

# GENERAL AGREEMENT ON TARIFFS AND TRADE

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## STRUCTURAL ADJUSTMENT AND TRADE POLICY

### Note by the Secretariat

#### I. Introduction

1. According to the GATT Work Programme adopted by the CONTRACTING PARTIES at the Thirty-Fifth Session in November 1979, the Consultative Group of Eighteen is to examine the subject of structural adjustment and trade policy and to advise the Council, and through it the Committee on Trade and Development, on the modalities for carrying out further work in this area. At its eleventh meeting in March 1980, the Consultative Group had a first exchange of views on the subject. The Group had at this meeting before it a discussion paper on adjustment policy prepared by the secretariat (CG.18/W/37) and a paper distributed at the request of Ambassador K.G.A. Hill, alternate member from Jamaica (CG.18/W/39). The present paper has been prepared in the light of the comments made at the last meeting in order to help the Group to further clarify the issues involved and to come to a consensus on the approach to structural adjustment problems in the framework of GATT.

#### II. The process of structural adjustment

2. A dynamic economy has to adjust continuously to changes in the conditions of supply and demand in specific products and factors. Thus, resources need to be reallocated in response to changes in technology, comparative advantage, taste and relative prices and scarcities. Without such reallocations an economy cannot grow. Thus changes in the relative use of energy resources and in production structures are a necessary element in the adaptation of economies to the recent increases in oil prices. Adjustments to import competition represent in general only a minor part of the resource reallocations that must take place if an economy is to grow.

3. Economically sound structural adjustments create a flow of benefits for the society at large by making the economy more efficient. But the adjustments also create costs for the individuals affected by this process: their capital stock may be devalued, their skills may become obsolete, and they may have to move to new surroundings and occupations. Entire towns or regions can be affected by a decline of a particular firm or sector. However, these adjustment costs are temporary while the corresponding benefits are permanent; and, if the adjustment is economically sound, the present value of the flow of benefits is necessarily greater than the present value of the flow of costs.

### III. Adjustment policies

4. In market economies most structural adjustments are undertaken in response to price signals by the economic agents themselves within a broad framework of rules enforced by the government but without specific policy interventions by the government; the absence of obstacles to competition is sufficient to ensure that the adjustments take place promptly and effectively. In the context of international trade the commitment of governments to an open trading system and to common rules and disciplines which ensure the stability and predictability of trading conditions is, in itself, a major factor in the incentive to adjust.

5. Specific government interventions are in principle only required to ensure an economically efficient adjustment process if there are gaps between social and private costs, as in the case of the costs of urban congestion or pollution, or if there are market imperfections, such as monopolistic practices or rigidities arising from entry barriers, fixity of labour costs, scale economies and similar factors. A particular element which needs to be taken into account is the persistence of high rates of inflation which by creating uncertainty inhibit movement of resources for new investment.

6. Innovation, and the structural adjustment thereto, can in general neither be mandated nor permanently suppressed by governments. However, governments can to some extent determine the speed and direction of the process of innovation and adjustment by creating incentives or obstacles to innovate and adjust. Their adjustment policies can be negative, because they hinder resources from moving to the production of goods in declining to that of goods in increasing demand, from less to more efficient production methods and away from sectors in which the country is losing its comparative advantage. The governments' policies can also be positive in the sense that they facilitate resource shifts towards the production of goods in increasing demand, more efficient production methods and sectors gaining in comparative advantage. One can further distinguish between general adjustment policies that in principle affect all economic agents and selective policies that discriminate between products, sectors, firms or regions.

7. General negative adjustment policies would comprise the creation of fiscal disincentives to invest, regulations that make it more costly to change jobs, to train for a new job or to resettle. General positive adjustment policies would comprise measures to enhance competition, the investment climate, the geographical and occupational mobility of labour and the training of the labour force. Selective positive adjustment policies might include governmental research grants to particular enterprises, such as grants to develop new sources of energy, loans or grants to firms to facilitate scrapping of equipment or payments to workers in threatened sectors to help them seek new employment or to migrate to new locations. Selective negative adjustment policies include the imposition of tariffs to help an ailing sector, the grant of subsidies to a loss-making enterprise or government procurement regulations favouring domestic industries unable to face import competition.

8. A government empowered to influence the process of structural adjustment in a particular sector will tend to be exposed to conflicting political pressures: on the one hand to the pressure of certain groups desiring to avoid or postpone adjustment, and on the other to the general pressure towards economic growth and hence rapid adjustment. Since the costs of adjustment are concentrated on specific groups while its benefits are widely spread throughout society, the balance of political pressures and counter-pressures will in general tend to favour a slow-down rather than an acceleration of the adjustment process. The more selective an adjustment policy is, the more information the government needs to obtain from the affected economic agents to implement its policies and the greater the stake of these agents in the policy. This may shift the influence over the adjustment process from the government to organized sectional interests with the consequence that policies intended to promote adjustment can become more and more defensive as they are implemented. The pressure towards an avoidance of adjustment is likely to be particularly strong if the adjustment inducing competition comes from abroad because the foreign competitors tend to carry less weight in the political decision-making process than domestic competitors would.

9. The slow economic growth that has prevailed since the early 1970's has induced many governments to adopt selective negative adjustment policies aimed at maintaining employment opportunities in particular sectors. Moreover, even where measures of assistance have been originally meant to be temporary and linked to schemes for reorganization or rationalization of the effective sectors, they have in actual practice and under the pressures of vested interest created by the assistance tended to become long-term and wholly defensive in character.

10. The establishment and administration of a legal framework designed to remove and prevent selective negative adjustment policies in the form of restrictive import measures and subsidies has been one of GATT's main contributions to the industrial restructuring that has taken place since the Second World War. This may be expected to be a major GATT contribution to the structural adjustments that will take place in the future, in particular those required by the industrialization of the developing countries.

11. The GATT has long discouraged the use of export subsidies. The recently implemented Code on Subsidies and Countervailing Duties, while recognizing that domestic subsidies may serve legitimate policy objectives also provides for increased surveillance and possibility of multilateral action with respect to the external effects of such subsidies. The prospect of continuing economic difficulties brings with it the risk of an increased resort to domestic subsidies as a means of avoiding adjustment to import competition so that the understanding embodied in the Code on Subsidies in this area may be expected to engage the active co-operation of governments in the future.

12. The rôle of general positive adjustment policies in helping economies to adapt to domestic and external requirements of change seems reasonably clear. Some of the questions about the capacity of governments to promote positive adjustment through selective measures of intervention have been discussed in paragraphs 8 and 9 above. Even where trade-related measures of adjustment assistance remain directed to the purposes for which they were intended, it could be argued that by linking maintenance or enlargement of market access to compensation for affected domestic interest their overall effect is to discourage rather than to facilitate the autonomous process of adjustment to domestic and external change. The case for selective measures of intervention would, however, be vindicated where they serve to overcome resistance to adjustment which governments have difficulty in containing, precisely because it is related to foreign competition.

13. Other questions relating to the possibilities of promoting positive adjustment through selective measures arise in particular from the information requirements of selective policies, e.g. the use of criteria for identifying particular sectors to which phase-out measures might be applied, how the assistance provided is monitored and whether sufficiently precise possibilities exist not only for identifying sectors in difficulty but also those towards which resources may be directed for productive long-term employment in the future. Particularly moot to the rôle of governments in promoting structural adjustment is the extent to which they can correctly anticipate the direction and speed of change signalled by market forces and come to judgements about the long-term viability of alternative use of resources.

#### Structural adjustment and rôle of GATT

14. The questions and considerations dealt with above suggest the following reflexions regarding a GATT approach to issues of structural adjustment:

(i) There is an important educational rôle to be performed in helping societies accept the inevitability of adjustment as part of the dynamics of economic growth rather than a cost imposed by foreign competition.

(ii) Governments for their part need to bear in mind that trade liberalization itself provides one of the most efficient incentives for adjustment. In this connexion, the phasing-out of selective supports to industry which serve to frustrate adjustment may be a particular area for co-operation among governments, having regard to the framework of international understandings which already exist with respect to the use of subsidies.

(iii) At the same time, there would appear to be need for a sharing of views between governments on general problems of adjustment and their overall experience with policies in this field. Such exchanges could usefully cover the instrumentalities available to governments to promote adjustment, the objectives towards which national policies are directed and their effects in practice. An informal exchange of views among high level officials directly involved in the formulation and implementation of adjustment policies may be especially helpful.

(iv) Particular attention also needs to be paid to the information requirements of adjustment policies and what may be done at national and international levels to increase information available to governments and enterprises concerning trends in investment, resource flows, technological change, development of new capacity, etc. so that they obtain a fuller picture of the environment in which plans and policies have to be devised.

(v) It could be considered whether structural problems in particular economic sectors may be avoided and the maintenance of trade liberalization facilitated if, in addition to exchanging information on macro-economic policies and targets, governments could also periodically jointly review information on developments affecting production and trade in particular sectors where difficulties relating to surplus capacity, imbalance between supply and demand or pressures for protectionist action are beginning to manifest themselves.