

✓GENERAL AGREEMENT ON TARIFFS AND TRADE

RESTRICTED

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STRUCTURAL ADJUSTMENT AND TRADE POLICY

1. In the past four years the question of structural adjustment had been extensively discussed in the GATT. It has been on the agenda¹ of the CG.18 four times, on the basis of three separate papers, and the Working Party on Structural Adjustment and Trade Policy, whose creation was originally proposed by the CG.18, carried out a very thorough review on the basis of which they reported to the Council in October 1983². It is not the purpose of this note to recapitulate these debates, and still less to re-open them: indeed, we suggest that the conclusions of the Working Party, which are annexed, accurately reflect the present state of thinking about structural adjustment among contracting parties, so far as it has been possible to reach common views on the subject, and might be taken by the CG.18 as the starting point for its own discussion. The main purpose of the present paper is therefore to identify a number of questions which remain open and to enable the Group to consider whether any conclusions of an operational kind can be drawn from the work that has been done.

2. The reason for the concentration of so much attention on structural adjustment, which has been noticeable in many other organizations besides GATT, is the recognition that many of the problems besetting the trading system since the early 1970s have been caused by the difficulties economies have had in adjusting to pressures for change. These difficulties appear to have increased considerably in this period, for three main reasons: pressures for change have been particularly strong and numerous; the generally depressed state of the world economy has made the adjustment process more painful and politically delicate than usual; and uncertainty deriving from these factors, plus a growing shortage of capital, have reduced the investment flows which are the main vehicle of adjustment. In addition, some would argue that policy-induced rigidities have reduced the flexibility which all economies need if opportunities for profitable re-allocation of resources are not to be missed.

¹CG.18/11,12,13 and 14 and CG.18/W/37,39 and 41.

²The Report of the Working Party on Structural Adjustment and Trade Policy (L/5568) received a preliminary examination in the Council, which will revert to it in the light of the views expressed in the Committee on Trade and Development and the Consultative Group of Eighteen. The Working Party considered that attention should continue to be focussed on the question and recommended that the Council decide how this should be done.

3. It is in fact evident that adjustment problems underlie most of the major issues and difficulties besetting the trading system. Let us consider some of the most obvious examples:-

- Safeguards. Safeguard action, whether taken in conformity with GATT articles or not, is very frequently justified by the claim that it is necessary to provide time for the protected industry to adjust to competition from imports. Measures taken under Article XIX may last for "such time as may be necessary to prevent or remedy" injury; the fact that they are supposed to be temporary implies that an adjustment process is expected to take place. At the same time, it is clear that industries may become vulnerable to injury caused by the importation of competing products precisely because they have failed to adjust in time to changing market conditions. The effect of a safeguard measure is to relieve the pressure for such adjustment. There is thus an implicit contradiction between the stated objective and the immediate effect of the measure taken, which may explain why many safeguard measures, both legal and illegal, have proved extremely difficult, if not impossible, to eliminate.

- Subsidies. Similar considerations apply to subsidies, which are one of the most commonly used forms of "adjustment assistance" to industries in difficulty and to those believed to have high growth potential. It frequently happens that a subsidy ostensibly granted to facilitate adjustment has the effect of reducing the adjustment pressure exerted by competition. The subsidized industry may thereby be weakened and develop a long term dependence on the subsidy. The impact on the interests of third countries will rarely be as obvious as in the case of safeguard measures, but it may often be serious. Even where a subsidy policy is motivated less by economic than by social considerations, such as the desire to maintain a large population in rural areas, the effects on economic structures and on international competition may be very marked. To the extent that subsidies can be used for the improvement of industrial structures, the question arises whether it is possible to distinguish types of subsidy which are actually likely to have this effect from other domestic subsidies, and whether the distinction can be given any operational value.

- Textiles. This is a particularly interesting case because the Multi-Fibre Arrangement requires that actions taken under it should not interrupt or discourage the "autonomous industrial adjustment process". The Textiles Committee has established a Sub-Committee on Adjustment to examine reports by importing participants on their adjustment policies and changes in their textile and clothing

industries. Adjustment may indeed have taken place, but the fact that after 23 years a special protective regime is still in force in this sector indicates that it has been inadequate to enable the protected industries to compete internationally.

4. Although it is very easy to perceive these relationships between GATT obligations and the adjustment process, it is less easy to see how this perception could be given operational force. The only direct reference in the General Agreement to the role of governments in promoting or impeding adjustment appears in the interpretative note to Article XXXVII:3(b), on the basis of which, in the 1960s, the Group of Experts on Adjustment Assistance Measures examined measures applied by industrialised countries. In debating the role of the GATT in this area, contracting parties have generally agreed that governments have a responsibility, through their general economic policies, to try to maintain an environment which favours the efficient operation of markets, increases the speed and ease with which economic resources can be allocated to the most productive uses, and stimulates investment and innovation. There is considerable divergence of opinion, however, about the desirability and utility of direct intervention by governments in the adjustment efforts of specific industries or firms, even though most, if not all, governments practise such intervention to a lesser or greater degree.

5. Thus, many governments defend their use of tariffs, quota restrictions or exports subsidies, as well as domestic subsidies and other forms of assistance, as being necessary to restore the viability of ailing industries or to promote the flow of resources into new ventures. But the same governments may well be greatly concerned about the distortion of competition resulting from similar sector-specific measures when practised by other countries. It is understood that there are political and social constraints on the speed with which adjustment can take place: all governments know that to delay or prevent adjustment entails costs which may be heavy, and they are fully entitled to decide that in some cases these costs have to be borne. International conflicts arise when the measures adopted to smooth the adjustment process have the effect of transferring part of the costs to other countries.

6. Such conflicts seem likely to increase in number and severity unless governments show greater readiness to resist the temptation to find scapegoats abroad for domestic adjustment problems, and this probably entails major efforts to educate public opinion on the functioning and value of the open trading system. Within national economies, technological developments are producing large shifts in the use of resources and in existing supply-demand relationships. Between countries, the rapid diffusion of technology is bringing forth new centres of production and quick changes in conditions of competition. Slow growth and what appears to be a long term problem of relatively high levels of unemployment no doubt increase the difficulty of coping with these developments. It would be rash to expect that economic recovery would in itself bring about improvements in production and trading structures that would relieve governments of continuing pressure for protectionist action.

7. The conduct of their domestic and border policies by contracting parties clearly needs to reflect the consensus that adherence to GATT rules and the furtherance of trade liberalization is the most effective means of promoting adjustment and avoiding conflict. There may also be a need to consider at high level whether governments can co-operate in ensuring that measures taken to alleviate the political and social problems which accompany structural change do not create additional difficulties for third countries. A related question which requires examination is how, in their efforts to promote structural change through support for innovation and research, for example, governments can avoid creating new distortions of competition.

8. The following questions are put forward as an aid to discussion:

- i) Is it possible to do more in the GATT to promote continuous adjustment? If the main requirement (after the maintenance of general economic policies conducive to flexibility) is that contracting parties should implement their existing obligations under GATT, is additional action necessary to ensure that the rules are applied?
- ii) How could it be established whether safeguard measures were in fact required to enable rationalisation or restructuring of specific sectors, preparatory to the reopening of these sectors to international competition, to take place with a minimum of social cost?
- iii) Should the existing rules be supplemented - for example by a provision that all safeguard measures should be accompanied by a structural adjustment programme which would ensure their removal in accordance with a pre-determined timetable? If so, how should such provisions be enforced?
- iv) Is there a need for an understanding among contracting parties as to the appropriateness of adjustment assistance measures, such as cash benefits, retraining schemes or other means of promoting job mobility, which may be taken by governments to deal with employment problems arising in industries or geographic areas affected by structural change? How far would there be a special case for assistance when these problems are related to import competition or other changes in trading conditions?
- v) Is it possible to develop criteria permitting a distinction to be drawn between subsidies which have the effect of promoting structural change and other domestic subsidies?

- vi) To what extent would governments be prepared to submit their structural adjustment policies and programmes for information to GATT and to consult about them, not only when specific difficulties arise for another contracting party under one or other provision of the General Agreement, but also as a means of avoiding such difficulties and promoting greater consistency of policy objectives?

ANNEXCONCLUSIONS OF THE REPORT OF THE WORKING PARTY ON
STRUCTURAL ADJUSTMENT AND TRADE POLICY (L/5568)

1. The Working Party considered that the exercise it had undertaken had led to a better understanding of the adjustment process in general and the role played by government policies in influencing the interaction between structural adjustment and international trade. In particular, it had enabled contracting parties to gain a better appreciation of the ways other governments viewed the adjustment process and its relation to trade policy in their respective countries.

2. The Working Party recognized the importance of, and need for, continuous structural adjustment in economies for their long-term growth and development. It saw adjustment in response to changes in the international trading environment as an important element in this more general process.

3. The Working Party noted that many factors, both national and international, including the macro-economic environment, gave rise to adjustment pressures and that it was sometimes difficult to assess their relative importance. International trade was, however, seen as an influence in every country, though its impact varied between countries and sectors. It is one of the key mechanisms through which pressures on economic structures in one country and policies to deal with such pressures come to affect other countries and to influence economic structures in them.

4. The Working Party noted that in certain sectors rigidities that hindered adjustment to structural change could give rise to pressures for protective measures and adversely affect international trade; at the same time domestic measures affecting structural adjustment could have important trade effects. In this connection, the agricultural sector and a number of industrial sectors, including some of special interest to developing countries, were referred to. The Working Party noted that many governments employed measures to influence the pace of structural change in specific sectors, and that these measures sometimes have adverse trade effects - and thus repercussions for trading partners as noted in paragraph 42. The Working Party stressed the importance of flexibility in economies, and government policies which facilitate such flexibility, for the smooth and rapid accommodation of adjustment pressures arising from imports as well as from other sources. Such flexibility reduces the risk of the accumulation of adjustment pressures that can lead to demands for protection; inflexibility increases this risk.

5. The Working Party believed that the GATT provides a framework for dealing with trade difficulties arising from the trade effects of measures bearing on adjustment as these relate to GATT rights and obligations, but noted the widespread view that its effectiveness in doing so was diminished because certain GATT provisions were not being fully implemented and because of the limitations of GATT rules and procedures in certain areas.

6. The Working Party believed that by promoting the liberalization of trade through the conduct of successive rounds of trade negotiations, the GATT had facilitated structural adjustment, though the degree to which this had happened had varied from sector to sector. Thus, while considerable liberalization had taken place in some industrial areas, less had taken place in other sectors including agriculture. The Working Party also believed that the GATT contributes to adjustment to the extent that it has succeeded in promoting a stable and predictable trading system and discouraging the use of trade measures that can impede adjustment.

7. The Working Party considered that the main contribution that the CONTRACTING PARTIES could make to the adjustment process would be to abide by their obligations under the GATT, to ensure strict adherence to GATT rules and to support and improve the GATT trading system, so as to further the fulfilment of the objectives of the GATT, including those in Part IV. By so doing, the GATT would also contribute towards the creation of an improved macro-economic environment for the adjustment process. Stress was placed on GATT's work in regard to further trade liberalization, especially in areas such as agriculture, and on the full implementation of the Ministerial Declaration of 29 November 1982, including the work on a comprehensive understanding in the safeguards area. Stress was also placed on the need to avoid trade difficulties for developing countries.

8. The Working Party believed that the exchange of information and examination of national experiences in regard to structural adjustment had been particularly valuable in providing insights into the nature of the adjustment process and the factors affecting it. The Council should ask relevant GATT bodies to take into account the insights gained and conclusions reached in the Working Party. The Working Party considered that the GATT should continue to focus attention on the question of structural adjustment and its relation to trade, in the light of the conclusions in paragraphs 1-7 above. It recommends that the Council decide how the above might be undertaken.