown only slowly of late. No reversal of this trend has yet been discerned despite Europe's efforts to improve its competitiveness and boost exports to Japan, and despite the decisions announced by Japanese authorities to open their market and stimulate domestic demand.

Although some of the most visible barriers have gradually been liberalised, following negotiations within GATT (customs duties, quotas, and, to a lesser extent, standards and certification procedures), the benefits that were to result from these negotiations have not materialised because of the persistence of nontariff barriers, particularly in the form of standards and certification, and above all, because of such particular characteristics of the Japanese economy as the inherent tendency to favour domestic goods to the detriment of imported products. Japan's exports to the community have, year after year, risen more rapidly and in more substantial proportions than its imports from the Community—as, indeed, in the case of its other industrial partners.

The key to the problem, common to all foreign producers of manufactured goods, lies in the behavior patterns and habits arising from the close links within the major industrial, trading, and financial groups and in the bureaucratic import, registration, and technical certification procedures. These features of the Japanese system are certainly starting to change, but the change is very slow.

All indicators show that Japan is far behind its OECD partners in imports of manufactured products.

	Japan	EEC	U.S.
Percentage of total imports	24.2%	46.1%	66.4%
Percentage of GDP	2.6%	6.2%	6.2%
Per capita	\$270.5	\$504.0	\$949.0

NOTE: 1984 figures

Under pressure from both the EC and the United States, the Japanese government has recognised this structural imbalance. On November 18, 1985, the foreign minister admitted that Japan's propensity to import was too low compared with that of its main partners, and that it had to be stimulated by structural reforms, among other things. Prime Minister Yasuhiro Nakasone, in addition to public statements calling on the Japanese to buy more foreign goods, indicated at his meeting with EC Commission President Delors in January 1986, that he intended to make increasing imports a "national objective," and that he had great hopes for the recommendations that were to be put to him by the private consultative group chaired by Haruo Maekawa, the former governor of the Bank of Japan.

The Maekawa Report, entitled "Structural Economic Adjustments in the Interests of International Harmony," published in April 1986, contains interesting recommendations concerning stimulation of domestic demand, structural adjustments in industry, international cooperation on exchange rates, and monetary and fiscal policy. These general guidelines were not, however, accompanied by many specific proposals. Moreover, Prime Minister Nakasone, faced with criticism from his own party and anxious about the ef-

fect of yen appreciation on exports, denied having made any undertakings to the United States regarding implementation of the report. Other statements issued by the official spokesman for the Ministry of Foreign Affairs also seemed to indicate that authorities were disassociating themselves somewhat from the report.

Moreover, the roots of the problem within the system itself are not yet widely recognised, still less openly admitted by the government and administration. Within the business community, there are substantial currents opposed to change or simply tending towards inertia or complacency. There are still those in Tokyo who believe it will be enough for Japan to cut down visible barriers to trade and exhort businessmen to buy more foreign goods. They see no need for domestic policy and structural changes. It is up to the overseas exporter to make the effort to increase sales to what, in their view, is the "free" Japanese market. Japan can pride itself on having the "most open market in the world"—never mind the actual volume of imports. Others see a reduction of the surplus with the United States as the only real necessity.

Clearly, there are limits to the ability of Japan's politicians to fulfill the expectations of international opinion unless they can rely on a sound, broadly-based national consensus reaching beyond government and administration to encompass the political parties, major industrial and financial groups, and public opinion as a whole.

The reversal of the present trend will obviously take time. Indeed, according to OECD forecasts, Japan's trade surplus may well continue to increase in the next two years, as a result of the decline of the price of oil and of short-term effects of the yen's revaluation.

The European Community recognises, however, that it, too, has to contribute to a solution of the problem and is determined to play its part in trying to correct the imbalance in its trade relations with Japan. To this effect, it intends to intensify its relations with Japan and to widen their scope through increased dialogue and cooperation. It also intends to put pressure on Japan to further open its market and will request that the balance of advantage between Japan and the EC be reestablished.

EC/United States

Relations between the European Community and the United States are also central to a smoothly operating multilateral trading

system. The United States and the Community together account for some 35 percent of world trade. The volume of trade between them in 1985 was more than US\$110 billion. Together, they constitute the two main pillars of the international trading system. No decision is possible on trade or financial questions in multilateral forums without a European-American consensus. Disagreement between them would stalemate the system—to everyone's disadvantage.

Even though the United States' economy is growing increasingly dependent on international trade (about 8.5 percent of its GDP at the start of the 1970s; 15 percent in 1984), there has been a tendency in recent years for the United States to distance itself from the multilateral organisation of international trade. It has shown little tolerance of what it considers the procrastination and shilly-shallying of its partners and of the GATT system. Faced with the impaired competitiveness of American exports as a result of an over-valued dollar, and with the loss of market shares (the most eloquent witness is the record 1985 trade deficit of US\$1.48 billion), Congress and various lobbies—particularly with elections approaching—have gravitated increasingly, along with trade unions and farmers, towards protectionism. While the Republican administration has kept to a "liberal credo," and President Reagan has used his veto against a number of protectionist bills, the administration has developed an "aggressive" attitude vis-à-vis the U.S.A.'s trading partners against all measures and practices that appear to the U.S. to unfairly favour these countries' exports or to impede market access of American products.

In the case of the European Community, the three most pressing bones of contention were the Community's enlargement, its Mediterranean preferences and, above all, its Common Agricultural Policy (CAP).

The United States is attacking Portugal's (1) replacement of its existing system of discretionary licenses for oilseeds with a system that will control quantities imported in relation to quantities released for consumption; and (2) the progressive abolition of the cereals import monopoly, with a reserve of 15.5 percent for Community cereals. The U.S. considers both measures illegal under the GATT.

The U.S. is demanding from Spain immediate compensation for its market share "losses" because of the application of CAP

mechanisms (the variable levy on imports) to maize and sorghum.

In so doing, the United States fails to take into account, or pretends not to know, that protection of the Spanish and Portuguese markets, taken as a whole, will decrease significantly from an average of 15 percent to 5 percent, in the case of tariffs, while many quantitative restrictions, surcharges, etc. have already been abolished; and Spain has replaced its "Cascade" Tax (which acted as a tax on imports and subsidy on exports) by VAT, which is neutral as regards trade.

The United States is acting contrary to GATT practices and precedents whereby the setting up of a customs union should not entail "compensation" for nonmember countries unless the overall effect is unfavourable to them. These practices and precedents were invoked for previous Community enlargements in 1973 (United Kingdom, Ireland, and Denmark) and in 1981 (Greece).

In the case of the preferences accorded by the European Community to the Mediterranean countries associated with it, the United States attacked the preferences for citrus fruit. In so doing the U.S. went back on an informal arrangement made in 1974 on EC preferential agreements (the so-called "Casey-Soames Agreement") and ignores the contribution the European Community's Mediterranean policy makes to economic and political stability in the region—something the United States would, itself, claim for the U.S.-Israel Free Trade Agreement.

THE NEW GATT ROUND

Necessity

Successive rounds of trade negotiations have done much to keep GATT abreast of change. But seven years have elapsed since the last one (Tokyo Round) was concluded. During that period economic growth slowed—particularly in Europe. This, together with rising unemployment, has accentuated the repercussions of trade on industrial and social policies.

Set against these developments, a further round of trade negotiations has now become a matter of urgent preoccupation. As far back as the OECD Ministerial Meeting in May 1984 and the London Economic Summit of June 1984, attention was given to the launch-

ing of such negotiations. In March 1985, the Council of Ministers of the EEC recognised the "utmost importance" of trade negotiations, but went on to caution that such negotiations would not of themselves be sufficient to strengthen the open multilateral trading system. The momentum has since gathered pace; the new round of trade negotiations was formally opened at Punta del Este in Uruguay in September 1986. The Ministerial Declaration launching the Uruguay Round also defines a common agenda, which is the result of lengthy and controversial discussions.

At the heart of the debate was the place of new subjects, *inter alia*, trade in services, in such negotiations. There remains a profound difference of views between, on the one hand, those who advocate an expansion of GATT and wish to concentrate on areas where there is so far little or no multilateral regulation; and on the other hand, those countries, notably in the developing world, whose economies remain more heavily and directly dependent on the export of goods. But this distinction may be artificial and erroneous. The GATT must deal with a changing trade environment to meet the needs of the future. At the same time, precedence cannot be given to new topics at the expense of the traditional ones. Nor would it be in the interest of the Community to seek to diminish in any way the importance which attaches to the progressive removal of traditional barriers to trade.

Objectives

In formulating aims for the new round, one has to be fully aware of what trade negotiations can and cannot achieve. One of the problems in past rounds has been to match expectations to reality. The trading community is badly served by overambitious programmes accompanied by unrealistic expectations. The Community will, therefore, make clear in Geneva the following.

1. The trade negotiations cannot solve problems whose origins lie outside the trade field, such as debt, capital flow, and the erratic behaviour of exchange rates and their implications. It is therefore vital that parallel efforts are made in the monetary and financial fields. Only a multidimensional approach tackling the difficulties in trade, the monetary system, and financial markets simultaneously will measure up to the problem.
2. The GATT alone cannot solve all the trade-related problems

in which other institutions have a hand. Such problems as counterfeiting can only be adequately dealt with if a balance is struck between the role GATT can and should play and the function of other international bodies, such as the World International Property Organization.

Thus, a new round of trade negotiations cannot be a panacea for all the ills of the present system. Once this is acknowledged, however, a number of basic requirements follow, if the negotiations are to succeed. These requirements are:

1. Negotiations designed to strengthen and reinvigorate the open multilateral trading system must demonstrate the continuing vitality and relevance of the General Agreement on Tariffs and Trade, as compared with bilateral or plurilateral deals between interested parties to the exclusion of others.
2. Through negotiations the balance of rights and obligations of contracting parties perceived to be unequal must be redressed and clarified.
3. In this connection, a particular responsibility falls on Japan, whose gains have not been matched by its contribution. The community cannot, for instance, envisage new concessions that would substantially benefit Japan, as long as that country's low propensity to import manufactured goods persists. The GATT must achieve a reasonable balance of benefits as well as an equitable balance of rights and obligations.
4. Attention will also have to be given to the role of certain other participants in the negotiations. There is a need for the state-trading countries in the GATT to make a real, rather than a purely formal, contribution to the negotiations. Increased commitments must likewise be expected from the more advanced developing countries, which should also shoulder larger commitments.

The negotiations can only be conducted in a constructive atmosphere. It will therefore be necessary to ensure that the principal trading nations respect firm undertakings that protectionist pressures will be effectively resisted. It would not be acceptable to conduct major trade talks against the background of new protectionist measures to be used as bargaining chips during the negotiations. It would also be damaging to the negotiations if major new disputes were introduced or threatened. In this connection, all parties should

reaffirm their readiness to participate in the search for more effective procedural formulae in the area of dispute settlement, although it should be understood that, in the final analysis, procedural mechanisms on their own cannot ensure the resolution of problems arising out of substantive differences.

Against this background, our general objectives in this new round of trade negotiations are: (1) to strengthen the multilateral structures and disciplines of the GATT and to seek to adapt it to include new areas of international trade; and (2) to provide conditions for a further liberalisation of world trade in goods and begin a similar process in the field of services, on the basis of reciprocity and mutual advantage.

The stake developing countries have in the multilateral trade negotiations is fully recognised by the Community. The key objective of GATT is, and must remain, the mutually beneficial expansion of world trade. Increased access for LDC exports to developed-country markets is an important goal which will allow developing countries to participate more fully in world trade and purchase the imports necessary for their development.

Therefore, we remain committed to the principle of differential and more favourable treatment for developing countries. In line with existing GATT obligations, we should not seek concessions from our developing trading partners that are inconsistent with their development, financial, and trade needs. Considering the growing heterogeneity among developing countries, contributions from countries participating in a new round of multilateral negotiations should take into account the progressive development of their respective economies and their trade situation.

Main Areas

Leaving aside such traditional subjects as safeguards, tariffs, fisheries, tropical products, quantitative restrictions, and other non-tariff measures, four areas appear to have a key role in this new round of negotiations.

Agriculture. Trade in most agricultural commodities is characterised by supply growing more rapidly than effective demand. Overproduction has spilled over into world markets, leading to keener export competition and falling prices, which negatively affected all parties. An improvement in this situation can only be achieved

by a joint effort of contracting parties on both their internal and external policies. In the meantime, contracting parties should avoid worsening the situation by engaging in aggressive export policies.

In these circumstances, the inclusion of agriculture in the negotiating round must aim at the establishment of balanced world markets through adjustment of supply to effective demand. This will entail contributions from all contracting parties directly or indirectly affected by the present situation. To this end, the negotiations must (1) cover all measures relating to trade in agricultural products on both the import and export sides, taking fully into account the particular characteristics and problems of the agricultural sectors of all contracting parties; (2) be conducted within a single body—the Committee on Trade in Agriculture—which would be the forum for all aspects of the negotiations dealing with agriculture; and (3) form part of one overall negotiating process, all main components of which must progress in parallel.

The prospects for improving market conditions in certain products or product groups would be substantially increased if the contracting parties mainly involved in trade in the products concerned were to adhere to the tighter disciplines enshrined in international commodity agreements. This is particularly relevant for markets characterised by a major supply-demand imbalance, such as cereals, sugar, dairy products, and some kinds of meat.

It goes without saying that the special characteristics of developing-country economies, especially the critical importance of the agricultural sector, should be taken into account to enable these countries to engage in trade in agricultural and food products on terms appropriate to their level of development and compatible with balanced food strategies.

Services. As an increasingly important component of the world economy and a dynamic source of new employment opportunities, the services sector is crucial to the process of structural adjustment. Major shifts in international trade flows in goods and services are occurring and should be accompanied by structural adjustment. A multilateral agreement progressively to liberalise trade in services would represent a potential source of new growth in the world economy from which all would benefit, including those who have little to gain directly from increased exports of services.

An effective, binding agreement aimed at expansion of trade in

services is best pursued in the framework of GATT, which has a history of effective, pragmatic trade liberalisation. The long-term aim of such an agreement should be the liberalisation of world markets for the widest possible range of internationally tradeable services, in particular through the elimination of protectionist obstacles. This goal can be achieved by the following interrelated moves: (1) the introduction of measures to increase transparency in the rules affecting trade in services, to ensure greater certainty and better forecasting for companies engaged in such trade; (2) establishment of an international framework of rules and principles for trade in services; and (3) elaboration of specific disciplines for individual service sectors or groups of service sectors.

Such an agreement would also need to take into account the differences between trade in services and trade in goods of the economic and institutional specificities of individual services and of differences in economic systems between countries.

Intellectual property and trade-related investment. On other subjects, such as intellectual property and trade-related investments, we need further clarification in the Geneva negotiations.

International trade and investment increasingly depend upon the appropriate protection of intellectual property rights, including patents, trademarks, indications of origin and copyrights, and related rights. Such protection should guarantee an adequate return of investment devoted to developing new goods and services or commercial goodwill, while at the same time, avoiding unreasonable barriers to trade. The protection available to intellectual property is inadequate in many countries, while in others intellectual property regimes are sometimes used in a way that unreasonably hampers international trade. The Uruguay Round could contribute to the definition of a better balance between these often conflicting objectives by; e.g., an examination of how GATT procedures could be used to ensure a greater respect for obligations already undertaken in the context of other relevant multilateral agreements.

National investment policies have as their objectives the pursuit of a number of economic, social, and political goals. The pursuit of some of these goals may have harmful effects on international trade, for example, through rules restricting imports or measures that artificially enhance exports. Some of these effects can already be addressed, at least in part, under existing GATT rules, but there

is scope for further clarification. Others, including, in particular, export requirements, are insufficiently covered by the general agreement and should be addressed.