

September 10, 1986

A U.S. STRATEGY AT THE GATT TRADE TALKS

INTRODUCTION

Pressures for increased trade protectionism have been greater in the United States this year than at any time since World War II. Only Ronald Reagan's veto stopped a bill that would have cut back textile and apparel imports drastically. And Congress still is threatening to pass an omnibus trade bill that would make it easier for industries to gain protection against their foreign competitors.

To counter protectionist pressures, Administration officials have negotiated various bilateral agreements to open foreign markets further to U.S. exports. In addition, Reagan Administration efforts have led to a new round of the multinational General Agreement on Tariffs and Trade (GATT) talks. On September 15th, the 92 members of the GATT will meet in Punta del Este, Uruguay, to set the agenda for this, the sixth round of talks since the creation of the GATT in 1947.

The U.S. negotiating team in Punta del Este should make sure the following items are included in this agenda:

- o Reducing tariffs and eliminating quotas as a form of trade protection.
- o Strengthening the GATT mechanism for settling trade disputes.
- o Treating government subsidies to industries and exports as unfair trade practice and establishing procedures to counter such practice.

- o Bringing trade in services under the framework of the GATT principles.
- o Liberalizing trade in high technology items.
- o Including agricultural subsidies and trade restrictions in the GATT and reducing immediately such practices.
- o Phasing out the Multi-Fiber Arrangement, which restricts the textile and apparel trade, and including these goods under the GATT.
- o Strengthening intellectual property rights by completing work on the GATT anti-counterfeiting code.
- o Initiating liberalization of international investment policies.
- o Blocking Soviet membership in the GATT.

The new round offers the U.S. a chance to turn the protectionist tide and to create a new order for international trade that will benefit all trading nations. The Administration should take this opportunity to eliminate trade barriers and liberalize world trade. Meanwhile, Congress should avoid all protectionist legislation, which would make it more difficult for U.S. negotiators to win concessions.

DEVELOPMENT OF THE GATT

Spiraling trade protectionism had been a major cause of the Great Depression of the 1930s. After World War II, therefore, the Western democracies understood that reconstruction and prosperity require trade liberalization. The 1947 General Agreement on Tariffs and Trade, accordingly, initiated a process for removing trade restrictions and created a mechanism for future liberalization. The central principle of the GATT remains the concept of Most Favored Nation (MFN) status, which grants to every participating nation the same trade treatment given to "the most favored" nation. In essence, therefore, each GATT signator agrees to allow access to its market and to apply its own trade laws, equally and without discrimination, to all other GATT members. Thus, if a country levies a 5 percent tariff on imported steel, it must apply this tariff equally to all other countries.

The five previous GATT rounds have led to greatly expanded world trade. The world is more interdependent economically today than ever. Total world trade is estimated at between \$1.5 and \$2 trillion per year and contributes nearly 16 percent of total world output, which is twice the figure for the early 1950s. In 1960, U.S. exports

plus imports equalled 10.4 percent of U.S. GNP. By last year, the figure was 20.5 percent.¹

The new GATT round will be characterized by a number of conflicting interests among the developed countries themselves and between the developed countries and the less developed Third World. But the array of cross-cutting interests offers U.S. negotiators the opportunity to form coalitions among the GATT members and to play these coalitions off against one another, so as to maximize trade liberalization measures. For example, Argentina, as a Third World country, has opposed liberalization of trade in services. But as an exporter of agricultural commodities, it has an interest in joining other countries with efficient farm sectors, such as the U.S., Canada, and Australia, against unfair European agricultural subsidies. Naturally, this gives the U.S. the opportunity to win Argentina's support for liberalization of trade in services. Traditionally, the U.S. plays the role of educator in such international forums as the GATT, trying to win through rational demonstration of its points. While the U.S. should not abandon this role, it also should take advantage more forcefully of specific chances to promote freer trade through a greater emphasis on political coalition building.

TARIFFS AND QUOTAS

High tariffs were once the major form of trade protection. But thanks to the five previous GATT rounds, GATT countries have reduced their average tariff rates substantially. Average U.S. tariff rates, for example, have dropped from over 50 percent in the 1930s to a current average of just over 6 percent. Many countries, however, impose higher tariffs than does the U.S., while others maintain high rates on specific items. Japan's tariffs average approximately 3.5 percent, for example, but its effective tariff on U.S. manufactured tobacco products is nearer 40 percent.

More common today than tariffs are quantitative restrictions or quotas. While technically illegal under the GATT, many countries employ them regularly. The European Economic Community is particularly guilty of this. The U.S. is also an offender. Using so-called voluntary restraint agreements and orderly marketing arrangements, Washington has restricted trade in such products as automobiles and steel. The growing worldwide use of quota restrictions makes it essential to win international agreement for a

1. The production process itself is becoming more internationalized. For example, the IBM personal computer, with billions of dollars in sales for the U.S. giant computer firm, uses 60 percent foreign-made parts.

plan of action to eliminate them. While working toward an agenda, the U.S. negotiators at this month's GATT meeting should seek to include:

- o Continuing the process of tariff reductions.
- o Phasing out the use of quotas.
- o When quotas cannot be eliminated fully, converting them to tariffs, which are already controlled under the GATT.

THE GATT DISPUTE SETTLEMENT MECHANISM

It is relatively easy to monitor compliance with tariff agreements. But today's more subtle and varied forms of trade restrictions make it more difficult to determine if a country is violating its treaty obligations. To strengthen compliance, the U.S. at the GATT meeting should seek to include the following goals during the new round:

- o Strengthening the GATT dispute settlement mechanism, by clarifying situations under which cases can be brought and by allowing greater penalties for violators.
- o Pledging U.S. cooperation in such GATT decisions.

TRADE IN SERVICES

Banking, insurance, telecommunications, and other service industries are of increasing importance to world trade generally and U.S. trade particularly. In the early postwar years, over half of U.S. GNP was generated by the service sector. Today the figure is about three-quarters. The foreign revenues of the American service sector are estimated at approximately \$60 billion annually, or nearly 30 percent of export earnings. Trade in services, however, is not protected by the GATT.

Bringing service trade under GATT will be difficult.² For one thing, the very diversity of services, as well as the restrictions placed upon them, preclude using uniform measures to reduce restrictions. Banking laws, for instance, are quite different from procedures for assigning airline landing rights. For another thing,

2. For a good review of this problem, see Jonathan David Aronson and Peter F. Cowhey, Trade in Services: A Case for Open Markets (Washington, D.C.: American Enterprise Institute, 1984).

many services have been provided traditionally by governments themselves and are considered part of the public sector. Banks and telephone companies, for example, are often owned or tightly controlled by governments.

Because of government involvement and the diversity of the service sector, liberalization of trade in services will have to proceed on a case-by-case basis. Nonetheless, U.S. negotiators at Punta del Este should raise such issues as:

- o Gaining agreement that certain services are to be covered by the GATT Most Favored Nation provision. Since not all the GATT countries are likely to agree to this, it might be necessary first to reach agreement with a limited group of GATT countries.
- o In the case of government procurement of services, applying the Agreement on Government Procurement, a GATT provision currently governing the purchase by state agencies of goods.
- o In the case of government regulation of services within a country, assuring the "transparency" of the decision-making process for such regulations. Often foreign suppliers of services are notified of changes in regulations after the fact. This gives them little or no time to adjust to the new situation. On the other hand, domestic suppliers of services are usually brought into the decision-making process, and thus not only have prior warning of regulatory changes, but are often able to influence such changes.

HIGH TECHNOLOGY TRADE

Trade in high technology items suffers from obstacles similar to those facing trade in services. First there is the problem of definition. Most people would recognize computer chips and complete computer units as high-tech products. But a growing number of everyday products actually employ computer chips and other high-tech components. As such, there are disagreements over whether a product is high-tech. Further, many high-tech products are closely related to the services they perform, and thus suffer trade problems similar to those of the services. Foreign suppliers of telecommunications equipment, for instance, might find government-owned telephone companies unwilling to purchase their products.

Since the U.S. is highly competitive in nearly all high-tech products, it is in the U.S. interest to secure maximum access to international markets for these goods. Here new GATT principles governing high-tech trade might not be necessary, as the problem probably could be solved with existing remedies. U.S. trade negotiators thus should seek the following goals:

- o Ensuring, in cases where high-tech products are treated as manufactured goods under normal GATT provisions, that such goods actually are treated as provided for under the GATT, and allowing for unfair trade practice sanctions against those who fail to treat high-tech goods accordingly.
- o Treating both the service and the high-tech problem together, where restrictions on high-tech goods result from restrictions against the services they perform.
- o Developing means within the GATT to deal with such problems, in cases where certification and safety standards are used merely to restrict high-tech trade.

SUBSIDIES

Bitter trade disputes have arisen because governments subsidize industries. Such subsidies take many forms. Sometimes private or state-owned companies receive direct government support to cover losses or to allow firms to reduce export prices. In other cases, the government sells domestic industries various government-owned or controlled resources, such as oil, at low prices not available to foreign industries. Such practices place companies trying to compete against a subsidized industry at a disadvantage at home and overseas.

The U.S. should initiate action against subsidies during the new GATT round by:

- o Working to prohibit all export subsidies.
- o Declaring preferential prices to domestic producers for government-owned or controlled resources a subsidy. Currently, such practices are not recognized as trade distorting under GATT rules. Therefore, damaged parties have little internationally recognized recourse against offenders. Declaring them to be an unfair trade practice would allow steps to be taken under GATT rules.

AGRICULTURAL TRADE

Agricultural products have been one of the most important sources of U.S. export earnings. In 1981, a record \$43.3 billion in farm products were sold overseas, nearly 20 percent of total U.S. exports for that year. The U.S. is the world's largest exporter of these commodities.

Yet in recent years this vital sector has suffered from a variety of problems, as a result of flawed U.S. farm policies and of the actions of foreign governments. The fall in commodity prices, coupled with the higher value of the dollar, was a blow for agricultural exports. But U.S. price supports for farmers also have made it difficult for American farmers to sell overseas, because the government price floor is far above the world price.

The solution to this would be for the U.S. government to phase out all farm price supports. But even if this politically difficult step were taken, American farmers would continue to suffer the effects of other countries' subsidies to their farmers. The European Community's Common Agricultural Policy (CAP), for instance, provides massive price supports and export subsidies to EEC farmers.

Agricultural trade generally is not covered by the GATT. This has caused U.S. farm exports to suffer. The new round provides an opportunity to include them under the GATT principles of free trade. It offers the U.S. the opportunity to eliminate its own agricultural subsidies in exchange for elimination of similar subsidies by other countries. The following steps would help deal with the agricultural trade situation and should be placed on the agenda:

- o Treating export subsidies and production subsidies as unfair trade practices.
- o Developing a schedule of phased reductions for agricultural subsidies.
- o Eliminating import quotas on agricultural commodities, or, at the very least, converting them into tariffs.
- o Recognizing GATT legal forms of adjustment assistance and encouraging the use of these forms as a way to relieve pressure for continued market restrictions.

THE MULTI-FIBER ARRANGEMENT

Trade in textiles and apparel is excluded from the provisions of the GATT and covered instead by the Multi-Fiber Arrangement (MFA). At the insistence of the U.S., the MFA allows for substantial restrictions on textile trade, such as discriminatory tariffs and quotas, which normally would not be tolerated under the GATT. The original goal of the multilateral textile agreement was to provide "temporary" protection to allow the textile industry in the U.S. and other developed countries to adjust to imports from Third World competitors. In fact, each successive agreement in the MFA series has tended to restrict trade even more than its predecessor. And rather

than enabling the textile industries in developed countries to adjust, protectionism has simply relieved any pressure to adjust.

During the new GATT round, Third World developing countries will be asked by the advanced nations to accept freer trade in services and high-tech products. Understandably, these less developed countries will see such calls as self-serving as long as the MFA continues to restrict trade in textile products, in which these countries have a comparative advantage. Concerning the MFA, U.S. GATT negotiators should see that the agenda includes:

- o Phasing out the MFA. Trade in textiles and apparel should be treated under the provisions of the GATT, in exchange for also including services and high-tech trade under the GATT.
- o Converting quotas to tariffs and then developing a schedule of reductions in those tariffs. The textile and apparel trade laws of the GATT countries should be applied without discrimination, in accordance with the Most Favored Nation principle.

INTELLECTUAL PROPERTY RIGHTS

While there are many codes and conventions for the protection of intellectual property rights, enforcement of these rights has been inadequate. For example, counterfeiting in the less developed countries of drugs and other products patented by U.S. pharmaceutical companies has been a serious problem. The U.S. government has worked on a bilateral basis with the countries involved to deal with this situation. Taiwan and Singapore, for example, have recently agreed to step up enforcement. But a more universal and enforceable code within the GATT framework is sorely needed. Specifically, U.S. negotiators should seek the following objectives for the new GATT agenda:

- o Seeking to complete the GATT's work on an anti-counterfeiting code. Some developing countries have been reluctant to endorse a strong code, but the U.S. should not compromise. Strong pressure should be brought to bear on those who are holding up completion of the code.
- o Ensuring that an adequate enforcement mechanism for this code is available within the GATT.

3. It is important to eliminate the MFA as soon as possible. The prospect of the admission of the People's Republic of China into the GATT has raised new fears of textile competition among other developing country textile exporters. In order to retain market shares without the need to become more competitive, these countries might decide to support the continuation of the MFA.

INVESTMENTS

While the GATT has never dealt with investment policies, these are nevertheless a crucial aspect of international commerce and can affect the flow of trade. Admittedly, investment issues are complex, and at best only marginal success can be expected from attempts within the GATT framework to liberalize investment practices. Still, the U.S. should attempt to:

- o Raise the issue of investments for discussion by the GATT members, pointing out that the flow of goods, services, and money usually go hand in hand.
- o Explore ways to use the GATT mechanism to begin the process of liberalizing investment policies, especially among Third World countries.

SOVIET GATT MEMBERSHIP

In an August 15th letter to the GATT Secretariat in Geneva, the Soviet Union requested the right to participate in the new GATT round. The U.S. rejected this request. The reasons for denying the Soviets the right to participate are clear.

First, the Soviet economic system is based on rejection of the free market principles that guide the GATT. Second, the Soviets have not said that they wish to abide by GATT principles--they wish only to participate in the proceedings. In all probability, this means that their goal is to embarrass the U.S. and its allies. The U.S. has a difficult task ahead in the new GATT round and cannot afford to waste political resources fighting off Soviet sabotage in the GATT forum. Consequently, U.S. negotiators need to be firm in their strategy of blocking Soviet membership in GATT.

CONCLUSION

The new GATT round will be the most difficult yet, by reason of numerous new trade barriers that must be addressed. Negotiations and implementation within the round will take several years.

Yet the results of the groundwork laid at the beginning of this new round could well set the conditions for U.S. and world prosperity for decades. The Reagan Administration has achieved the opportunity to negotiate important trade liberalization by winning agreement for

this sixth round of talks. U.S. Trade Representative Clayton Yeutter can be expected to proceed aggressively. Meanwhile, it is up to the U.S. Congress to support these efforts by refraining from any protectionist measures that could jeopardize the free trade opportunities offered by the latest GATT round.

Edward L. Hudgins, Ph.D.
Walker Fellow in Economics