"THE GATT SYSTEM IN A CHANGING WORLD ECONOMY"

Address by Mr. Arthur Dunkel, Director-General,
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It is a pleasure to be here this evening, and to have the opportunity of discussing, with this knowledgeable and influential audience, some aspects of the evolution of international trade relations.

It was quite some months ago that the Trade Policy Research Centre did me the honour of suggesting that I should come to speak here. I was slow to respond - not because I was playing "hard to get", but because of the feeling that I ought first to spend a sufficient time in my new job at GATT to acquire a reasonably secure grasp of the tasks and issues which it faces, and to form some general ideas about the direction in which the international trading system was moving.

I am now very glad that I did not come to London immediately on taking up office in GATT. If I had done so, I should have made a quite different speech. Although I hope you would not have found it too boring, it would have been concerned with rather more down-to-earth issues than those on which I intend to touch this evening.

The undelivered speech

My undelivered speech might have gone something like this:

- I should have recalled that my two predecessors, Sir Eric Wyndham White and Mr. Olivier Long (to both of whom I wish to pay tribute), had presided successfully over a series of major trade negotiations, of which the most recent had been the Kennedy and Tokyo Rounds.

- I should have warned you that GATT would probably make few headlines for a while, since no similarly spectacular negotiations were in prospect.
- I should have stressed that the various multilateral codes negotiated in the Tokyo Round were ventures into new territory, that they were not self-executing, and that putting them into effect would in consequence require a new style of continuous negotiation. But I should have had to underline that this work would be essentially technical and unpublicized.

- I should of course have recalled that GATT still had one important piece of Tokyo Round business to complete (the negotiations on possible changes in the rules of safeguards), and I should have acknowledged that we faced, later in 1981, what everyone assured me would be a very tough negotiation on the future of the textiles arrangement.

- I should have insisted that developing countries, and in particular those which are now emerging as industrial trading powers, need to share more actively in the management of the GATT system, and I should have taken pains to show the importance of North-South trade to both sides.

- I should have suggested that a fresh look at the problems of trade in agricultural products was required, both because the old approaches to these problems have yielded only modest results, and because there are now other countries, besides the traditional agricultural exporters, which also have a stake in this trade.

- Finally, no doubt, I should have said that GATT would need to think hard about its future activities, and especially about exploring new fields such as that of trade in services.

All of the foregoing, in my undelivered speech of a few months ago, would probably have led me to conclude that GATT - its government delegations, its secretariat, as well as its new Director-General - could look forward to fulfilling an interesting, satisfying and not at all unimportant rôle, a rôle which one might summarize as being to keep up the momentum generated by the Tokyo Round in favour of the maintenance and expansion of a fair and open world trading system.

The need for a different speech

In fact, I could still have delivered that speech this evening.

Nothing in it has ceased to be true. In that sense, it has in no way been overtaken by more recent developments. In particular, it remains a major and pressing task to bring the results of the Tokyo Round into full effect. Any deviation from the commitments undertaken in the Tokyo Round would be a serious setback for the multilateral trading system under GATT, at a time when that system is already under strain.
It is, however, precisely because the strain on the system is so evident, because events and trends on the world trading scene are a source of general preoccupation, that I have laid aside that undelivered speech. I felt that I should be failing to make proper use of the opportunity presented this evening if I did not instead raise here some more fundamental problems which underlie many of the present tensions in international trade. I do so because I believe an understanding of these problems presents new arguments in the anti-protectionist cause.

The rise in protectionist pressures

Two weeks ago, the GATT secretariat published a first assessment of economic and trade trends in 1980, and of prospects for 1981. It attracted a fair amount of attention, both for the facts it set out and for the policy conclusions it drew. The broad picture that emerged from the factual analysis was that, in terms not only of trade growth but of a number of other economic indicators, 1980 had been the third worst year for the world economy since World War II. Since that assessment was compiled, more figures have come in which actually make the picture look even gloomier than it did just a fortnight ago.

In such a situation, the fact that protectionist pressures are widespread and increasing should be no surprise. At the origin of these pressures — and I underline that they are usually pressures, not actions — are the very real difficulties being encountered by a wide range of industries, in many countries, and the equally widespread tendency to blame these difficulties on foreign competition. These industries, which are often among the largest employers of labour in their national economies, are for understandable reasons appealing to governments for help.

It is however important, and only fair, to acknowledge that governments have in general responded to these appeals by means other than direct import restriction. The slowdown in the growth of international trade is to be explained, not by any wave of outright protection, but mainly by the fall in total demand, and the increase in uncertainty. Overt protectionist actions have been fairly few. There has, however, been increased activity in the so-called "grey area" of mutually-agreed restraints, import monitoring, and so on, as well as greater resort to measures such as subsidies which distort competition. It is these "grey measures" which show the present temptations to governments to diverge from some fundamental principles of the international trading system.

Why, then have these temptations on the whole been resisted so far? My own view, and it is not a very reassuring one, is that the reason why there has been no substantial slippage towards protectionism is that governments are inhibited from going further by a kind of balance of terror.

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Governments have feared that if they restrict, say, imports of textiles from an inconveniently competitive supplying country, that country might, in turn, close off its own valuable export markets. They have been aware also of the more subtle danger of a different kind of protectionist contagion: that is, the reaction of third countries unwilling to accept that products excluded from the markets of others be diverted to exert additional competitive pressure on their own. And they have undoubtedly also been conscious, to some extent at least, of the longer-term danger that sectoral protection, and the proliferation of bilateral agreements, will erode the multilateral trading system as a whole.

Can we be satisfied with this balance of terror?

The answer, I am afraid, is that we cannot. Even if in some circumstances unworthy means may serve desirable ends, the defensive attitudes involved in this case cannot provide an adequate basis for the firm and predictable economic and trade policies the world economy urgently needs to recover its vitality. They are inadequate also because they encourage resort to short-term substitute measures, measures which are in the "grey area", which are typically bilateral or sectoral in character. Measures of this kind may bring some relief. But the relief is frequently illusory; it provides no durable solution, and all too often it is bought at the price of misallocation of resources.

In search of some basic reference points

I believe that this is a moment when we ought to stand back a little, a moment when we should recall some basic considerations, economic and also political, that inspired the authors of the GATT. In times of difficulty, we need to re-establish our basic reference points. And this is a responsibility which those who are entrusted with the task of watching over the application of the GATT surely cannot seek to escape.

I have already mentioned bilateralism, and I want to emphasize that I have nothing against bilateral agreements as such, provided they are concluded within the context of the established multilateral rules. Indeed, one tends to forget that the principles of GATT are as often put into practice in a bilateral context as they are in multilateral meetings at GATT headquarters in Geneva. But as an earlier generation learned in the 1930's and 1940's, bilateralism divorced from a framework of multilateral principles tends to create more problems than it solves. In an interdependent world, no country is so strong that it can afford to abandon the multilateral approach; moreover, no valid trade or monetary policy can be formulated in response to isolated bilateral flows.
As for a sectoral approach to policy, it leads fatally to an undirected drift in trade policy from one problem to another, without regard to the interrelations between them. Short-term solutions for particular difficulties, ignoring long-term consequences, misallocate resources, and their disruptive effects tend to spill over from the field of trade into the areas of finance and the balance of payments.

These may seem to you to be rather sweeping assertions. I will try to explain and justify them.

It was perhaps once possible to look at individual economies in some degree of isolation from their world context. That time is past. As evidence, look at the way in which economic trends in Europe and Japan depend on those in the United States, and vice versa. Or remember how, after 1973, the economies of the industrialized countries absorbed the first oil shock comparatively easily, in part because of maintained demand by the developing countries — and then remember that this demand was in turn maintained because developing countries were able to borrow from the industrialized countries. More and more, the world economy must be seen as an interdependent, autonomous whole, to the development of which each country contributes such influence as it has, but which none can control.

In a world which will soon contain six thousand million inhabitants, residing in more than one hundred and sixty sovereign nations, every country is a small country, even if some are smaller than others. There are many measurements of size. China is large in population, but fairly small on the world trading scene. The United States is large in most economic respects, but its exports are virtually equalled in value by those of the Federal Republic of Germany, which has only about one quarter of the US population. Japan, with nearly twice the population of Germany, exports (and this may well surprise you) manufactured products to a total value of only a little more than half that exported by Germany. Nor is total activity a good guide to the significance of particular sectors. New Zealand, no factor at all in most areas of world trade, is a force to be reckoned with in dairy products and lamb. My own country is an economic pygmy in many respects, and has for example, no automobile industry, but it is a comparative giant in textile machinery, in watches, and of course in international finance.

The need for a system

Faced by such diversity, and also by the evident dependence of each of our economies on the performance of the others, it seems increasingly obvious that, even if some countries are better placed than others to assume the responsibilities of leadership, the world's interdependent relationships cannot satisfactorily develop except on the basis of some system.
The dictionary defines a system as "an aggregate of regularly interacting parts". The key word is "regularly". The essence of a system is predictability, regularity. It is regularity which makes it possible to form expectations, to plan, to conduct oneself rationally. In world conditions that are unpredictable, no government can alone adequately safeguard its national interest. It can do so only within a system, established by rules.

In the case of the world economy, the rules indicate the limits within which any one government may legitimately take economic policy actions. They serve thereby as the basis on which all governments, and the business community, can form legitimate expectations and plan their policies. Without rules of this kind, be they the monetary rules of the IMF, the trade rules of the GATT, or the conventions of the OECD or other international organizations, no single firm could plan its adjustment to the continuing changes in the world economy. Nor, in consequence, could any national economy enjoy stability, because - let me emphasize - the stability of an economy results from continuous adjustment by all its component units and agents. The adjustment and stability of all countries depend on the rules. The maintenance and observance of the rules is thus a joint responsibility.

In the field of trade, the international instrument promoting adjustment is the GATT. The rules of GATT clarify the mutual rights and obligations of member countries; equally importantly, they protect each government against domestic pressures to prevent or slow down adjustment. Seen in this light, the responsibilities which governments have assumed under GATT are more than simple defences against a reversion to economic nationalism. They are an active force in favour of change.

Of all ideas, the idea of change is that which, in present economic circumstances, evokes both the greatest hopes and the greatest fears - hopes, in those countries which we have come to call the Third World; fears, in the industrialized world. And yet, the essential point, the point of which we must never lose sight, is that the world economy is not static, but dynamic. It is a continuously evolving entity within which each component national economy - large or small - must adapt continuously to changes in the competitive environment, if it wants to maintain even the income levels it has already attained.

Interrelationships

In the same way that one needs a global view of the world economy, the only way to see each national economy clearly is to look at it as a whole. One sometimes forgets that all industries are interrelated, and that actions in favour of one industry inevitably set a precedent for actions in favour of the others.
The interrelations between industries are a matter of economic fact. Bear in mind that steel is said to account for 17 to 18 per cent of the cost, or price, of a finished automobile, and it will be obvious that measures which affect the steel industry are likely to have eventual repercussions in the automobile industry. Although their problems are not identical, it is certainly no coincidence that both industries are in crisis today.

It is a matter of political fact that if one industry receives protection, this will inevitably invite pressures from others for similar protection. Such pressures are difficult to resist. There is no theory to tell the policy maker up to what point, or in what kind of case, a grant of protection to an industry is justified by national interest. In consequence, each grant invites new demands, and the government must find it increasingly difficult to deny to some what it has already granted to others. The point of all this is that, in failing to take full account of the pervasive interdependence in the economy they act upon, governments are creating problems for themselves at a faster rate than they can solve them. There is reason to fear that eventually they will be overwhelmed by the problems they have so created.

Each government wants national exports to prosper and expand. Yet it is often forgotten that the amounts of a nation's exports and imports depend directly upon each other. Limiting imports reduces exports as well, both because it reduces the purchasing power of one's customers and because it makes domestic producers less competitive by raising their costs. If a number of important trading countries embark on such a course simultaneously, for the purpose of "saving jobs", more jobs will in the end be destroyed than can be saved. It is this fact that makes it essential that all governments support and reinforce one another's efforts to resist pressures for protectionist action.

Another important interrelation, not always or adequately kept in sight, is that between the physical production structure of an economy and its financial structure. The "problem of adjustment" tends to be viewed almost exclusively as one of physical, industrial structures. Yet it cannot be solved if the financial structures are not sound, flexible and resilient - and we all know that these structures are under considerable strain at present.

Much of the strain now felt in the international financial and banking system is the result of prolonged inflation. I do not have to talk of that aspect. But trade policy, too, has a direct effect on the quality of banks' assets. It is a point easy to make to a London audience. In this city, with its tradition of banking for the world at large, it has always been understood that a capital exporting country must keep an open market for imports so that its foreign debtors can earn the foreign exchange needed to service their debt. In saying this, I am not thinking...
only of the indebtedness of developing countries, even though that is an important part of the problem. The bulk of assets of each national banking system consists of loans to domestic enterprises. The profits of these enterprises, however, and thus the quality of the banking system's assets, now also depend, to an important and increasing degree, on international trade and international operations. To put it more precisely, they depend on the stability and predictability of conditions in international business. When one cannot rely on international rules, such as the rules of GATT, to ensure this predictability, investment mistakes cannot be avoided, investment cannot flow to where it is most needed, profitability will decline and with it the resilience and security of the financial structure.

As far as concerns the balance-of-payments difficulties of the non-oil developing countries, these can be met in two ways. One is by transfer of resources - aid and lending. The other is by increased export earnings. These are not alternatives; both are required. Yet we know that transfer of resources in the form of aid is difficult to maintain and unlikely to increase. The borrowing capacity of these countries is thus essentially dependent on the level of their current exchange earnings.

I could say a great deal more about the trade and payments problems of developing countries. Much of it would no doubt be familiar to you. But since I am speaking in an industrialized country, I should like tonight to underline just one point which ought surely to be vividly in the mind of any government tempted to restrict imports from the Third World. This is the growing, and inadequately recognized, importance of the developing countries as trade partners of the industrial countries. In 1973, the developing countries bought about 19 per cent of the manufactured exports of the industrialized countries; by 1980, the proportion had grown to 26 per cent of a considerably higher total figure. And for every dollar's worth of imports of manufactures from the oil-importing developing countries, the industrialized countries sold them two dollars' worth; moreover, if you bring the oil exporters into the picture, the figure becomes three and a half dollars' worth of manufactured exports for every dollar's worth imported.

Some conclusions

Let me now try to draw some conclusions from this inadequate but perhaps suggestive picture of the enormously complex international economic system. Or rather, let me pose a few questions - questions to which there are no easy answers.

First, is there any way in which a fully industrialized economy can resist the challenge of the newly industrializing countries without thereby reducing its own economic opportunities for the future?
Second, is there any basis on which a government can make decisions about the appropriate size of different industries? Can democratic governments, under electoral pressure, peacefully coordinate such decisions among themselves?

Third, a question that concerns the executive officers of large industrial corporations, of the institutions of the capital market channelling investable funds to particular purposes, and of large trading and merchandising concerns. Can these people, with all their specialized, detailed knowledge of the potential of the world economy, articulate sound plans for the future, if there is no secure, reliable framework of economic policy in their own country and in other countries?

I see no answers to any of these questions, other than firm reliance on the basic principles underlying the present multilateral economic system — and in the case of the trading system, that means the principles of GATT. Such reliance is not, I am convinced, just desirable: it is absolutely essential. And since it will not be at all easy to achieve, there is need for a concerted effort to establish momentum in the right direction.

I am not unhopeful that such an effort will be made. From past experience we know that it is often in times of difficulty that the best and boldest decisions for the future are taken. The fundamental challenge we face is to recreate the necessary confidence in the economic system, so that business will dare once again to take the risks which are the necessary basis on which the world economy can recover its vitality.