GENERAL AGREEMENT ON TARIFFS AND TRADE

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IMF: STATEMENT BY J. DE LAROSIERE, MANAGING DIRECTOR OF THE INTERNATIONAL MONETARY FUND, AT THE MEETING OF THE GATT CONTRACTING PARTIES AT MINISTERIAL LEVEL, 15-19 SEPTEMBER 1986[1], PUNTA DEL ESTE, URUGUAY

It is almost four years since I last had the opportunity to address this distinguished group. During that period the problem of protectionism has become even more entrenched. In the industrial world there has been a proliferation of voluntary export restraints, market-sharing arrangements, quotas, and subsidies. In most cases, these have been applied on a bilateral or sector-specific basis. At the same time, the developing countries have made only limited progress in dismantling their own array of trade restrictions.

In my remarks today, I want to highlight the risks to trade, growth, and international co-operation that are posed by protectionism, and to outline what can and urgently needs to be done about it.

1. The world economic situation

The world economy is in a delicate transition period. The early part of 1986 was marked by a number of problems. Despite lower interest rates and lower oil prices, the pace of activity in industrial countries slowed. World trade growth was sluggish and primary commodity prices - which were already at an historical low - weakened further. Developing countries' terms of trade, real export earnings, and real imports all declined - and this at the very time when they were struggling to restore creditworthiness and to achieve satisfactory growth. In addition, flows of private financing tapered off, and there were large current account imbalances among the three largest industrial countries.

Prospects for 1987 are somewhat better. The effects of lower interest rates and lower oil prices should become increasingly evident in final demand of industrial countries and thereby provide a welcome boost to trade and growth worldwide. Our own projections suggest that real output should rise by about 3 per cent next year in industrial and developing countries alike. Similarly, as exchange rate changes have time to affect trade volumes, the external imbalances of the United States, the Federal Republic of Germany, and Japan should begin to shrink.

But there is nothing automatic about getting from here to there. Industrial countries need to move forward to eliminate those financial imbalances that threaten the sustainability of growth. It is crucial - not

[1]Delivered on behalf of the Managing Director by C. David Finch, IMF Counsellor and Director of the Fund's Exchange and Trade Relations Department.

only for the United States but for the world economy as a whole - that the planned reduction in the United States budget deficit be implemented without slippage. Developing countries need to pursue policies that will generate more domestic savings, maintain external competitiveness, improve domestic resource allocation, and restore overall financial stability. And international co-ordination must be nurtured, so it can assure mutual compatibility of policies among large countries, and help to mobilize enough financing to support genuine policy reform in the developing world.

2. The great dangers of protectionism

These are formidable challenges. The stakes are too high to countenance failure. Yet the entire endeavour is being put in jeopardy by a steady assault on the open international trading system. Let me elaborate.

The developing countries are facing a heroic task. With real per capita income still below 1980 levels in many countries, there is a compelling case for growth. But they also confront heavy debt service obligations. If they are to achieve both of these objectives simultaneously, they must be able to export. By restricting these countries' access to their most important market, protectionism ties one hand behind their backs. It depresses aggregate demand, reduces the supply of foreign exchange necessary for imports and debt service, discourages investment in the export sector, and limits economies of scale. The truth must be said: if debtor countries are to enact reforms that orient their economies more toward exports and are to continue to service their external debt, creditors cannot deny them the incentives and means to do so.

But protectionism does not reside exclusively in the North. The developing countries themselves maintain a broad range of trade restrictions. The GATT recognizes that there can be legitimate infant-industry arguments for protection. Too often, however, trade restrictions are kept in place when these arguments have long since ceased to apply. Equally, import restrictions for balance-of-payments purposes, which are permitted under the GATT, cannot really corrct the underlying imbalances and, indeed, often simply delay needed adjustments. The consequences of protection by developing countries for world trade and growth are adverse. With about a quarter of industrial country exports now going to developing countries, increases in trade restrictions by developing countries only exacerbate growth slowdowns in the industrial world and produce negative feedback effects on their own exports. Such protection also limits the scope for trade among developing countries. It hampers the extent to which exports can be redirected to developing country markets when demand for imports in the industrial world slackens. Finally, it weakens the pressure for trade liberalization in industrial countries.

Protectionism does not just adversely affect a country's trading partners. Indeed, experience shows that the costs for the country imposing the restrictions are just as serious. Consumers pay more for what they buy; firms lose the incentive to find and to apply cost-saving techniques; resources get locked into low-productivity sectors whose comparative

advantage has long since disappeared; and exporters find it difficult and expensive to obtain the imported inputs they need. With little pressure for efficiency and for change, structural problems only get worse, and growth and real incomes suffer. The historical record is clear: countries that attempt to seal themselves off from the world economy grow more slowly and have more trouble in adjusting to shocks than those that do not.

Last but not least, protectionism poisons the well of international co-operation. Trade policy, exchange rate policy, and financial policies cannot be kept separate from one another. We have seen how large exchange rate misalignments can magnify the pressures for protectionism. By the same token, the trade conflicts engendered by protectionism spill over into other policy areas. International co-ordination requires countries to take better account of the international repercussions of their own policies. Protectionism is the antithesis of that principle. During the past year we have made some real headway in strengthening the commitment to, and the practice of, international co-ordination. The Plaza Agreement, the broad co-operation on the debt strategy, the reductions in interest rates, and the establishment in the Fund of the Structural Adjustment Facility - all stand as testimony to what can be accomplished. But that spirit of co-operation is still fragile. We must not allow it to be snuffed out by discord in the trade area.

3. The upcoming trade negotiations

Given the evident dangers and costs associated with protectionism, one may ask: why is it so widespread? One reason has to do with the political process. Concentrated producer interests are usually able to lobby more strongly for protection than are comparatively less well organized and more diffuse consumers and taxpayers. A second reason is that there are, unfortunately, still some popular myths about the effects of protection. One of them is that trade restrictions will allow a country to correct a deficit in its current account. But the truth is that current account balances are governed by fundamental savings and investment relationships. Slapping a restriction on imports of a particular product or industry will do nothing to alter these macro-economic relationships. It will only lead to increased imports of unprotected commodities and to a risk of retaliation. Another such myth is that protection will lead to an increase in employment. The truth is that it will not increase total employment: it will simply shift employment from efficient export industries to inefficient import-competing ones - hardly a good bargain in the long run. In addition, each job that is "saved" in the protected industries can wind up costing consumers a great deal, with one recent study placing that cost at between four and nine times the average annual wage in those industries.

But this still begs the fundamental question: how can the drift toward protectionism be arrested and reversed? Better information about the true effects of protectionism would help but is unlikely to be enough. In my view, the answer is to be found in the post-war experience of international economic co-operation. Its basic premise - that global economic problems require outward-looking and growth-inducing solutions -

is equally valid today. An active effort from all parts to liberalize trade is necessary to restore this global view.

In the course of the upcoming trade negotiations, governments will be confronting a large number of complex and interrelated issues on trade policy. Let me therefore offer a few guideposts.

First, governments should aim at restoring the primacy of non-discrimination in trade. If selectivity, bilateralism, and discrimination become the norm, the very basis for a fair and efficient expansion of world commerce will be destroyed. In this connection, the proliferation of voluntary export restraints and the recently extended Multifibre Arrangement are causes for concern.

Second, a primary objective of the negotiations should be to secure as broadly based a trade liberalization as is possible. This means that not only tariffs but also non-tariff barriers should be addressed seriously. All participating countries should contribute to, and gain from, the negotiations. The scope for such mutual gains will be enhanced if liberalization includes not only manufactured products but also trade in agriculture and services. Comprehensive trade rules provide a proper framework for the conduct of trade policy. In this respect, the reinstatement of an effective safeguard system would fill an important gap that has been in evidence since the Tokyo Round.

Third, a way should be found to deal with the problem of subsidies. They hinder structural adjustment, enlarge fiscal deficits, and provoke retaliatory actions by trading partners. Subsidies applied to primary products are particularly worrisome in present circumstances when world prices of these products are under such retreat.

Finally, the GATT system itself should be strengthened. Governments have given the International Monetary Fund broad responsibility to exercise surveillance over exchange rate and macro-economic policies. An enhancement of GATT surveillance in the trade field would go a long way toward making permanent the commitment to liberal trade that must underlie these negotiations.

4. The rôle of the Fund

The Fund and the GATT are natural allies. The international monetary system cannot function effectively with rising protectionism, just as the international trading system depends upon a smoothly functioning international payments system. Both institutions seek to promote positive interaction between international transactions and economic growth. In the GATT, countries are expected to remove bilateral and discriminatory restrictions and to rely exclusively for domestic protection on most-favoured-nation tariffs. In the Fund, members are expected to liberalize restrictions on payments and transfers for all current international transactions and to follow sound exchange rate policies.

The Fund's activities recognize this close complementarity in several ways. The Fund periodically conducts consultations with all its member countries under its Article IV. Since 1983, the coverage and analysis of trade policy matters in such consultations has been expanded. The Fund supports adjustment programmes that are designed to overcome payments problems and to promote durable economic growth. In so doing, it helps member countries to maintain open trade and payments systems. Under Fund-supported adjustment programmes, members refrain from imposing new - or intensifying existing - import restrictions for balance-of-payments purposes. Where member countries are placing undue reliance on trade restrictions, the Fund - working closely with the World Bank - encourages liberalization. Finally, the Fund collaborates closely with the GATT, not only in the conduct of balance-of-payments consultations under the GATT's Articles but also on other matters of mutual interest.

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The international trading system, much like the exchange rate system, is meant to be a facilitating mechanism for more fundamental economic objectives, such as sustainable economic growth, price stability, high employment, and a balanced expansion of world trade. But over the past few years, that well-conceived plan has received insufficient attention. Trade actions have become part of our economic problems rather than part of the solution to them. The upcoming round of multilateral trade negotiations provides an important opportunity to reverse this negative trend and to reinstate trade policy as an engine of economic growth and efficiency. It is an opportunity that the international community can ill afford to let slip by.