Address by Mr. Arthur Dunkel, Director-General, General Agreement on Tariffs and Trade, at "Ostasiatisches Liebesmahl", Hamburg, 5 March 1982

I regard it as a great honour to have been invited to speak to you tonight, knowing as I do the long line of distinguished men who have addressed the Ostasiatisches Liebesmahl in years gone by. For the same reason, it is a daunting challenge, too, but I know I start with the advantage of an audience predisposed in favour of the message that must be carried by the Director-General of the GATT. In this city, with the great Hanseatic tradition of openness to the world, and particularly to an audience committed to trading with Asia, there is little need to preach the gospel of free trade. There may be a need, however, for the friends of the open trade system to recognize that passive support is no longer enough if the system is to be preserved.

In preparing this speech I naturally called to mind my own recent experience of the countries of Asia. In the last fourteen months I have visited India, Pakistan, Hong Kong and all the countries of ASEAN in my capacity as Director-General of GATT. In all of these countries I occasionally felt as if I were there on false pretences - as if I should have presented a card indicating that I was ex officio Chairman of the GATT committee in charge of the Multifibre Arrangement: for in all of them the MFA seems better known than the GATT.

That businessmen and politicians in Asia consider GATT's activities primarily from the viewpoint of textiles and clothing is understandable. After all, textiles and clothing account for ten per cent of their total exports, and twenty per cent of their exports of manufactures. But it is very worrying, on several accounts.
I believe that failure to renew the MFA in December would have entailed disruption and uncertainty going far beyond the textile sector - that there was in fact no sensible alternative. But we have to recognize that the MFA is a negotiated derogation from the basic law of international trade. It allows the main principles of the GATT to be ignored in a crucially important sector of world trade. For countries which are critically dependent on textiles, this is bound to call in question the sincerity of those in the West who so often, and so eloquently, proclaim their dedication to the principles of liberal trade.

It is often said, of course, that textiles is an unfortunate, unavoidable but unique exception from the rules, and I would not have made so much of it tonight but for the fact that, in recent years, one sector after another - steel, shipbuilding, synthetic fibres, automobiles, not to mention agriculture, where intervention has become institutionalized - has been subjected to special arrangements with protectionist effects. By this I mean the so-called self-restraint and orderly marketing agreements. These sectoral deals differ from the MFA in being essentially bilateral and wholly outside the rule of law. So far they have involved mainly the industrialized countries, though some developing countries of Asia are being drawn into them. These arrangements resemble the MFA in being presented as regrettable temporary expedients, necessitated by short-term pressures or crises. But every time a government cedes to such pressure it makes it more difficult for itself and for other governments to resist the next demand, and more likely that new demands will be made.

The tendency towards bilateralism and sectoralism in trade policy is the greatest present danger both politically and economically to order and prosperity in the world economy. In political terms, it must undermine the credibility of those in industrialized countries who champion the open trading system and commend it to the developing world. More profoundly, it endangers the very possibility of maintaining the international economic cooperation which has made possible the progress of the last thirty years: for that cooperation can only be based on multilateralism and obedience to general rules.

When commercial policy is conducted on a sectoral basis, the interaction between industrial lobbies and national administrations makes an eventual return to liberal trading extremely difficult. To take away a privileged position is always more difficult than to refuse it in the first place. It is more likely, as bureaucrats identify with the interests of "their" industries, that restrictions will be tightened. We cannot perhaps blame
the textile manufacturers of the industrialized world for losing sight of the fact that the overall trade deficit of the industrialized countries in textiles and clothing is offset, as to about 80 per cent, by their exports of dyes, synthetic fibres and textile machinery to the developing world. But governments can be blamed if they fail to see it: their prime function is to appreciate the global, not sectional, interests of their own countries and, if possible, of the world.

A foreign trade policy has to consider national trade needs globally. It operates by fairly simple rules of general application. Trade policy in this sense is being progressively supplanted by a series of discrete sectoral trade policies which, being laboriously negotiated first between the government and each industry lobby, and then between the government and each exporting country, do not lend themselves to coordination. As such deals proliferate, coherent policy-making becomes impossible. Economic efficiency is lost at every stage, for the essential purpose of these arrangements is to frustrate the market in its function of allocating resources efficiently. They represent — and I am sure their authors know it — a collapse of confidence in the ability of our economies to adjust to competitive pressures and in the ability of governments to cooperate for the common good. They are in fact an admission of failure, for, surely, none of the policy-makers of the major developed countries believes that protectionist policies can do anything but harm. But the most pernicious aspect of sectoralism is perhaps that even the governments which practise it seem able to disguise from themselves its essentially protectionist character.

An equally dangerous distortion of competitive conditions, which is also spreading rapidly, is the use of subsidies, both domestically and in export markets. The fact that in all Western economies subsidies have risen sharply in relation to GNP over the last ten or fifteen years, and that they are increasingly given in addition to protection, is a logical consequence of the sectoral approach — a consequence, let me say, which is logical and absurd at the same time. In the highly trade-intensive Western economies, most industries export even though they also have to compete with imports in their domestic markets. In the present circumstances, a subsidy or increased protection against imports is seldom sufficient to improve their profitability; usually it only restores these industries' competitiveness on the domestic market by validating previous increases in their production costs relative to the costs of their foreign competitors. Without an additional subsidy, industries in this situation could not maintain their shares in export. In passing, I should say that the growth of competition through export subsidies poses a special problem for developing countries, which cannot afford to join that game, but cannot afford either to allow the terms of competition to be thus turned against them. And
so, as each country protects its national industry domestically, all of them together are, by subsidies, artificially intensifying the competition of these industries in the export market - which, of course, consists of each other's domestic markets, the same markets all are trying to protect.

We can of course understand the tensions and the commercial and industrial conflicts that are growing among the industrialized nations. Trade is slowing down, unemployment grows, inflation is high, and everybody is looking for somebody to blame. Every government has a need to find scapegoats when the effects of its policies turn out not to be the ones it has expected and announced. Thus, the problem of competition with Japan has begun to assume the proportions of a crisis, though in reality it is only a symptom of the more general problem - and Japan is only the forerunner of a series of highly efficient newcomers on world markets for manufactures. The West appears to be mesmerised by the spectacular productivity of Japanese industry - but the far-sighted Japanese are already worrying about Korea, India and, in ten years perhaps, China.

I know that exporting to Japan poses special problems. The Japanese Government itself has recognized that there are things it should do to facilitate the entry of foreign goods, and has begun to implement them. This is to be welcomed, but is not a panacea: we must not forget the important truth which Ludwig Erhard preached in the 1950s, that an economy becomes more, not less, efficient as it opens itself up to imports.

A better functioning of the international monetary system, which would enable Japanese society, through a higher exchange rate, to reap the benefits of its efficiency in the form of cheaper imports, would greatly reduce these tensions. But in my view the only permanent solution to the so-called "Japanese problem" is for the Western economies to raise their productivity to Japanese levels, to accept the challenge. It is possible to exclude more efficient producers from one's domestic market, at great political and economic cost; but the corollary is acceptance of defeat in third markets.

Finally we have to consider the effects on the international order of the sectoralisation of commercial policy. A particular consequence is that the necessary balance between the industrial and the financial side of the economy can no longer be maintained. Countries with heavy foreign debt must be able to export if they are to service their debt without cutting back imports. In the years following the 1973/74 oil crisis, exports from industrial to developing countries were the most rapidly expanding flow of international trade, sustaining the level of economic activity in the industrialized countries. The expansion was possible because, in those years, the developing countries were able to borrow from the highly liquid international capital market. The level of foreign debt is now very high, and so are real interest rates. The indebtedness can be sustained only by a continuing, if not accelerated, expansion of trade. But in 1980 and 1981, the growth of trade has been slowing down.
Thus all countries are hit when the international trade system ceases to function satisfactorily. Those introducing the restrictions suffer most severely, for two reasons. Protection and subsidies distort their industrial structure away from that which would be required for more rapid industrial growth. Equally if not more important, protection also threatens the soundness of their financial institutions. The capacity of international trade to contribute to the recovery of industrial economies is thus lost.

I may perhaps have stated the case too bluntly. I know that in times as difficult as these there are always persuasive arguments for deviations from the general rules, and I recognise that even in normal times full observance of them is not to be expected. The GATT itself contains "escape clauses", and has a record of waivers and exceptions both negotiated and otherwise. But what is disturbing in the present situation is the growing dimension of the "grey area" in which restrictions are imposed without legal sanction, the feeling that we are confronted with a gradual erosion that is even more difficult to deal with than an open crisis. Even governments themselves are beginning openly to doubt their capacity to stave off the crisis they fear coming. Thus we are told from the highest level that protectionism is no longer a possibility but a probability. Elsewhere the notion is gaining influential adherence that trade should be conducted on the basis of strict reciprocity - which in my view implies repudiation of existing international obligations, and of all the lessons of the past which have demonstrated that strict reciprocity is technically infeasible.

I am also frequently told that the rules of the GATT fulfilled perhaps their function in a given time but have since become obsolete, and are now ineffective in the face of contemporary problems. In response I usually point out that lately, the rules have not been given much chance to prove themselves. Solutions to the most important problems of international trade policy are largely being sought through ad hoc accommodations between small groups of countries outside GATT rules. So how can we know that the rules are ineffective? Whereupon these apparently well-meaning people explain to me that it has been necessary to take these apparently short-term but acute problems out of the GATT, in order to alleviate the strain on its poor, old and fragile rules.

Let us look at this attitude more closely. When people say the rules of the GATT have become ineffective, they are only saying that the rules are not being observed. Mutual accommodation is thought to be easier through private arrangements in which GATT commitments are politely ignored; and I admit such arrangements, viewed individually, may be easier in the short run, and for the short run only. But they create precedents, the relief granted to one industry is difficult to deny to another, and so after a while we are ... well, we are where we are.
The critics of the rules are in effect saying that the rules ceased to be respected because they were "unrealistic", too strict, too demanding, to begin with. From which it seems to follow logically that looser, more permissive rules would be more faithfully followed - or more strictly observed - by the governments. Is it so difficult to see that this proposition is self-contradictory and empty, indeed stunningly trivial?

Allow me therefore a few remarks on the rôle of rules in international trade policy, a rôle which I conceive of as the rule of law in intergovernmental relations.

Discrimination in trade has been historically a main source of international conflict. The long period of peaceful prosperity between the Napoleonic wars and World War I was very largely based on the système des traités - commercial treaties which, though concluded bilaterally, formed a multilateral system, being interlinked by the most-favoured-clauses which constituted the central commitment of each. After World War I it proved impossible to restore this system, we all know with what consequences. What GATT achieved after World War II was actually nothing revolutionary: it succeeded in restoring that older system. It innovated only in placing it on an explicitly multilateral basis, and in greatly increasing the number of countries participating in the multilateral treaty system.

Let me recall that in the 1920s the words "reciprocity" and "non-discrimination" (or "unconditional most-favoured-nation pledge") denoted contradictions, mutually exclusive alternatives. The fact that in the GATT countries have been negotiating and contracting with each other on the basis of reciprocity and non-discrimination is due to their understanding that reciprocity is always a subjective notion which cannot be looked at in bilateral terms. It cannot be determined exactly; it can only be agreed upon, and such agreement is possible only among countries sharing a commitment to some higher principle which, in the case of GATT, has been, simply, the rule of law. This is what I meant by saying that strict reciprocity is technically not feasible as the sole basis for any one nation's commercial policy. One side alone cannot decide what reciprocity is.

Let me go further and say that international economic policy commitments, in the form of agreed rules, have far-reaching domestic effects, indeed effects so important that they are indispensable for democratic governance. They are the element which secures the ultimate co-ordination and mutual compatibility of the purely domestic economic policies. They form the basis from which the government can arbitrate and secure an equitable and efficient balance between the diverse domestic interests: producers vs. consumers, export industries vs. import-competing industries, between particular narrowly defined industries. Last but not least, only a firm commitment to international rules makes possible the all-important reconciliation, which I have already alluded to, of the necessary balance on the production side and on the financial side of the national economy.
In all these ways the commitment to international rules defines and fixes the permanent national interest in economic matters - which, I repeat, is an indispensable function in a democratic system providing for an orderly change of political governments at relatively frequent intervals.

It is thus nothing but intellectual laziness to consider these international disciplines to be an undue constraint on governments, something of a concession from national interest to international comity. This amounts to saying that a government free from external constraints would be better or more completely able to secure all the interests of its nation. But this is about as deep and useful an insight as saying that in a world in which there was no scarcity of goods we would all be better off. Another way of explaining the current political and economic malaise is to say that it stems from an unwillingness to think carefully about the difficult but important concept of national interest.

It seems appropriate here to ask if the system of law which governments have laid down in the GATT no longer in their judgement corresponds to the national interests of their countries, or whether the problem is that these countries are no longer willing to make the continuous adjustments which the system demands.

It will be no surprise to you, in the light of what I have said already, that I believe the second explanation is the true one. I am still convinced that it is in the national interest of every trading nation to abide by the rules, which were accepted as valid for good times and bad, and to frame their internal policies accordingly. One of the major benefits of international disciplines is that they offer equal opportunities and require comparable sacrifices from all the countries involved in international competition. Those who believe in the open trading system must recognize and accept the need to correct those rigidities in their economic and social systems which obstruct the process of continuing adjustment on which economic growth depends. Once decision-makers in the economy are convinced that governments are resolved to follow this line, one may hope that the present crisis of confidence would be overcome and the recovery might begin. I know that this is easier said than done, and that it calls for effort and sacrifice, but I see no alternative.

Conclusion

Our present problems - unemployment, inflation, stagnating growth and stagnating trade - make strict adherence to international rules especially difficult. But can we wait for the heavy weather to blow away before we reaffirm the rules? Surely not, for if we waited we would be saying that not only the GATT system but rule of law as such, democratic constitutionalism, are only fair-weather ideas.
Our economists explain the economic difficulties I have mentioned in terms of uncertainty - uncertainty which the rules were designed to minimize, did successfully minimize for more than twenty years, and which then returned and grew as exceptions from the rules grew more common. I do not have to expand on the consequences. You know better than I what it is to make long-term contracts and commitments in a situation where uncertainty has been enhanced because rules have ceased to be reliable.

Fortunately, there are signs that an increasing number of governments are concerned about the trend of events, and about the danger to the multilateral system which its continuation would pose. It is not simply that bilateral solutions are seen to be unstable, or that ad hoc deals in one sector are found to exacerbate difficulties in another. The habit of international co-operation, based on respect for general rules of economic behaviour, which has underpinned the enormous material progress of the post-war era, is seen to be threatened. Governments which badly need each others' understanding and support are dragged into dangerous disputes over sectional interests which are themselves inimical to the national welfare. The cost of protectionist measures is always greatest for the country imposing them.

One of the clearest indications to date of the determination of the trading nations to reverse the downward trend is the decision of GATT's Contracting Parties to convene at Ministerial level in November this year. As you may know, ministerial meetings in the GATT have been rare occurrences: the last one was held in 1973. For this reason they are taken seriously, and are expected to produce results. This meeting is now the focus of our hopes that order can be restored. It will of course reaffirm the commitment of the Contracting Parties to the rules of GATT, but I think Governments appreciate that a merely verbal reaffirmation would not be enough. Mere words would confirm to the business world that governments have exhausted their capacity for constructive, co-operative action, and are reduced to collective incantation.

Fortunately, there seems to be a growing consensus that positive action is needed to restore confidence in the trading system and that the GATT, while by no means perfect, is the only viable instrument for such action. We must aim to reach a common understanding of the state of GATT law, and to secure the effective and universal application of the rules. We must decide where the existing procedures need improvement. And above all we must confront squarely the problems that have dominated this speech - those measures taken in the grey area to limit access to domestic markets or gain unfair advantage in export markets.