

Ronald Reagan Presidential Library
Digital Library Collections

This is a PDF of a folder from our textual collections.

Collection: McMinn, Douglas W.: Files, 1982-1985

SERIES: II: ECONOMIC SUMMIT FILES

Folder Title: France – Issues

(1 of 12)

Box: RAC Box 13

To see more digitized collections visit:

<https://www.reaganlibrary.gov/archives/digitized-textual-material>

To see all Ronald Reagan Presidential Library Inventories, visit:

<https://www.reaganlibrary.gov/archives/white-house-inventories>

Contact a reference archivist at: **reagan.library@nara.gov**

Citation Guidelines: <https://reaganlibrary.gov/archives/research-support/citation-guide>

National Archives Catalogue: <https://catalog.archives.gov/>

Last Updated: 05/24/2024

WITHDRAWAL SHEET

Ronald Reagan Library

Collection Name MCMINN, DOUGLAS: FILES

Withdrawer

SMF 2/21/2008

File Folder FRANCE-ISSUES (1)

FOIA

S2007-081

Box Number 13

NOUZILLE

172

ID	Doc Type	Document Description	No of Pages	Doc Date	Restrictions
50971	PAPER	ISSUES <i>R 5/24/2010 NLRRM2007-081</i>	40	1/5/1982	B1

Freedom of Information Act - [5 U.S.C. 552(b)]

- B-1 National security classified information [(b)(1) of the FOIA]
- B-2 Release would disclose internal personnel rules and practices of an agency [(b)(2) of the FOIA]
- B-3 Release would violate a Federal statute [(b)(3) of the FOIA]
- B-4 Release would disclose trade secrets or confidential or financial information [(b)(4) of the FOIA]
- B-6 Release would constitute a clearly unwarranted invasion of personal privacy [(b)(6) of the FOIA]
- B-7 Release would disclose information compiled for law enforcement purposes [(b)(7) of the FOIA]
- B-8 Release would disclose information concerning the regulation of financial institutions [(b)(8) of the FOIA]
- B-9 Release would disclose geological or geophysical information concerning wells [(b)(9) of the FOIA]

C. Closed in accordance with restrictions contained in donor's deed of gift.

ORGANISATION FOR ECONOMIC
CO-OPERATION AND DEVELOPMENT

SG(82)1

~~CONFIDENTIAL~~

Paris, drafted: 5th Jan. 1982

dist: 11th Jan. 1982

*File
France
Summit
(Lyon)*

ISSUES TO BE ADDRESSED IN THE TRADE
FIELD IN THE 1980s

Note by the Secretary-General

DECLASSIFIED
NLRR M07-081 #50971
BY AI NARA DATE 5/24/10

TABLE OF CONTENTS

	<u>Para.</u>
I. OVERVIEW	1
II. TRADE AND GENERAL ECONOMIC POLICIES	28
- Inflation and unemployment	28
- Productivity and real wages	33
- Changes in the international monetary system	36
- Export incentives	44
III. TRADE AND STRUCTURAL CHANGE	45
- Positive adjustment policies	50
- Protection and support for declining activities .	54
- Support for promising activities	55
- Domestic subsidies	58
- Export controls and access to supplies	59
- Environment	60
IV. THE INTERNATIONALISATION OF BUSINESS ACTIVITIES ...	61
- Restrictive business practices	65
- Trade-related investment issues	67
V. TRADE WITH THIRD COUNTRIES	69
- Developing countries	72
i) Non-oil developing countries	74
ii) Oil-exporting developing countries	78
- Centrally planned economies	80
VI. SECTORAL TRADE PROBLEMS OUTSIDE MANUFACTURING	82
- Agriculture	83
- Fisheries	85
- Primary commodities	86
- Trade in services	89
VII. THE PROCESS OF INTERNATIONAL CO-OPERATION ON TRADE ISSUES	92
- Directions for improvement	95
- The mechanisms of trade co-operation	104

I. OVERVIEW

1. Despite rising concern about protectionism, international trade continued to be a very buoyant feature of the world economy during the 1970s. In the short span of ten years the share of exports (or imports) of goods and services in OECD GNP rose from about 13 per cent in 1970 to about 20 per cent in 1980. This is a vivid reminder of the extent to which governments, in dealing with their crucial domestic problems of inflation and unemployment, have become increasingly subject to forces beyond their individual control.

2. It is true that about one-third of this increased share can be attributed to the rise in oil prices. But it is also the case that, in volume terms, trade in manufactured products continued to grow nearly twice as fast as GNP, trade in agricultural products accelerated slightly despite the slower growth of GNP, while the value of trade in services kept pace with that of merchandise trade.

3. Most projections (World Bank, Interfutures) suggest that these trends should broadly continue and that trade will continue to be a significantly dynamic factor in the world economy in the 1980s. It is widely recognised, however, that the world trading system is being subjected to severe strains, and there is concern lest these projections should prove too optimistic. Indeed, there are some signs that the growth of trade in manufactures relative to GNP has been slowing down.

4. ~~These strains are being generated by: high inflation and unemployment; divergent trends in productivity and real wages; wide swings in terms of trade and exchange rates; rising international indebtedness; rigidities in the face of accelerated structural change; the rapid internationalisation of business activities; the arrival of important new actors on the world trading scene; continuing problems in agricultural trade; the growing importance of trade in services; concern about the security of supplies of energy and raw materials; and the fact that a number of these developments are leading to increasing government involvement in trade and trade-related questions.~~

5. The purpose of this note is to try to set out the main features of the economic, structural and institutional setting in which the world trading system will be operating during the 1980s and, from there, to identify the more important trade and trade-related issues to which they may give rise. Then, in the light of this analysis, a final section discusses various ways in which the process of international co-operation on trade issues might be improved, in order to deal better with the frictions and strains likely to continue in the 1980s. The following is a summary.

Trade and general economic policies

6. Regrettably, economic policy in the 1980s seems only too likely to continue to be dominated by the twin problems of inflation and unemployment. A well-functioning trading system can make a major contribution to mastering these problems. At the same time, however, poor general economic performance creates severe strains and distortions in the trading system. In particular, high unemployment, concentrated on some regions and socio-economic categories, leads to heavy socio-political pressures for protection.

7. To restore vigorous and sustainable economic growth will require not only bringing inflation down to manageable levels, but also keeping public expenditure within the limits people are prepared to pay for, achieving a greater degree of monetary stability, ensuring adequate incentives to save, invest and work, and improving the functioning of capital and labour markets.

8. Trade can be mutually beneficial between countries with widely different levels of productivity and real wages. What matters is not the level of a country's real wages, but that, as translated through its exchange rate, they should be in line with its productivity performance. This applies equally to intra-DECD trade, and trade with the so-called low-wage countries. If trading problems are to be avoided, economic policy in countries losing competitive strength must be directed to bringing the growth of real wages back into line with productivity trends, themselves hopefully improving, and in the more successful countries to absorbing the major part of the benefits of their good productivity performance at home. ~~Trade liberalisation can make an important contribution in both cases.~~ Evidently, the aim is not for the efficient countries to lower their productivity, but for the less efficient ones to improve theirs.

9. Changes in the international monetary system have had major implications for the world trading system. It has become easier to finance trade and current account deficits. But there is a question whether existing institutional arrangements for dealing with finance and trade, both domestically and internationally, are not too compartmentalised to allow sufficient consideration of the two way relationships, both positive and negative, between increased trade and rising international indebtedness.

*Closer coord
of GATT
& IMF*

10. Difficulties have been created for those responsible for trade and industrial policy by the way in which the present arrangements for exchange rates have been working over the last few years. There is a question whether enough attention has been paid to this in the formulation of monetary and exchange rate policies. There is a more substantive and controversial question of whether international co-operation could be strengthened so as to avoid unduly rigid or overly flexible exchange rates.

11. Under conditions of high inflation and unemployment, there is a strong temptation to employ trade-distorting export incentives. There are questions on the actual trade-distorting effects of such policies: on the scope for further improvement in the arrangement on export credits: and on the subsidisation of exports of investment goods to potential competitors.

Trade and structural change

12. Slower economic growth has increased the pain involved in adjusting to structural change, but has not reduced the need for it. Key factors in the 1980s will be further adjustment to higher energy prices, to technological breakthroughs in areas such as micro-electronics and information processing, and growing competition from - and markets in - developing countries.

13. Positive adjustment policies can help to facilitate structural change. There is a question as to how this work should be continued in the OECD after the expiry of the mandate of the Special Group on Positive Adjustment Policies, and whether more attention should be paid to the possible trade distorting effects of such policies.

14. On government support for declining industries, questions arise concerning non-traditional trade restraints: domestic, industrial, regional and manpower policies: and greater transparency. As regards support for promising activities, questions arise concerning the consequences of differences between Member countries in the rate of introduction of new technologies, and the application of criteria for potentially trade-distorting interventions in this area. There are also some more general questions concerning domestic subsidies, related to the GATT Code on subsidies and countervailing duties, and the possible role of further work at the international level in this area.

15. In the area of export controls, the issue is essentially that at the relationship between the security of supplies and access to markets. As regards environment control the question is whether there is a need for further action on trade-related issues.

The internationalisation of business activities

16. The internationalisation of business activities, as epitomised by the growth of multinational enterprises and international banking, is likely to continue in the 1980s, although possibly at a slower pace. This has been beneficial in facilitating growing specialisation between and within countries, industries and companies, and in channelling capital and know-how to where it can be best used. But it has also provided new opportunities for companies and governments to try to capture these benefits for themselves by influencing in their favour their market shares and the direction and pattern of international investment.

17. On restrictive business practices, questions arise concerning market-sharing, export cartels, mergers, the role of MNEs, extra-territorial application of anti-trust laws, and, more generally, whether, despite differing national approaches, international co-operation on restrictive business practices could and should be strengthened. On investment, questions arise particularly on investment incentives and disincentives (including performance requirements), and the possibility of developing consultation procedures and criteria to help reconcile conflicting national interests in this area.

Trade with third countries

18. Reversing the earlier post-war trend, trade with third countries has been the most dynamic element in OECD trade since 1973. This should continue in the 1980s, with third countries possibly accounting for up to one half of the increase in OECD exports. This will have a major influence on the nature of the trade problems encountered, since these countries have different economic structures and institutions, often with a greater degree of government involvement, have not been greatly involved in operating the post-war trading system, and are often subject to significant domestic and geopolitical pressures.

19. On the non-oil developing countries, there are questions concerning: the role of the GATT safeguard clause in smoothing adjustment difficulties in the industrial countries; the right mix of policies for successful export-oriented growth; and possible approaches to trying to progressively integrate the more advanced developing countries into the world trading system, while providing more favourable treatment for the poorer countries. There are also questions relating to mixed credits and aid tying.

20. On the oil-exporting developing countries, trade-related questions arise because of the dual nature of their economies, the temptation for them to keep domestic energy prices below world levels, and for oil-scarce consuming countries to enter into trade-distorting bilateral deals.

21. Trade with the centrally-planned economies is essentially bilateral and largely outside GATT, or any internationally agreed rules. Questions arise as to whether a more concerted approach would be desirable, and what might be done in areas such as countertrade, pricing policies and export credits.

Sectoral trade problems outside manufacturing

22. For historical reasons an important part of agricultural trade remained outside normal GATT rules, which have also proved to have limited relevance to trade in other primary commodities. The rapid expansion of trade in services is raising new problems.

23. On agriculture, there are questions on: how to deal with market disturbances; moderate the trade-distorting effects of agricultural policies in both domestic and third markets; reduce trade barriers; and reconcile the objective of food security with the expansion of international trade. For fisheries there are serious problems for production and trade related to the adoption of exclusive 200-mile coastal fishing zones. For primary commodities there are questions concerning: security of supplies; adequacy of investment; stockpiling; export earnings' stabilisation schemes for developing countries; and improving market structures and access to markets, notably for semi-processed and processed products.

24. Services have been the fastest growing sector of domestic economies, and world trade in services has risen to around \$600 billion, equivalent to one-third of trade in merchandise. Problems arise because of the highly regulated nature of many service industries, and because competition in services depends often on freedom for direct investment, the right of establishment, and the right to engage in regulated activities. There are questions on: what may be valid non-economic reasons for regulation; how far the principles applied to merchandise trade are applicable; and what approaches should be adopted to foster greater international co-operation in this area.

The process of international co-operation on trade issues

25. The strains arising from the current economic difficulties, the appearance of new problems, and the growing direct involvement of governments in foreign trade, call for improvements in the process of trade co-operation. The directions in which improvements might be sought include:

deeper

- The need to broaden the coverage of international trade co-operation, to include a wider range of domestic policies having an effect on international competition, since the multiplication of government interventions at the micro-economic level could gradually undermine the benefits of the open trading system.

- The need to consider trade problems and policy responses in their broader economic policy context. It is important to have around the table, with an appropriate weight, all the major interests involved, including those responsible for macro-economic policy, so that broadly based compromises can be found, which may include important non-trade features. A key question is whether it would be possible to mobilise more effectively "countervailing powers", so as to better resist trade and other measures which have long-term adverse effects on inflation and consumers' choice.

- The need to adjust to the growing number of important participants in international trade. This implies developing different approaches towards different groups

of new donors and choosing the appropriate forum for discussing the relevant issues. A delicate balance needs to be struck between limited groups permitting greater efficiency and representation of countries less directly involved so as to avoid trade problems being "solved" at somebody else's expense.

26. These general considerations have implications for the mechanisms used in international trade co-operation. Trade rules and binding commitments have a central role and there are certain areas where this approach might be extended. In many trade-related areas, however, where precision is difficult to achieve and flexibility is needed, non-binding guidelines (or codes) have proved useful, provided they are based on a political commitment. The consultation and the dispute settlement procedures have been improved in the MTNs. However, the new procedures are in their infancy and may tend to remain somewhat narrowly focussed. Improvements could be sought by trying to have consultations on major market imbalances prior to actual trade disputes, by letting representatives of "countervailing power" have a greater role in initiating multilateral consultations, and by organising such consultations so as to cover a wider range of relevant questions and possible solutions.

27. These considerations may raise questions concerning possible adaptations or improvements in the present institutional arrangements dealing with trade co-operation, but these are not discussed in this note.

II. TRADE AND GENERAL ECONOMIC POLICIES

Inflation and unemployment

28. Success or failure in mastering the twin problems of high inflation and rising unemployment will clearly be the most important single factor in the evolution of the world trading system in the 1980s. A well-functioning trading system can make a major contribution in this respect. Foreign competition is a powerful force restraining inflationary price-setting and wage-bargaining behaviour. Productivity gains resulting from international specialisation help to narrow the inflationary gap between limited resources and demands for higher real incomes.

29. Looked at the other way around, however, it is equally clear that poor general economic performance creates severe strains and distortions in trading relations. International trade is a positive sum game from which all can gain so long as the basic macro-economic price signals - including the exchange rate - are right, and economies are sufficiently flexible at the micro-economic level. But with high and uncertain levels of inflation the signals can easily go wrong, so that the benefits and costs of trade become very unevenly distributed both between and within countries. The combination of high inflation with high unemployment makes things even worse.

because the necessary adjustments at the micro-economic level become more painful and strongly resisted.

30. Between 1973 and 1981, OECD unemployment increased from 9 to 25 million. Under-employment and disguised unemployment have also increased sharply. These increases have been strongly concentrated on regions and localities heavily depending on declining industries, as well as on certain socio-economic categories (young people, women, minority groups, etc.).

31. The relative - and often absolute - contraction of employment in tradeable goods, and notably manufacturing, has been due to a variety of developments such as weak domestic demand, shifts in the pattern of demand, technological changes, etc. But foreign competition in domestic and third markets has often appeared as the most visible and most immediate cause of employment difficulties in declining industries. This is why intense social and political pressures so often focuss on sectoral and bilateral trade balances.

32. In the face of severe external shocks, macro-economic policy has so far been unable to cure the twin problems of high inflation and unemployment because of distortions and rigidities in the functioning of OECD economies. To restore vigorous and sustainable economic growth, and hence a climate in which international trade can fully play its beneficial role, will require not only bringing inflation down to manageable levels, but also keeping public expenditure within the limits people are prepared to pay for, achieving a greater degree of monetary stability, ensuring adequate incentives to save, invest and work, and improving the functioning of capital and labour markets. Policies to this end fall outside the scope of this paper. The following paragraphs concentrate on some specific aspects of macro-economic and micro-economic policies which are particularly relevant to the good functioning of the world trading system(1).

Productivity and real wages

33. It is a basic tenet of the case for an open trading system that trade between countries with different levels of real income and productivity can be mutually beneficial, as amply demonstrated over the last thirty years. What matters from the trade point of view is not the level of a country's real wages, but that, as translated through its exchange rate, they should be in line with its productivity performance. This applies equally to trade between OECD countries and trade with the newly-industrialising and so-called low wage developing countries.

(1) Some of these issues are discussed at greater length in Trade Policies in a Macro-Economic Setting, C(81)93 (1st Revision).

34. Trade problems will inevitably arise if there is a tendency for real incomes to lag behind, or run too far ahead of productivity gains. In the latter case, particularly if public expenditure is also increasing strongly, profits are squeezed, investment in new products, processes and markets falls, and a cumulative deterioration in competitive strength may set in. Trade restrictions will only make matters worse by blunting the competitive forces making for needed changes in industrial structures, real incomes, exchange rates, etc.

35. A major question is whether enough attention is given to the role of general economic policies in dealing with trading problems which arise in this way. Significant differences in productivity performance between countries are bound to continue, reflecting differences in their levels of development, economic circumstances, the speed with which they are able to adapt to changing conditions, varying preferences as between work, leisure, social progress, etc. If trading problems are to be avoided, economic policy in countries losing competitive strength must be directed to bringing the growth of real wages back into line with productivity trends, and in the more successful countries to absorbing the major part of the benefits of their good productivity performance at home. Trade liberalisation can make an important contribution in both cases. Evidently, the aim is not for the efficient countries to lower their productivity, but for the less efficient ones to improve theirs.

Changes in the international monetary system

36. Major changes in the international monetary system during the 1970s have had important implications for world trading arrangements.

37. The very rapid growth of international financial markets, together with the emergence of some OPEC countries as structural surplus countries, has made it both easier and more necessary to finance trade and current account deficits by foreign borrowing. As a result, cases of OECD countries imposing trade restrictions to protect the balance of payments under Article XII of the GATT have become increasingly rare, while concern about the employment effects of foreign competition has shifted attention to Article XVI and various safeguard mechanisms.

38. The extremely rapid growth of international indebtedness has, however, had other important implications: While it has greatly facilitated the rapid industrialisation of new competitors on world markets, it has also meant that the viability of the vast network of international financial intermediaries has become increasingly dependent on the ability of these countries to earn enough foreign exchange through exports - mainly of manufactures - to service these debts. There is a question as to whether existing institutional arrangements for dealing with finance and trade, both domestic and international, are not too compartmentalised to allow sufficient consideration of the two way relationships both

positive and negative, between increased trade and rising international indebtedness.

39. The second major change has been the move to more flexible exchange rates. During the 1960s, undue rigidity of exchange rates, particularly in respect of the reserve currencies, created distortions in trade and industrial structures. The move to more flexible exchange rates helped to facilitate the major changes in the pattern of world trade and payments following the first oil shock. But there is increasing concern about some aspects of the way the present arrangements for exchange rates have been working over the last few years.

40. One feature has been that, at a time of great concern about inflation, those responsible for anti-inflationary policies have increasingly welcomed the impact of an appreciating currency in reducing import costs and sharpening competitive pressures on the domestic price level. Experience has indeed shown that a strong currency can help to bring down inflation while putting strong pressure on companies to rationalise production and move up-market. Unfortunately, however, the downward pressure on domestic inflation has often not proved sufficient to offset the adverse impact of the higher exchange rate on profits and competitiveness, thus creating serious problems for those responsible for trade and industrial policy. Since these adverse effects generally make themselves felt only progressively, while the beneficial impact on inflation is readily apparent, they may not always be given enough weight in the formulation of macro-economic policy.

41. A second feature is that there have been a number of recent examples of exchange markets over-reacting to short-term developments in interest rates, current balances, political trends, etc., so that exchange rates have moved sufficiently out of line with the underlying competitive strength of the country concerned for sufficient time to have distorting effects on trade flows, investment decisions and industrial structures.

42. It is widely agreed that there is no simple answer to these problems which, as noted, can and have arisen under both more fixed and more flexible exchange rate régimes. Trade restrictions provide no answer. Indeed, import restrictions by a country with an over-valued currency, or export restraint by a country with an under-valued currency, will only make things worse by reducing the flows of foreign exchange which would otherwise help to restore more appropriate exchange rates. Nor is it simply a matter of asking those responsible for monetary and exchange rate policy to take more action to stabilise exchange rates, since such action may well run counter to other key objectives of domestic policy - especially as action to resist currency appreciation normally has inflationary consequences, and to resist depreciation, deflationary consequences.

43. An important question nevertheless arises as to whether enough attention is paid, either at the national or international level, to trade and industrial policy issues in the formulation of monetary and exchange rate policies, or of questions concerning exchange rates in the formulation of trade and industrial policies. Beyond this, there is the more substantive and controversial question of whether international co-operation could be strengthened so as to avoid unduly rigid or overly flexible exchange rates, and thus ease the problems for trade and industrial policy when exchange rates get out of line with trends in underlying competitive strength.

Export incentives

44. At a time when governments feel constrained in stimulating domestic demand because of fear of rekindling inflation, but are at the same time acutely worried about high and rising unemployment, there is a strong temptation to promote exports by any means available.

Questions(2)

- i) How much concern is there that a wide range of domestic policies may increasingly be implemented in ways which deliberately favour exports over domestic sales?
- ii) As regards more specific measures to promote exports:
 - considering progress achieved in international co-operation as regards government support for export credits, what is the scope for further improvement in the existing arrangement on export credits, including more extensive coverage of sectors and more flexible arrangements for adjusting interest rates?
 - should more consideration be given to other ways of encouraging exports which may distort competition, e.g. through providing insurance against exchange rate changes and inflation?
- iii) Is there a risk that cheap and abundant credits for exports of investment goods to new centres of production in third countries could lead to worldwide excess capacity in industries facing stagnant demand and eventually provoke trade conflicts? If this is considered as a serious problem, would it be desirable to do more to restrict competitive export promotion in sensitive sectors, or would this tend to accentuate existing tendencies to market-sharing and cartelisation?

(2) Other questions, relating to export subsidies in agriculture, mixed credits and export incentives in East-West trade, are also dealt with in other parts of this note.

III. TRADE AND STRUCTURAL CHANGE

45. Slower growth has not decreased the need for adjustment to structural change: indeed, developments such as higher energy prices, rapid development of new technologies in areas such as micro-electronics and information processing, and growing competition from - and markets in - developing countries have increased it. At the same time, slow growth and high unemployment have made adjustment more difficult and socially painful. Much change has nevertheless taken place in industrial structures: for example, OECD employment in textiles and clothing fell by 17 per cent in the 1970s, while employment in services rose by 25 per cent.

46. Confronted with the accentuated problems of structural adjustment, industrial, regional and manpower policies have been increasingly directed to easing the strains on industries facing severe adjustment difficulties and trying to encourage the development of promising activities. Since the measures taken were often complemented by - or a substitute for - trade measures, a key feature of the 1970s which is likely to continue into the 1980s is that the dividing line between trade policies and most other economic policies has become increasingly blurred.

47. The consequence has been a loss of transparency, i.e., it has become increasingly difficult for the government concerned, or its trading partners, to appreciate - let alone quantify - the costs and benefits of its actions to retard or accelerate structural change for workers, consumers and taxpayers. The Special Group on Positive Adjustment Policies has just completed an important study on the techniques used for such analyses. A question may arise as to what further steps should be taken to build on this work to improve transparency at the national and/or international level, and to permit more systematic reporting and monitoring of government measures affecting industry and trade.

48. A second question arising in this context is whether more systematic monitoring of trends and likely future shifts in industrial structures can assist in detecting where trade problems are likely to arise. Some are dubious because of the complexity and uncertainty of such projections, and the risk that this approach could encourage attempts to share out market. Others feel that they could be helpful, and that more resources should be devoted to this kind of work at the international level.

49. It is important to note that the distinction between "declining" and "promising" activities is somewhat artificial. Within a "declining" sector or branch of industry it is possible to find highly dynamic segments - and prosperous enterprises - and the reverse is true for "promising" sectors and branches. Moreover, the dynamic effects of major technological advances are not confined to the industries generating them, but can spread over a wide range of activities in which they find productive and efficiency-improving applications.

Positive adjustment policies

50. As set out in The Case for Positive Adjustment Policies (OECD, 1979), the need for flexibility in the economy is essentially related to the contribution that such flexibility can make to domestic economic welfare. But effective positive adjustment policies can, over time, make a major contribution to dealing with trade problems.

51. The major features of the orientations for positive adjustment policies adopted by OECD Ministers in 1978 are:-

As regards industrial policy:

- assistance to specific industries or companies should be strictly temporary;
- such assistance should be integrally linked to plans to phase out obsolete capacity and re-establish financially viable enterprises; and
- the cost of such assistance should be made as evident as possible to decision-makers and the public at large.

As regards labour market policy; measures to support employment should not have the effect of locking labour into declining sectors. Agricultural policies should be designed to achieve their social, economic and political objectives at minimum cost to the consumer and taxpayer. Regional policies should concentrate on general measures to develop viable industries, through providing infrastructure and financial and fiscal incentives, rather than simply bailing out enterprises in financial difficulty.

52. There is a strong two-way relationship between positive adjustment policies and macro-economic policy. If general economic conditions are favourable, structural adjustment takes place much more easily and smoothly. On the other hand, high rates of inflation, high and fluctuating rates of interest, inappropriate levels of real wages or exchange rates - and the uncertainties created by such conditions - greatly complicate the task of those trying to adjust to structural change. They also put great pressures on governments to intervene selectively in the economy to offset some of the effects of, for example, high interest rates or exchange rates, on the weaker sectors and companies, in ways which run counter to the principles enunciated above.

53. Questions arise as to how much has been achieved by the adoption of the Orientations and the subsequent work of the Special Group on Positive Adjustment: whether and in what way this work should be continued; whether more attention should be paid in this work to the possible trade distorting effects of subsidies and other measures designed to speed-up or slow-down structural change; and how such work might contribute to the

successful implementation in the GATT of the Agreements negotiated in the MTNs concerning subsidies, government procurement, etc.

Protection and Support for Declining Activities

54. Action taken to support declining activities has taken many forms including quotas, voluntary export restraints, orderly marketing arrangements, trigger prices, tacit acceptance of market-sharing arrangements, rationalisation schemes, investment incentives, employment subsidies, export subsidies to preserve shrinking markets, etc.

Questions

i) What kind of revision, as presently discussed in the GATT, of the safeguard clause governing conditions and modalities of recourse to protective measures would improve the present situation, particularly as regards:

- utilisation of non-traditional trade measures, such as voluntary export restraints and orderly marketing arrangements, and specific conditions to which they should be subject; and avoidance of the extension of MFA-type arrangements to other sectors:

- international monitoring of measures taken and of their modes of application.

ii) What can be done to minimise the undesirable trade-distorting consequences of policies aimed at:

- helping temporarily non-competitive industries and enterprises;

- helping chronically depressed regions, where this directly or indirectly involves support to declining industries;

- supporting employment by means of temporary direct or indirect subsidies (or tax concessions), in particular targeted to special socio-economic groups?

iii) In certain cases, where chronic excess capacities have led to some form of international arrangements or understandings, such as those in steel and shipbuilding, is sufficient progress being made to reduce capacity and revert to normal competitive forces?

iv) How desirable are special programmes to assist adjustment and maintain incomes specifically for trade-related displacement, as compared to other causes of displacement? Is there a role for reductions in payroll taxes or wage subsidies to help companies engaged in labour-intensive activities?

Support for Promising Activities

55. There are complex questions concerning the international compatibility of national efforts to encourage promising new activities and advanced technologies: In many advanced technology areas, R and D costs are high, and the depressed economic environment is placing increasing pressure on firms' ability and willingness to finance research. At the same time, it is broadly recognised that innovation has a critical role to play in strengthening the competitiveness of firms as well as countries(3). While the government has a role in financing long-term research and technological development at the more fundamental level, the dividing line between fundamental and applied R and D has proved difficult to define or maintain in the face of intensified international competition.

56. While the support measures have generally involved very limited expenditures in broad terms, in some high-technology areas they may lead to intensified international competition. This can have beneficial effects by expanding the range of suppliers (particularly in concentrated industries), providing a stimulus to innovation and its diffusion, allowing a more even international distribution of the gains from technical advance, and thus more generally enhancing consumers' welfare. In particular, major gains could accrue to all countries hurt by the rise in energy prices, from support to technologies for developing new energy resources and energy-saving devices. More generally, while it remains true that it is difficult to "pick the winners" in the technological race, broad support to new technologies improving the general efficiency of the economy, including in non-tradeables, could make a major contribution to facilitate structural adjustment.

57. Such measures can also, however, contribute to worldwide misallocation of resources and distortions in production. They can affect trade patterns in high-technology products, and lead to international trade frictions or escalation of government support, particularly if the extent of the subsidies available to firms in different countries varies significantly. When the measures are aimed at protection of the domestic market - e.g. through preferential government procurement, certification standards and NTBs - and at aggressive assistance to exports, this can substantially penalise risk-taking by unaided - but often highly efficient and innovative - producers(4).

(3) See Technical Change and Economic Policy, OECD 1980.

(4) See, for example, Telecommunications Equipment Industry Study, DSTI/IND/81.28.'

Questions

- i) What kinds of trade problems are likely to arise from differences in the growth of innovative capacity, automated production and technology-intensive exports between Member countries, given the greater instability in market shares inherent in technology-based competition?
- ii) Is there danger that government support measures for promising industrial activities can discourage private entrepreneurs and private risk capital in other countries, or, conversely, increase pressures for government support? May support directed to the same industrial activities tend to create worldwide over-capacities and structural problems in the future? What could be done to strengthen the process of international consultation and co-operation in this area? Should consideration be given to identifying principles which could guide countries in avoiding trade distortions? Would it be desirable to strengthen the appropriate sections of the relevant GATT codes in this connection?
- iii) Could manpower authorities do more in assisting the development of new industries, notably in the areas of vocational education and training programmes coupled with on-the-job training and through programmes which actively assist labour mobility?

Domestic Subsidies

58. The problem of domestic subsidies cuts across virtually all the problems discussed in this note. The trade aspects of domestic (as well as export) subsidies are covered by the Code adopted under the MTNs on subsidies and countervailing duties, interpreting the relevant Articles of the GATT. The relevant provisions do not prohibit and do not restrict the use of such subsidies, but signatories undertake to seek to: avoid causing serious injury to other signatories' interest through such subsidies; provide information on request; and enter into consultation (with the possibility of recourse to the conciliation and dispute settlement procedures if needed) with the injured party when so requested. Notwithstanding the improvement brought about by this Code, it seems that, in practice, much depends on the use made of consultation procedures and of their outcome.

Questions

- i) Is the present Agreement, which relies mainly on consultations, sufficient to bring about progress in reducing the undesirable effects of domestic subsidies on trade and on economic efficiency? How could such progress be enhanced?
- ii) Would it be advisable to undertake further work on domestic subsidies, at international level, with the aim

of reaching a better understanding on the use of such subsidies and the conditions for their use, and on the trade as well as on the domestic effects? Should a pragmatic approach be adopted which would include more systematic examination of the existing practices? By country? By sector? In relation with examination of adjustment policies?

Export controls and access to supplies

59. Export controls in the broader sense (quantitative restrictions, export duties and taxes) may have different motivations. Besides strategic considerations of a more political nature, the main reason is to privilege supplies to the domestic market. They may also correspond to other objectives such as supporting export prices or securing a competitive advantage to the domestic processing industry. In practice, export control measures have not been widespread: measures recorded concern or have concerned a few products such as foodstuffs, raw materials and metal scraps. More generally, the question of access to supplies (or export liberalization) should also be looked at as a counterpart of that of access to markets (or import liberalization) and vice-versa.

Questions

- i) Is there presently a fair balance between understandings or provisions concerning market access and access to supplies?
- ii) Should existing provisions concerning export controls be reviewed? Should in particular an attempt be made to draw up criteria for justified recourse to export controls, and guidelines and procedures for the implementation of such measures, with a view in particular to alleviate the problems raised by such measures? How could a satisfactory balance be struck between internal motivations and external effects of export controls?

Environment

60. Following the preoccupation of governments in the early 70s to protect and improve the environment, and the new legislations adopted to that effect, guiding principles as well as notification and consultation procedures on subsidies were adopted in OECD in 1972 and 1974 in order to prevent the emergence of obstacles to trade or distortion of competition in international trade and investment due to environmental policies or to deal with such problems if they arose.

Questions

- i) To what extent are the present arrangements operating in a satisfactory manner and is there any need for further action beyond the present activities?

- ii) Is there any risk that the present cyclical and structural difficulties in the trade field and in particular in some sectors might lead to the erection of obstacles to trade (such as technical barriers) on environmental grounds?

IV. THE INTERNATIONALISATION OF BUSINESS ACTIVITIES

61. Since the early 1960s, there has been an accelerated development of interlinkages between international trade, production and finance in the private sector. This highly complex development was related, on the one hand, to the activities of multinational enterprises (MNEs)(5), notably in respect of direct investment and horizontal co-operation(6) and, on the other, to the rapid expansion of international capital markets and international banking(7).

62. As far as economic efficiency is concerned, this development has been on balance highly beneficial to the world economy. Through international sourcing, sub-contracting and offshore processing, firms have been able to mobilise the productive potential of countries with a strong comparative advantage. Growing international specialisation within industries and companies has permitted the reaping of large economies of scale even in the major industrialised countries. Finally, the process of internationalisation has provided further stimulus to industrial efficiency through the transfer of technology.

(5) In 1960, international production by U.S.-based multinationals, i.e. the production by branches and subsidiaries abroad, was roughly estimated to be three times the value of U.S. exports. By 1971, this ratio had increased to four. For both Germany and Japan, the same ratio rose from a small fraction in 1960 to about 2.5 by 1971. The volume of intra-company trade passing national frontiers has also grown rapidly, reaching some 22 per cent in 1966 and 25 per cent in 1970 as a share of world trade excluding East-West trade.

(6) Outward direct investment flows of thirteen OECD Member countries have increased from some three billion dollars in 1961 to more than \$22 billion in 1979 (see Recent International Direct Investment Trends, OECD 1981). Practically throughout the period, direct investment outflows in current dollars have been rising more rapidly than OECD GNP, at about the same rate as international trade. Despite some slowdown since 1973, international direct investment has remained more buoyant than domestic investment.

(7) International issues of bonds have increased from \$680 million in 1964 to \$4.7 billion in 1973 and \$20 billion in 1980. International medium and long-term bank loans have increased from less than \$21 billion in 1973 (first year for which data were collected) to more than \$78 billion in 1980.

63. The interlinkages between capital flows and trade have become increasingly complex. As a rule, direct investments should result in an intensification of mutual trade. In practice, however, when the purpose of direct investment is to get behind protective barriers, domestic production has tended to replace imports. Another complicating factor has been that the two-way flows related to investment appear increasingly in items other than the merchandise account. The exports of many industrialised countries include a growing proportion of know-how in forms of technical assistance, consultancy, licensing and franchising, etc., whereas other countries export labour, tourism, etc.

64. The dynamics of the internationalisation of business activity have offered a large potential for attempts to capture its benefits. Private business has found new opportunities to engage in restrictive practices, including some ruled out domestically by legislation(8). In turn, many governments have tried to influence in their favour the direction and pattern of international investment and to maximise its benefits for the balance of payments and for employment.

Restrictive Business Practices

65. Work by the Committee of Experts on Restrictive Business Practices(9) as well as other evidence collected by various bodies of the Organisation and other agencies show that:

- There appears to have been continued concentration of world output and trade in large MNEs as their size and number have been constantly growing;
- Oligopolistic behaviour on a world scale is evident in some industries;
- That there has not been more open violence to GATT rules is also partly explained, in a recent GATT report, by the increasing resort to privately agreed, and officially tolerated if not promoted, restraints on trade

(8) Recognition of the potential benefits and pitfalls of the activities of MNEs has prompted OECD governments to adopt in 1976 a Declaration recommending, inter alia, the observance of Guidelines for MNEs, co-operation in respect of incentives and disincentives to international investment and the establishment of consultative procedures. The Guidelines include specific recommendations on restrictive business practices. (See International Investment and Multinational Enterprises, OECD, 1979.)

(9) See their reports on Export Cartels (1974), Mergers and Competition Policy, Restrictive Business Practices of Multinational Enterprises (1977) and Concentration and Competition Policy (1978).

and competition. Developments in such important industrial sectors as steel, automobiles, consumer electronics, synthetic fibres and perhaps other petro-chemicals exemplify this tendency. Collusive arrangements have been facilitated by the possibility in many countries of legalising certain types of cartels, notably export cartels.

66. Two major problem areas in the field of restrictive business practices which appear to be important for international trade are export cartels and the practices of multinational enterprises, themselves related to the trend towards mergers and concentration. A third issue is divergent national approaches towards private restrictive practices, which have international implications, and which can result in conflicts between countries over jurisdiction and sovereignty, thereby creating uncertainty in international trading relationships.

Questions

- i) What is the economic rationale invoked by governments for their generally permissive attitude towards export cartels? In particular, how far is the motive to facilitate rationalisation or to avoid import restrictions being imposed in other countries? Has sufficient consideration been given to repealing the exemption from restrictive business practices legislation for export agreements?
- ii) One of the reasons advanced to justify mergers and other forms of concentration is the need for a certain scale of operation, if firms, particularly in the smaller countries, are to be able to compete in world markets. How far does this justify a policy for encouraging mergers and concentration, as against the risk that this may increase oligopolistic behaviour in international trade (e.g. price leadership and parallel pricing)?
- iii) Is there evidence that multinational enterprises engage in allocating output, sharing markets or pricing above normal profits more frequently than purely national enterprises? Less frequently? Would it be possible to make more operational use of the recommendations on restrictive business practices included in the OECD Guidelines on MNEs?
- iv) Given the present differences in national competition laws and the problems raised by the extra-territorial application of national legislations, are existing international voluntary arrangements (e.g. OECD 1979 Council Recommendation, the United Nations Set of Principles and Rules for the Control of Restrictive Business Practices) adequate to deal with international restrictive business practices, or is there a need for further machinery, including improved procedures to resolve disputes?

Trade-Related Investment Issues

67. In view of the potential benefit of direct investments to host countries, it is hardly surprising that many governments - not only those of developing countries - have tried to apply special incentives to attract them. While, notably in developing countries, some investors have been offered a protected domestic market, in others a variety of measures, such as investment grants, low cost financing, and tax holidays, are being used to encourage investment inflows. On the other hand, in order to assure a greater share of the potential benefits - and in some cases due to the perception of governments of a bias on the part of subsidiaries of foreign firms to confine their sales to the domestic market, while buying much of their inputs abroad - measures have also been taken to impose export performance and import content requirements.

68. There is only limited knowledge of the effects of trade-related investment measures on international investment flows as well as on the impact of performance requirements, investment incentives and other government interventions on the behaviour of firms(10). The generally accepted view is that the measures enumerated above create distortions to the free flow of international investment. They can also distort international trade flows and thereby jeopardise the open multilateral trading system. But, as noted above, the counter argument is sometimes made that such measures can be a necessary response to correct existing distortions. While in some cases direct investments are made to overcome existing trade barriers, on balance the growth of international trade through trade liberalisation and the growth of international investment through investment liberalisation have been complementary developments contributing to the overall growth and the increasing internationalisation of the world economy.

Questions

- i) Can investment incentives and disincentives, including performance requirements, be seen as a response to externalities and market imperfections (e.g. restrictive business practices related to direct investments)?

(10) Following the decision of the 1979 OECD Council at Ministerial Level, the CIME is completing the first phase of its examination of the effects of incentives and disincentives on the flow of international investment, which has resulted in two reports, Survey of International Investment Policies in OECD Member Countries, (IME(81)14 and Annex) and The Effects of Investment Incentives and Disincentives on the International Investment Process, (IME(81)17), which it is expected will be sent to the Council early in 1982.

- ii) Going beyond Article III of GATT, can international criteria be developed to reconcile conflicting national interests in the area of incentives and performance requirements? Would it be desirable to establish new or expand existing possibilities within OECD for consultations on such measures found to have a significant effect on international trade?
- iii) How could such understandings be conceived in order to include policies applied by non-Member countries?

V. TRADE WITH THIRD COUNTRIES

69. Up to 1973, the fastest growing market for OECD countries was the OECD area itself, accounting for three-quarters of the growth of OECD exports between 1963 and 1973. But since 1973, intra-trade increased slowly and the share of third countries in exports of manufactures rose from 27 to 34 per cent, and for investment goods from 33 to 43 per cent. The shift to third country markets was equally impressive for agricultural exports. On the import side, the share of third countries in manufactures has risen slowly from 7 per cent to 14 per cent in 1979, mainly because of rapidly rising imports from the newly industrialising countries (NICs).

70. These shifts were related to the faster growth of output and demand in non-OECD countries, particularly in the oil-exporting developing countries, and to the export-oriented policies followed by some non-oil developing countries. Most projections made by Interfutures and by the IBRD suggest the continuation of these trends in the future, so that, all other things being equal, third markets may account for between two-fifths and one half of the growth of OECD exports in the 1980s.

71. Although third countries constitute an extremely heterogeneous group, trade with them tends to be different, for a variety of reasons, from trade between industrial countries which broadly speaking have similar economic institutions and policies. Added to this, there is an element of economic and political risk as well as differences in the commodity structure of trade. The following discussion covers three groups: developing countries, sub-divided into oil-exporting and non oil-exporting countries, and centrally planned economies(11).

(11) No explicit reference is made to China which is a sui generis case, being a non-oil developing country with potentially important oil resources and many features of central planning as well as a political regime which goes with it.

Developing Countries

72. Until the early 1960s, developing countries were essentially passive participants in international trade, mainly exchanging primary products against manufactures. The more advanced among them tried to industrialise through import substitution (sometimes based on regional markets). As a result, their share in world trade gradually fell. Their trade policies attracted little attention in the industrialised world, and they stayed almost completely outside the liberalisation moves initiated in the OEEC and GATT. Their main concerns were the terms of trade, commodity price stabilisation, and the related heavy dependence on cyclical variations in activity in industrial countries.

73. This picture has changed, at an accelerating pace, from about the mid-1960s. A few developing countries have turned to outward-looking, or export-oriented, policies and have increased markedly their shares in world and OECD markets for manufactured products(12). And the rise in oil prices has created an admittedly heterogeneous but very distinct group of developing countries with strong bargaining power and an interest in collective action. But while, in economic terms, oil exporting countries occupy a fairly distinct position, the developing countries have generally continued to act together as a political group pressing for changes in the rules governing international economic relations and in the institutions applying them(13).

(i) Non-oil developing countries

74. Within the group of non-oil developing countries, expansion of two-way trade with the OECD was heavily concentrated on the NICs. These countries have convincingly demonstrated that, with appropriate policies, foreign trade can be turned into an engine of growth. But experience has also shown the difficulties in controlling this engine so as to avoid domestic distortions and external tensions. As all developing countries, the NICs have to avoid excessive domestic demand pressures leading to unsustainable current account deficits. But they also run the potential danger of insufficient domestic absorption leading to an inappropriately strong current account coupled with large capital inflows (although not while they are still absorbing the second oil shock). In this context, trade liberalisation, exchange rate policies, and domestic measures to promote absorption have proved to be of strategic importance.

(12) For a detailed discussion see The Impact of the Newly Industrialising Countries on Production and Trade in Manufactures, OECD, 1979.

(13) For a critical assessment of the role of trade in North/South discussions, see DAC Annual Report 1979, pp 26-36.

20

Also, the fundamental orientations of their policies affecting resource allocation in respect of the capital intensity of investment, the balance between agriculture and manufacturing, and the commodity structure of foreign trade play an important role in determining the smoothness of outward-looking growth policies. As regards trade policies proper, the NICs have now a vital stake in maintaining free access to markets of industrial countries and they can contribute to this by pursuing trade liberalisation and by consciously diversifying the commodity and geographical pattern of their exports. These issues will become also increasingly relevant for the development policies of a number of other middle-income countries. In general Developing Countries have been impressed by the achievements of the market model. They are, however, concerned that, externally, they might be deprived from its benefits by protectionist policies in Developed Countries and internally, export-oriented growth would lead to unbalanced development. In fact distortions in this respect arise mainly from not using market forces. The present moment is therefore crucial for policies which are going to be followed by Developing Countries. They have to be convinced by Developed Countries' own policies of the benefits of the market system and so be brought into the system.

75. In favourable overall economic conditions, a number of other developing countries could successfully embark on outward-looking policies. This is conditioned, however, not only by the absence of discrimination against newcomers in industrial country markets, but also by the established NICs moving up market and being prepared to liberalise their own imports. And there will remain a large number of low-income developing countries which depend on relatively slowly growing earnings from primary commodities which will continue to be only loosely attached to the international trading system. The dilemma is that while everybody recognises the growing differentiation of developing countries, it is often felt that it could be politically dangerous to act accordingly in devising policies.

76. On the side of the industrialised countries the issue is not how to "accomodate" the developing countries for humanitarian or other reasons. It is rather how to ensure that trade with them benefits consumers in the industrialised countries through lower prices and increased efficiency, and workers in industrialised countries through increased exports to rapidly expanding markets in the developing world. In the manufacturing sector, the need is for policies which facilitate the transfer of resources to new activities both between and within industries, as discussed earlier in this note. Other important structural changes may be called for in primary products, both agricultural and mineral: e.g. further processing of primary exports in developing countries, shifting highly energy-intensive processes closer to cheap sources of energy, making full use of the large untapped land resources of several industrialised countries, etc.

Questions

- i) To what extent and in which areas (e.g. adjustment and the safeguard clause) does a solution of the problems raised by the developing countries depend upon progress to solve specific difficulties that concern international trade at large, including trade between OECD countries? Is it felt that the example set by industrial countries in applying the rules and solving the difficulties arising in their mutual trade relations can enhance or diminish the attraction that the open multilateral trading system exerts on developing countries?

- ii) What could OECD countries do, and what are they prepared to do, in order to assure and improve access to their markets for developing countries' exports, either on an MFN or an preferential basis (including a possible reduction of tariff escalation) and, where needed, through differential treatment in favour of the less advanced developing countries ?

- iii) How should OECD governments respond to demands from domestic interest groups for conditions to be set in respect of orderly growth and fair competition ? In respect of minimum labour standards or a "social clause", is it possible to distinguish between working conditions which are unacceptable on humanitarian grounds, and those which simply reflect the level of development of the country concerned, and hence its comparative advantage (and disadvantage) ? And even if this were possible, are there not considerable dangers involved in establishing a direct link between trade policy measures and improvements in labour standards desirable on humanitarian grounds ?

- iv) As regards developing countries, how could their greater involvement in the trading system be brought about with notably a better balance of rights and obligations ? In particular, should there be a link between market access granted to developing countries and their progressive integration in the international trading system ? Should an attempt be made to establish a set of basic rules applicable by all countries ? How could greater differentiation in trade policies be achieved to take account of the great variety of situations and needs among countries, with the aim to reserve more favourable or special treatment to those countries or cases where it is really needed ? What should OECD countries reactions be to preferential trading arrangements between the developing countries (ECDC) ? What might in this respect be the relative contribution of the three following approaches :

- a country approach consisting of an examination of individual trade and related policies of important trading countries in the South;

- a sectoral approach, which would bring developing countries with important trading interests in a given sector into the framework of multilateral discussions and possible consultations;

- a policy approach, consisting of an examination by trade and trade related instruments (e.g., subsidies) ?

In what framework should such approaches be pursued ? How could OECD contribute to develop common views of Member countries and help in the dialogue with advanced developing countries ?

- v) Is there any point in trying to reach a global understanding with developing countries on the views canvassed above ? What form might such an understanding take (global trade pledge, political declaration, resolution) and where should it be adopted ?

77. Since CDA is being increasingly concentrated on non-oil developing countries (other than NICs), it is in relation with these countries that the possible trade-distorting effects of practices used by aid donors, such as mixed credits and aid tying, are of special relevance. Efforts are already under way to tighten the notification procedures and to improve the transparency of mixed credit transactions, paving the way for the improved exchange of information on mixed credits.

Questions

- i) Should a concerted effort be made to use the results of the improved exchange of information to seek agreement on ~~guidelines for mixed credits~~ - possibly through some formalised consultation and complaints procedures ? Can arrangements or safeguards be introduced to limit trade distorting effects and to improve the developmental value of mixed credits ?
- ii) Would it be quite unrealistic to resume efforts to agree on a multilateral arrangement on aid untying ?

(ii) Oil-exporting developing countries

78. The growing importance of oil-exporting countries as markets for OECD countries has been the most important change in trade flows since 1973. It affected not only manufactures, where the share of OPEC in OECD exports more than doubled to around 10 per cent(14), but all other product categories and notably food as well as a host of services(15).

(14) The figure would be some 2 percentage points higher if non-OPEC oil exporters were included.

(15) Between 1973 and 1980, the share of oil-exporting countries (including non-OPEC) in total world merchandise imports and exports increased respectively

79. In the case of oil-exporting countries, trade has also become an engine of growth, essentially because of the massive improvement in terms of trade. There are, of course, huge differences between individual oil-exporting countries both as regards their domestic economic structure and their foreign trade position. In the wake of the oil price increases, they have all stepped up the share of imports in domestic consumption while somewhat reducing, in real terms, that of exports in domestic output. Many of them are increasingly confronted with the difficulties inherent in "dual economies". As real incomes and the exchange rate are strongly influenced by large scale oil revenues, domestic production of tradeables other than oil and gas is or tends to become uncompetitive even on their domestic markets. Hence industrial and agricultural activities can only be maintained and developed through heavy subsidisation, energy supplied at well below world market prices, and very high import barriers. This can only aggravate inefficiency in the domestic economy and could likely to create serious trade conflicts with other countries.

Questions

- i) The huge gap between the cost of production of energy and its market price enables some energy-rich countries to build up energy (or feedstock) intensive industries based on cheap inputs(16). Is enough being done to anticipate and moderate the trade frictions that this could lead to?
- ii) The scramble for oil and gas and the related pressures on the current account have led some importing countries to attempts to resort to bilateral arrangements aimed at securing markets for their exports, notably investment goods and high technology products, and giving various forms of quid pro quo to oil-exporting countries in exchange for access to supplies. Have such bilateral deals caused significant trade problems for other countries ?

Centrally Planned Economies

80. The markets of Eastern Europe and the Soviet Union have been growing quite rapidly throughout the 1960s and in the first half on the 1970s, partly because of the ease with which these countries were able to finance their growing current account deficits with the OECD. However, even at its peak, East-West trade was of marginal importance for most Western countries, notwithstanding the existence of significant outlets for some industries or products (wheat, steel pipes, etc.) and a rather high dependence on energy supplies from the East. For a few neighbouring countries in Europe, East-West trade has nevertheless continued to be important.

(16) This issue is not limited to the oil-exporting developing countries.

81. East-West trade is essentially bilateral and still largely outside the trading system of the GATT, or internationally agreed rules(17). In this context, the difficulties experienced by several Eastern countries in servicing their large accumulated debt, or even their current imports through competitive exports, has given rise to practices(18) which create problems for the open multilateral trading system. Moreover, the fact that potential demand is very much concentrated on advanced technology sectors implies that political and military considerations are bound to play an important role for the conduct of trade policies.

Questions

- i) Taking into account the political aspects, should Member countries aim at a degree of co-ordination or concertation in their approach to East-West trade? Could this be done, for example, with regard to countertrade and to pricing practices? Should some of the present policies be strengthened, i.e. in the export credit field?
- ii) What kind of differentiation, if any, should be made amongst the countries of the Eastern group?
- iii) More generally, could more be done to progressively integrate East-West trade into the rules and procedures governing the open world trading system ?

VI. SECTORAL TRADE PROBLEMS OUTSIDE MANUFACTURING

82. Broadly speaking, the rules embodied in GATT apply to international trade in manufactures(19). For historical reasons an important part of agricultural trade remained outside these rules, and they were found of limited relevance for trade in non-food primary commodities. The expansion of international trade in services which started in earnest only after the elaboration of the rules for merchandise trade is opening a number of questions as regards their applicability and adjustment to different circumstances.

(17) In this context, it should be recalled that four Eastern European countries are formally GATT members and there have been moves towards World Bank/IMF membership.

(18) For a recent summary of the problems see Advantages and Drawbacks of Countertrade Deals (TC/WP(81)27 Confidential).

(19) An important exception is textiles and clothing where a succession of multilateral arrangements have constituted a major departure from GATT rules.

Agriculture

83. As shown in the Study on Problems of Agricultural Trade (20), the agricultural policies followed by a number of importing countries have contributed to raise their self sufficiency for a number of commodities and had a major impact on trade flows. Nevertheless, the volume of world agricultural exports has grown consistently faster than agricultural output and, while the growth of output slowed down to 2 per cent between 1973 and 1980 from 2 1/2 per cent in the previous decade, the growth of exports accelerated from 4 to 4 1/2 per cent. The major reason for this has been the emergence of important new markets in third countries where real incomes have been rising fast and/or agricultural output has been sluggish. The study also suggests that a gradual integration of domestic and international markets would create fewer problems in the more protected countries than is often thought because (in contrast to the situation during much of the second half of the nineteenth and first half of the twentieth century) the elasticity of supply in the more efficient temperate zones producers is relatively limited.

84. The central issue is how to bring agriculture gradually closer to the trading rules applied to other products in the framework of an open multilateral trading system, so as to help the optimal allocation of resources, internationally and within each country.

Questions

- i) Should more be done to co-ordinate internationally national actions to deal with major market disturbances and to establish international mechanisms to monitor market developments and to improve the functioning of agricultural markets, in particular by limiting destabilising fluctuations in prices and trade flows?
- ii) Is there scope for modifying the implementation of national agricultural policies so as to achieve their legitimate objectives, e.g. with regard to income support, with less distorting effects on trade-flows ?
- iii) How could the interpenetration of national and international markets be improved: avoidance of export restrictions, freeze of levels of protection, limitation of export subsidies with evident trade distorting effects (in particular on third markets), and eventually a co-ordinated and progressive reduction of trade barriers (perhaps first confined to a few products in which OECD producers predominate)? What about the special interests of developing countries as importers and exporters in this respect?

- iv) How to reconcile the objective of food security with the expansion of international trade, including the possibility of keeping alive spare capacities only used in times of crisis?

Fisheries

85. The OECD countries have had 200 miles fisheries zones in force since the late 1970's. Time is required for the adaptation to the new circumstances which offer the coastal states possibilities for conservation and management of the fish stocks, particularly in the North Atlantic where most of the major fish stocks were seriously depleted. In other oceans, depletion of the fish stocks was not always as serious but the mobility of the fleets would certainly have resulted in a fast extension of overfishing detrimental consequences. In the few years since effective national control has been exercised there are signs of improvement. The prospects for fish catches and processing over the longer term are now more stable than in the time of free access of all countries to the fishing grounds. In this field, OECD offers the sole international forum for timely consultations on the basis of factual transparency.

Questions

- i) What positive adjustment measures can be taken to alleviate the situation of fishing industries suffering serious production losses because of the extensions?
- ii) What are the likely trade issues which need to be addressed in view of changed circumstances?
- iii) How do government measures relating to production controls, taxation, grants and subsidies affect rational exploitation, both biological and economic and international trade in fisheries?

Primary Commodities

86. Since 1973, the slowdown in economic growth, notably in the industrialised countries, combined with continued technological changes permitting a reduction of primary inputs per unit of output and more cautious inventory policies have resulted in a marked slowdown in the trade of non-food primary commodities. Whereas between 1963 and 1973, world exports of minerals (including fuels and non-ferrous metals) expanded at an annual rate of 7 per cent in real terms, between 1973 and 1980 they declined half a percentage point annually. Though the decline was concentrated on fuels (mainly oil), the share of other minerals and agricultural raw materials in the current value of total world exports has declined from 12 per cent in the early 1970s to 8 per cent at the end of the decade.

- 31 -

SC(81)1 28

87. Despite this declining quantitative importance, preoccupations with the security of supply, in particular for strategic raw materials, have been prominent ever since the 1972/73 commodity boom and the precedent of OPEC action. Moreover, since the present excess of supply over demand for industrial raw materials could easily be reversed in a phase of expansion, preoccupation with insufficient investment in many developing countries, notably in minerals, has led to a critical examination in the framework of the OECD High Level Group on Commodities(21).

88. As a result, the policy issues in the commodity area include not only the traditional preoccupation of producers - access to import markets, price levels and instability and their increased participation in the processing, distribution and marketing of their commodities - but also the concern of consumers with the security and adequacy of supplies. Many of these issues have specific North/South aspects.

Questions

- i) What should or could consuming countries do to improve security of supply of strategic raw materials? Would there be an advantage in a concerted approach vis-à-vis economic stockpiling? Diversification of sources and investment?
- ii) What could be done at the international level to ameliorate the investment climate to ensure an adequate volume and pattern of direct investment flows? Is there merit in reconsidering international insurance schemes and/or other schemes to reduce perceived risks in direct investment? Could some form of monitoring of investment be usefully envisaged?
- iii) In addition to commodity agreements to stabilise prices, and in view of the apparently limited scope for such agreements, should renewed examination be made of the case for strengthening and extending export receipt stabilisation schemes in favour of developing countries or, more especially, the least developed countries?
- iv) What, in general, could be envisaged to improve market structures and international trade in commodities, including the reduction of obstacles to access to markets and to local processing?

(21) The Sub-Group of Experts on Investment of the High Level Group on Commodities has carried out a detailed examination of raw material investment issues (see CE/CG(81)14) and the High Level Group itself considered Member countries' stockpiling policies (see Strategic Raw Materials, CE/CG(81)15).

Trade in Services

89. At around \$550-600 billion in 1979, international transactions in invisibles (excluding transfers) were equivalent to more than one-third of world merchandise trade. This ratio has remained roughly unchanged since the late 1960s. However, the structure of international trade in services has changed considerably, under the impact of the emergence of some oil exporting countries as large exporters of capital and importers of labour and know-how. International transactions in shipping lost momentum, while there was a sustained increase in tourism and most other categories of non-factor services.

90. Although not always directly linked to international transactions, the domestic "service economy" has gained in importance in all industrial countries, and its structure is changing rapidly with the continued contraction of some traditional services and the rapid expansion of new ones, including the supply of services by manufacturing (and sometimes even agricultural) enterprises(22). These developments had a particularly marked impact on the structure of employment. The share of the labour force employed in the service sector has continued to rise and, equally important, within the sector producing goods, the proportion of employees performing service jobs increased very fast.

91. Problems in this area are considerably complicated by the highly regulated nature of most service industries and by the fact that international competition depends particularly on freedom of direct investment, the rights of establishment, and permission to carry out regulated activities. Indeed, there can be little doubt that the growth of international transactions in various services would have been considerably more rapid in the absence of existing obstacles. Considerable work has already been carried out in the OECD(23) and in GATT to identify the main problems arising in the services area. As these exploratory efforts are still underway, it is recognised that any answers given to the following questions at this early stage will necessarily be quite preliminary.

Questions

- i) On the basis of efforts to date to identify the most important categories of obstacles to trade in services (including internationally traded services and the provision of services on an establishment basis), which types of obstacles appear to be most suitable as the focus of future international efforts to reduce or

(22) In this context, the exponential growth of robotics, micro-electronics and computerised data processing activities has played a major role.

(23) For a review of ongoing activities in trade in services, see Trade in Services, C(81)147.

eliminate identified problems and to improve international co-operation in this area? What appear to be the major impediments to achieving progress through such efforts? In particular, to what extent is the motivation behind the identified obstacles based on valid non-economic public policy objectives (such as consumer protection or national security) and to what extent do the measures appear to be based on protectionist motivations or to create unnecessary obstacles to trade in services? Could a better awareness of the economic benefits of a more liberal international trading system in the services area help generate support for the reduction of unwarranted impediments? To what extent are the principles applied to trade in goods appropriate - perhaps with some modifications - to trade in services (for example, the principles of fair and open international competition, the most favoured nation principle, the national treatment principle)?

- ii) What should be the relative emphasis of sectoral (industry-specific) approaches as compared to across-the-board approaches in efforts to improve international co-operation in this area? If pilot efforts in selected sectors are deemed desirable, which sector(s) should be given priority attention? Should efforts be concentrated on the most important obstacles in each of the main service sectors? Can some categories of obstacles be more fruitfully addressed through a horizontal approach? If so, which category(ies) of obstacles should be given priority attention? How should the developing countries be involved in this work?
- iii) What would be the benefits of developing an international body of rules and procedures which would provide a coherent framework for resolving trade problems in services and contribute to enhance international co-operation in this area?

VII. THE PROCESS OF INTERNATIONAL CO-OPERATION ON TRADE ISSUES

92. The gradual build-up of machinery for international trade co-operation has been a major achievement of the post-war period. Essentially based on the principles and rules of GATT, various mechanisms of discussion, consultation and negotiation have been put into place. Besides the GATT machinery (itself institutionally linked with the IMF), organisations with different geographical coverage as well as different competences and modus operandi such as the United Nations system, the OECD, the European Community and EFTA, have played an important role in international trade co-operation.

93. To some extent it is the very success of this co-operation in terms of the expansion of trade which has brought new problems: e.g. increasing resort to measures

falling outside the agreed rules, new competitors wanting to benefit from the system (without necessarily accepting all its rules), etc. In general, co-operation has become less rule-oriented than in the earlier period. Even more important have been the strains arising from poor economic performance in terms of inflation and employment and the increasing difficulty of adjusting to structural change under these conditions.

94. Moreover, there is a risk of growing government involvement in trade questions in the 1980s. The continuation of various trends discussed in previous sections may contribute to such an involvement. First, the continuing growing importance of exports of machinery and equipment (including complete plants) and high technology products, i.e. areas where governments are often already involved domestically (R and D, government procurement) and where conditions of delivery - finance, technology transfer, performance requirements, counter trade, etc. - often lead to government involvement in trade relations. Second, as noted earlier, up to one-half of the increase in trade in the 1980s is likely to be with developing and state-trading countries with strong government involvement in trade. Some of these countries might be tempted to orient their purchases of machinery and equipment to those developed countries which treat their exports more liberally. Third, in the field of development assistance, there is the growth of mixed credits and tied aid. Fourth, there is the increasing importance of trade in services, often in areas which have traditionally been subject to much regulation.

Directions for Improvement

95. Against this background, several major themes emerge from the previous sections as regards the directions in which improvements in the process of international trade co-operation might be sought in the 1980s.

96. First, there is a need to broaden the coverage in international trade co-operation to include a wider range of domestic policies having an effect on international competition. Partly as a result of trade liberalisation, the trade-distorting effects of domestic-policy measures have become more perceptible. And, as discussed in Section III, government intervention at the micro-level, in particular in the framework of industrial, technological, regional and employment policies, has been on the rise in many countries. Irrespective of the merits of such interventions destined to achieve domestic objectives and of their usefulness in promoting promising activities, their scope and impact are highly relevant for the play of market forces and hence for international trade co-operation.

97. Recognition of this situation led to the inclusion of non-tariff barriers in the last MTNs. The existing codes give, however, only a partial and limited answer to the question,

which is how to reconcile government intervention at the micro-economic level with the principles and objectives of the open trading system. While governments are naturally reluctant to accept limitations on the use of domestic policy instruments, they have, in the context of the OECD's work on positive adjustment policies, been prepared to discuss these instruments from the point of view of their economic efficiency. Perhaps more attention should be paid to the possible trade-distorting effects of such policies. Admittedly, the effect of domestic interventions on international trade is often difficult to analyse with any precision. Nevertheless, the multiplication of such interventions, frequently designed and implemented by officials not fully aware of international implications, can gradually undermine the benefits of the open trading system. Recognition of this danger has been behind the efforts of the European Communities to clarify and regulate interventions which impinge on competition among Member countries.

98. Second, it has become more necessary to consider trade problems and policy responses in their broader economic policy context. The previous sections have elaborated the various interlinkages between micro-economic policies, balance-of-payments adjustment, development policies, etc. and trade problems. These linkages have been weakened by the fact that industrial countries (as well as several developing countries) have ceased to introduce import restrictions on balance-of-payments grounds. Hence their macro-economic policies are no more considered in the framework of GATT. However, both macro-economic and trade policies are scrutinized in the IMF when countries seek balance-of-payments financing facilities. By treating trade problems and policy responses in isolation, the scope for optimal policy responses or for the settlement of disputes is much reduced. It is important to have around the table, with an appropriate weight, all the major interests involved, so that broadly based compromises and solutions can be found. For instance, discussions or consultations on import restrictions should bring in those responsible for anti-inflationary policies and industrial adjustment, so as to ensure the genuinely temporary character of any safeguard measure in trade which would be deemed necessary. Another example is to involve in international consultations concerning trade restrictions those responsible for macro-economic policies and balance-of-payments adjustment, so that, for example, the question of the appropriateness of the exchange rate can be squarely faced. All these questions raise, inter alia, the possible need for closer working relations between the GATT, the IMF and the OECD.

99. This broadening of the discussion raises a fundamental problem. Both domestic micro-economic interventions and trade policy measures can in time have adverse effects on efficiency and the range of consumers' choice, and hence on the real income and well-being of the population. But, whereas the short-term benefits of such measures on employment, wages and profits are highly visible and concentrated, the long-term

adverse effects on inflation, efficiency and the standard of living are much more diffuse. This asymmetry is a factor facilitating collusive pressures by organised business and labour. Normally Governments, notably Treasuries, are concerned with the interests of consumers, though the latter do not constitute a distinct entity. This raises questions as to how effectively these interests can be taken into consideration. International Organisations less subject to pressures from interest groups have a role to play in this respect as custodians of the system and its contribution to economic welfare and efficiency.

100. Third, it will be necessary to adjust to the growing number of important participants in international trade. This is particularly so in the case of NICs and some oil-exporting countries, but also for some state-trading countries. Their growing importance has generally not been reflected in the process of international trade co-operation, in which they do not fully participate. To a large extent, industrialised countries have adapted themselves to various trade practices of these countries, with only marginal progress towards their integration in the world trading system. The reasons are obviously not the same for the various groups of actors considered. Neither would the ways and means to improve the co-operation process be similar in all cases.

101. Generally, the large number of countries complicates the process of co-operation, especially at the global level: at the same time, the mechanisms should ensure that all countries directly concerned are involved in some way. The UNCTAD framework is useful for pursuing the North-South dialogue at a general level, and for the search for consensus on broad policy approaches to trade between developed and developing countries in the wider context of North-South economic relations. However, because of its structure in the form of geographical groupings, and its more political character, UNCTAD may not be well placed to deal with specific and concrete trade problems involving particular developed and developing countries.

102. The GATT is better placed to fulfil this function. At the same time, however, the concern not to give away legal rights and for developing countries in particular not to accept new obligations can reduce the scope for fruitful co-operation on specific trade problems. Also, some important developing countries have not yet joined GATT. The question also arises whether consultations on these problems with developing countries should not be broadened beyond these trade policy aspects, to include inter alia, the trade implications of the domestic policies pursued by, especially, the NICs. This raises issues concerning improvement or adaptation which may be needed in the institutional setting in order to allow such a broadening and to take account of the differences in the setting of trade and trade policy problems according to the stage of development among developing countries.

103. "Countervailing power" may also be considered in terms of country participation in the process of solving trade problems, an issue becoming more difficult with the growing number of major trading countries. There has indeed been a tendency in recent years for trade problems to be considered in bilateral terms and for consultations to be restricted to those countries having a major and direct interest in those problems. It can be argued that consultations in a completely open framework would reduce the efficiency of the consultation procedure by reducing the possibility of frank and pragmatic discussions. The difficulty of setting up appropriately restricted fora may, inter alia, explain the increased use of bilateral consultations outside the multilateral framework. On the other hand, participation of countries less directly concerned can bring about a better balance of power as well as ensure greater attention to the broader interests of all partners and to the smooth functioning of the trading system as a whole.

The Mechanisms of Trade Co-operation

104. Trade co-operation rests on certain key mechanisms: rules and guidelines for policies; consultation on problems arising out of trade or trade-related policy measures and practices; procedures for the settlement of disputes; consultation on trade problems and related industrial and other issues before they reach critical levels and before policy action is taken; mechanisms allowing for improvement in the trading system and its functioning.

105. Rules elaborating some fundamental principles are a key feature of the international trading system. They are a factor of certainty in international trade relations: they reduce the risks of problems and serve as points of reference for the settlement of disputes. Some argue, however, that excessive emphasis on strict adherence to rules may tend to undermine them and it can be preferable, in some cases, to tolerate some minor departures in the interest of preserving the legal framework. Nevertheless, it would seem that strengthening or adaptation of existing rules, as well as setting up new rules in areas not covered, should continue to play an important role, and there have been several examples in this note (e.g. safeguards, trade in services, etc.) where this might give positive results.

106. It must be acknowledged, however, that there are limits to a regulatory approach. It is not possible to express the complexity of economic reality in precise rules, so that they must include some degree of flexibility. In some areas, therefore, it has proved useful to complement rules by seeking a political commitment on certain general objectives, and establishing guidelines for policies to be followed, taking into account the interlinkages between various policies. The guideline approach has been successfully used for a number of issues tackled in the OECD (e.g. restrictive business practices, MNEs, etc.). This should not detract from the

importance of a system of rules and binding commitments, in particular in the trade field, and of strict adherence to the rules giving credibility to policies.

107. The consultation and the dispute settlement procedures have been improved in the MTNs. However, the setting in motion of these procedures depends on requests perceived as complaints which countries are in many cases reluctant to introduce. An avenue that might be explored is to enable representatives of the "countervailing power" (e.g. consumer groups, officials in charge of national competition policy, officials of international organisations), to take the initiative of consultations. In addition, the consultations are in general limited in their scope to the strictly trade policy aspects as covered by specific provisions. Broader, and especially, macro-economic considerations or interlinkages between various policies are perhaps not given sufficient weight. The Panel system now widely used in the GATT is designed to provide the basis for more objective assessment of the case and for the exercise of countervailing power. Could further steps be made in this direction by allowing various domestic or international interest groups to express their views?

108. Trade problems are not necessarily related to existing trade policies or practices but, as presently often the case, rather to major tensions on specific markets resulting from changes in demand and in comparative advantage. In such cases, there may be a question whether early consultations on emerging market imbalances before action is taken, taking into account macro-economic as well as trade aspects, could help to find solutions which represent an optimal policy-mix from the point of view of economic efficiency and of the functioning of the trading system.

109. In recent years, with increased difficulties, there has been an expansion of consultations on sectoral trade problems. With few exceptions, however, most of these consultations have been bilateral or on a restricted basis outside the multilateral framework. While bilateral or otherwise restricted consultations are recognised as part of the process of international co-operation, they cannot be a substitute for, but should be integrated in multilateral approaches to trade problems. In fact few, if any, problems are of a strictly bilateral nature. Solutions adopted may have implications for trade in general, well beyond trade flows between the partners involved and even the sector or products concerned. Bilateral consultations do not always ensure that the interests of other partners are taken properly into account, and lack the kind of countervailing power which may be necessary for the identification of the optimal solution for international trade and the trading system as a whole.

110. To sum up, there is a case for more use of broadly based forms of multilateral consultation. The question is, however, to decide on what criteria and on whose initiative they should

40

be set in motion. Another question concerns the appropriate participation of countries, which both allows all relevant interests to be taken into account, but also facilitates frank and concrete discussions. In addition, participation should allow consultations to take into account the broader economic aspects of the trade matters under consideration. Arrangements for such consultations should be essentially pragmatic and avoid being too formal or overburdening the officials involved.

111. Whatever the improvement in the mechanisms, the solution of trade and trade policy entirely rests on political will or good will of partners. There is no way of imposing decisions, nor of enforcing application of rules, which the countries in question would see as running against their apparent interests. Neither compensation nor retaliation is satisfactory from an economic point of view, and retaliation can be counter-productive and harmful for the trading system. Determination to safeguard the system, partly underpinned by the fear of a chain reaction combining imitation and retaliation, should be a strong incentive to find mutually acceptable solutions to trade problems. But, in addition, it is of paramount importance that the fundamental interests of the various partners can be brought to light in the process of international trade co-operation.

112. The process of international co-operation on trade issues has been examined in this section from the point of view of its present apparent deficiencies and directions in which it might possibly be improved. The implications at the institutional level have generally not been considered. There is no suggestion that any additional organisation should be set up. Nor have suggestions been made as to the kind of adaptation or improvement in the present institutional arrangements which might be called for. It is clear, however, that there are a number of important issues in this respect which might deserve consideration.