

A NEW CODE ON PROTECTIONISM *

THE MULTILATERAL TRADING SYSTEM : A NEW CODE ON PROTECTIONISM

I attach the paper you commissioned fleshing out and examining the idea of proposing to the Americans that they take the lead in trying to restore credibility to the multilateral trading system. I have also arranged for copies to go to Mr. Anthony, Mr. Howard, Mr. Street and Mr. Peacock.

The paper suggests that the best way of putting the basic idea into practice would be for the US to launch a new Code on Protectionism. It notes that the successful launching of such a Code would be in Australia's long-term interests, although we would have to stand ready to make adjustments and our freedom to take short-term protective action could be constrained. The paper also emphasises domestic and international political obstacles the US Administration can be expected to see with the proposal, and a good deal of space is devoted to developing the context in which it might be presented so as to increase its attractiveness.

Although some judgements are involved along the way, the paper provides a pretty fair case for at least opening the matter up with the US Administration. Mr. Street's impending talks with Shultz provide an opportunity for testing the water in a general way before making a final decision one way or the other. There would also need to be further development of some details before you could formally put it to President Reagan.

G. J. Yeend,
Secretary

*(This is a text of a letter dated 5 January 1983 and enclosure from Mr. G.J. Yeend, Secretary of the Department of the Prime Minister and Cabinet to the then Prime Minister of Australia, the Right Honourable Malcolm Fraser, C.H., on a proposal for a new Code on Protectionism. Shortly after the preparation of the enclosure, there was a change of government in Australia. Its existence was made public in 1984, and this copy was made available by Mr. Malcolm Fraser.)

THE MULTI-LATERAL TRADING SYSTEM : A NEW CODE ON PROTECTIONISM

INTRODUCTION AND SUMMARY

This paper canvasses the possibility of proposing to the United States that it take new and specific steps to reverse the present global trend to protectionism and to restore the basic principles of the multilateral trading system.

1. The basic proposal is that the US declare its preparedness with, and only with, other countries similarly disposed and on a basis of reciprocity:

- (i) not to increase protection; and, in a manner to be agreed
- (ii) to reduce protection

and its intention to establish and notify to the GATT a new "Code on Protectionism" open to all countries, whether members of the GATT or not.

2 It is considered that in advancing the proposal we could present it as:

- . consistent with Australia's traditional multilateral approach to trade policy issues;
- . the sort of bold and timely action necessary to prevent a further dangerous drift to protectionism;
- . if pursued resolutely by the US, likely to attract wide multilateral support, including, although almost certainly not initially, the EC and other European countries; and
- . if successful in its ultimate objective, in Australia's long run interests despite the shorter-term domestic adjustments that might be involved.

3. It has to be emphasised, however, that the success of such a proposal depends entirely on the willingness of the US Administration to depart significantly from its established approach to trade issues with Europe. It has to be recognised also that, because of the greater shorter-term domestic and international political risks the Administration will almost certainly see in the approach proposed in this paper, it will not be easily shifted from its present course. Much of this paper, therefore, canvasses the broad nature of those risks and the context in which the proposal might be presented so as to increase its attractiveness to the US.

BACKGROUND

4. The Australian initiative for a standstill and windback of all protectionist measures presented to the recent GATT Ministerial was an attempt to prevent protectionism spreading and further exacerbating inflationary pressures and the global recession.

Although those consequences of increased protectionism were widely acknowledged at the GATT meeting, the declaration to emerge from the meeting was weak and will be little brake to countries wishing to interpret it in their own interests.

5 The European Communities in particular frustrated efforts to obtain firm commitments to halt and reverse the trend to protectionism. The Communities again proved particularly difficult to negotiate with as a group, and were basically content to stalemate negotiations and keep their options open. Thus, unless there were to be a radical and completely unexpected change in the EC attitude, the prospects for progress in any subsequent formal GATT framework seem remote.

6. What is needed, therefore, is a proposal able to surmount the difficulties of the GATT negotiating framework and the intransigence of the EC and other West Europeans. It should aim for initial wide multilateral participation, while acknowledging that, at first, Western Europe will probably not participate. The outcome sought, however, should be of such a nature and have such an impact as ultimately to compel the Western Europeans to take part.

7. The country with the necessary combination of economic weight, position of strength in the free world and commitment to the principles of free trade which might successfully be able to initiate such action is the United States. It is thus ideally placed to take a lead.

FEATURES OF THE PROPOSAL

8 A new Code on Protectionism should aim ultimately to be comprehensive, applying to the full range of trade distorting measures (as did the earlier Australian initiative). Practical considerations alone, however would require its implementation in stages. The initial Code should apply only to measures inconsistent with GATT obligations or falling outside the GATT framework - the so called "illegal" measures, which account for the bulk of increased protectionism. It could be extended to other forms of protection as Code signatories gained confidence in the benefits of further actions.

9. The GATT Ministerial experience suggests that measures to arrest protectionist trends are unlikely to be successfully negotiated in any large multilateral forum. It is proposed, therefore, that the US, perhaps in consultation with a handful of sympathetic countries, draw up the new Code and, as in the case of many of the MTN Codes, open it to participation from interested countries on a take it or leave it basis. The "standstill" component would be implemented immediately. The subsequent "windback" would probably require some negotiation as to timing, phasing and so on.

10. The proposal would not leave the US open to charges of attempting to by-pass the GATT. It could be presented as merely adding to the aggregation of Codes emerging from the MTN. Its purpose would be to strengthen commitment to GATT rules

Strictly speaking, a new Code would (as do some MTN Codes) involve departures from the basic MFN principle in Article 1 of GATT. This has been justified in the case of MTN Codes on the basis of their benefits being available to all who accept their obligations. A similarly constructed Code on Protectionism could therefore be fully defended on the basis of precedents established.

11. Barriers to trade in agricultural products would be included along with barriers to trade in other products. Agriculture is more complicated to embody in a standstill and windback since conventional means of protection, even quotas, are less relevant. The intention in various agriculture measures is first to protect the domestic market and then to subsidise otherwise uncompetitive surpluses into third markets. Thus, there needs to be a halt on both domestic protection and subsidies. This, however, might be too ambitious for a start. The most that might be feasible is a standstill (and windback later) in subsidy levels and in farm price supports. (This would have the dual effect of making subsidised exports gradually less competitive and would gradually discourage high cost production which is the source of the problem).

12. Perhaps what needs to be emphasised above all is that the success and worth of the proposal depends very heavily on US willingness to embrace and resolutely pursue it on a take it or leave it basis. If the Americans were attracted, it would have to become for all practical purposes a US initiative. Her natural instinct may be to consult major trading partners - Japan and the EC - but if that led to negotiations and opportunities to emasculate the proposal it would not have been worth pursuing.

AUSTRALIA'S INTERESTS

13. Any action that led to the restoration of the basic principles of the multilateral trading system would be beneficial to Australia's long term interests. It is within a well functioning multilateral trading system that:

global and hence our own growth prospects will be most favourable;

- . inflation and budget deficits around the world can be best contained;
- . industries in all countries will better adjust to competitive pressures;
- . we can best pursue our interests as a significant trading nation, including with the dynamic and rapidly growing countries in our region; and

the Western strategic alliance, of which we are part, will be strongest and most stable.

14 Of course, participation in a new Code on Protectionism would require a willingness on our part first not to increase and, later, to reduce trade barriers in Australia.

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Such obligations would be somewhat less at the outset, if the Code applied initially only to "illegal" measures, though, to be fair, our so-called tariff quotas (like other countries' VER's) probably fall within the compass of "illegal" measures. Against that there could also be a period when, as the initial proponent of the Code, we were one of only a handful of participating countries and at a time when unemployment in Australia was at record levels. We would also have to be prepared for increased competition in third markets, including agricultural products.

15. The sort of adjustments that we might be called upon to make cannot be anticipated but, as always, there would always be winners and losers. It also has to be noted that business - certainly representatives of some peak business Councils - have been relieved to see the Australian initiative fail at the GATT Ministerial, would be opposed to Australia advancing any similar proposal, and would presumably oppose our participating in any Code. Although we would, as already noted, gain overall in the long-run from a more open world trading system, the Code could also restrict our freedom in the near-term to extend temporary assistance.

16. The extent to which Australia would stand to lose credibility by unsuccessfully promoting such a proposal with the US is a matter of judgement. It could be argued that our international reputation would suffer little by raising a well prepared and argued proposal to reverse the drift to protectionism, particularly when attempts to do so through more conventional channels (the GATT) have proved such a failure. Mr. Street's discussion with Secretary of State Shultz could also provide an opportunity for testing the water in a general way before finally committing ourselves. On the other hand, the Europeans in particular would represent the proposal as yet another example of an unrealistically "purist" approach.

17. There is also the question of the implications of advancing such a proposal for our overall political relations with Western Europe. It would have to be emphasised that we were not in the business of promoting increased trans-Atlantic tensions, but given our recent differences with the Europeans in the trade field it would be difficult to persuade some of them initially that the proposal was not aimed at embarrassing and isolating them. In the end, of course, the real test would be whether they could ultimately be persuaded to participate.

US REACTION

18. The key question is the likely US reaction to the proposal. The US could, in-principle, be expected to be sympathetic to a proposal that sought to re-invigorate the multilateral trading system, would readily acknowledge the potential benefits to world trade and growth, dealing with inflation and budget deficits, the benefits to developing countries and so on. In practical terms, however, its reaction to the proposal is likely to be conditioned by three things:

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- . the domestic US economic and political consequences;
- . the chances of success - ie. winning wide multilateral support; and
- . possible strategic implications, particularly with European NATO partners.

Domestic Considerations

19. Domestic political difficulties for the US Administration in pursuing such a proposal should not be under-estimated. This would be especially so if the EC were not part of the Code, though making it clear the EC would not get a free ride would help. The Administration is nevertheless under substantial farmer, industry and Congressional pressure to take additional protectionist measures. Given the President's dependence on the co-operation of Congress (in which the Democrats have the majority in the House of Representatives) he could be expected to give great weight to possible wider implications for his relations with Congress.

Possible Participants

20. Possible participation is difficult to predict with any confidence and in any event would be importantly conditioned by how resolutely the US was prepared to pursue the idea in the face of inevitable opposition. However, if, and only if, determinedly pursued by the US the overall outcome might, in time, be along the following lines:

- . The EC and EFTA countries would almost certainly not agree to participate initially, particularly if agriculture were included. Widespread participation by other major trading countries, however, would put significant economic and political pressure on those countries subsequently to participate.
- . Canada would probably have no option but to participate (around two thirds of its trade is with the US).
- . Japan would quickly realise that many existing and potential protectionist measures are directed against it, although it would have to weigh that against the difficulties of reducing its own non-tariff and agricultural protection. It would not relish "having to take sides" in a US/EC divergence of view. But, with 25% of Japanese exports going to the US, its incentive to participate would be substantial.

ASEAN countries would be similarly uncomfortable with a US/EC divergence, but if Japan participated their trade links with Japan and the US (together accounting for over 50 per cent of extra-ASEAN exports) would make participation very hard to resist

- . US, Japanese, ASEAN, Canadian, Australian and New Zealand participation, would encourage further developing country participation especially among those interested in trade eg. Korea, Sri Lanka and some Latins. Some Convention countries (African and Caribbean) would be reluctant in the absence of EC participation. It is unlikely that Brazil and Argentina would easily be persuaded to join but given the parlous state of their economies they ultimately would probably come in. India, too would be a reluctant but probable participant.

Earlier Commonwealth Heads of Government Meetings suggest widespread participation by Commonwealth countries.

Strategic Considerations

21. Maintaining Western strength and cohesion for strategic reasons will bear heavily on US thinking. It will not easily embrace a proposal putting such pressure on the EC in the trade area, which it may well regard as increasing tensions within the Western Alliance.

22. New Secretary of State, Shultz, has also put a lot of personal effort into mending fences (eg. the pipeline embargo) with the Europeans, including trying to repair the non-achievements of the GATT Ministerial. For those reasons Shultz in particular may prefer to build on what common ground the US can identify with the Europeans, rather than strike out in new directions. The question then is whether he and other senior members of the Administration could be persuaded that, while the bilateral approach to Europe is appropriate and effective in many areas, the time has come for a fresh approach to protectionism.

23. In summary, the US Administration will see the proposal as involving a departure from its established approach to Europe on trade issues, perhaps involving international and domestic political risks. Our task, therefore, would be to persuade the US to the contrary, and to convince it that our proposal offers more hope of reducing its underlying trade and strategic tensions with its European trading partners than the "fence-mending" course on which it has already embarked.

PRESENTATION TO THE US

24. As regards strategic questions, the proposal could be presented to the US along the following broad lines:

- . The multilateral trading system served the world well for the first two and a half decades after World War II. It is now seriously threatened;

The last decade has seen a steady drift to protectionist measures, which has accelerated disconcertingly in the last few years;

The recent GATT Ministerial has done little or nothing to arrest that trend - nor will the EC/US bilateral talks get at the fundamental problems;

- . If the drift to protectionism is allowed to go on the risk of the world drifting into a 1930's style "trade-war" and depression will rise correspondingly. Not only does protectionism impede growth and trade flows, it also impacts adversely on the capacity of heavily indebted developing countries to service debts by exporting and this threatens the payments system as well. Hence the possibility of a drift to the 1930's;
- . What is needed, and is proposed, is an initiative capable of surmounting the difficulties of the GATT negotiating framework,
 - one that offers the EC full rights of participation and seeks their participation sooner rather than later.
- . The US is the only country capable of successfully taking the lead.
- . If the US does not take the lead because of its concern that European reactions may go beyond purely trade issues then, in effect, Europe will be allowed to continue imposing its inward looking and protectionist view of organising the trading system on the rest of the Western world, a view which is philosophically alien to many and economically damaging to all,
 - in other words it will be allowed to usurp the US's traditional leadership role and to take the West in the direction of a breakdown of the trade and payments system, with all the implications that could have in the moderately longer term for the strength of the Western alliance.
- . Australia recognises that the proposal, if it were to lead to the short-term isolation of the EC in the trading system, may temporarily strain relations between Europe and North America but so would a "trade-war" which may follow doing nothing.
- . If the US pursues the proposal resolutely, however, other major trading powers eg. Japan, ASEAN, Canada, Australia and many developing countries will support it, thus leaving the Europeans either to follow suit or be the "odd men out". In those circumstances the pressures on it to participate would include:
 - growing political discomfort in standing apart from a worthwhile and widely supported multilateral agreement,
 - the growing cost to many of its industries not benefitting from reductions in trade barriers between Code signatories,
 - the weight added to anti-protectionist forces within EC countries, and

- the different attitudes to the proposal that would exist between more (eg France) and less (eg FRG) protectionist countries within the EC.
- . Present bilateral efforts to defuse tensions within the alliance are understandable and necessary, but when Europe steadfastly refuses to move on trade issues in any negotiating context then there is no real alternative to this sort of multilateral pressure if an already fast deteriorating situation is not to get worse. In other words, continued compromise and accommodation to European protectionist leanings on strategic grounds may well involve significantly greater long term risks to the strength and cohesion of the Western alliance.
 - protectionism undermines the strength of the Western economic system, its capacity and resolution to maintain an adequate defence capability and its very philosophical base,
 - continued erosion of multilateral trading rules, increasing resort to "beggar-thy-neighbour" policies and continued lack of prosperity will create tensions and instabilities, reaching beyond Europe into such areas as the ASEAN/Pacific, which could only be to the political and strategic advantage of the enemies of the West.
- . Nor does international stability depend solely on the cohesion of Western-aligned States. Continued inaction against protectionism will frustrate the integration of developing countries into the world economy, and may well force ASEAN and Pacific countries to be increasingly inward looking.*
- . In summary, Australia believes that a firm display of US leadership to bring the trading system back on course offers longer-run benefits for the world economy, the Western alliance and international stability far outweighing any shorter-run tensions that might arise.

25 As regards US domestic political problems, the following sorts of points may help the President present the proposal including to the Congress, in a positive light:

- . as just noted, there would be wider economic, strategic and political benefits to the US if it could successfully launch the proposal;
 - . market opportunities would be opened up for US producers, both directly and as a result of the general boost to world trade and growth;
- domestic.../

* As an aside in this context, US co-operation with the region would be enhanced by giving greater support to the development of commodity agreements such as tin and rubber upon which considerable store is set

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- . domestic hostility to the proposal may be allayed to the extent that while the Europeans do not participate they cannot receive the benefits;
- . a multilateral Code on Protectionism may prove a practical and positive counter to domestic pressures for more protection - which would presumably have its own political consequences among anti-protectionist lobbies;
- . if those domestic pressures can be headed off the possibility of any trade war is clearly diminished
 - if they cannot, and the EC holds to its present views, will the trade disputes that will increasingly flare up with the EC (perhaps even a trade war) not cause their own domestic political problems?

FORM OF APPROACH

26. Given that a bold and significant change in direction is being suggested, the President would rely heavily on the advice of advisers such as Shultz and Brock. If it were decided to proceed with the proposal, it would be important that it be put to the President personally by the Prime Minister as soon as possible. This would help ensure that the benefits to the world trading system, to the Western alliance and to US leadership and standing in the world were given appropriate emphasis from the outset.

27. As already pointed out, the support of Shultz and Brock would also be crucial and they would need to be appropriately and personally briefed before the Prime Minister saw the President, or he would be in no position to react. It seems desirable, therefore, that during his visit to the US, 11-14 January, Mr. Street begin to open up the question with Shultz in a general way, canvassing in particular some of the points in paragraph 25 above. A decision would also be required as to how the personal briefing of Brock was to be conducted.

THE WILLIAMSBURG SUMMIT

28. The potential role seen for the proposal at the Summit in June needs careful consideration. It almost certainly would not be helpful, for example, for the proposal to be taken to the Summit by the US for discussion/negotiation with European Summit participants. The Europeans would presumably reject the idea and it would then be more difficult to proceed with it. It may be more productive if the US were encouraged either:

- . to launch the new code multilaterally in advance of the Summit; or, preferably
- . launch it immediately following the Summit if European participants again resist meaningful commitments on protectionism which could be floated by the US there

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THE HOBART CONFERENCE (25-28 MARCH)

29. Once the proposals were put to the US it would be difficult to prevent it becoming known publicly. The question then arises how could this be handled in relation to the Hobart trade meeting. If the US accepted the idea it could be explained as part of the further background to a discussion of how this region might relate to a wider world. If a significant part of the wider world was likely to become less protectionist then it might want to relate in a particular way. If however, the US could not take the lead suggested then it is more likely that the world will be moving in a more protectionist direction. This presumably would elicit a different response from the regional group meeting in Hobart.

30. In any event, some appropriately timed contact in Western Pacific capitals may be necessary to avoid giving rise to perceptions that it was cutting across the Hobart concept, was motivated by any purely bilateral considerations with the US, or was not consistent with our support for the multilateral trading system.

5 January 1983.

GATT - US RULES OF ORIGIN*

At the Council's meeting on 2 October, textile-exporting developing countries drew attention to measures taken by the United States in this sector. On 4 and 5 September¹ these countries had already expressed before the Textiles Committee their concern about the serious repercussions that the measures could have on their exports.

Speaking on behalf of the textile-exporting developing countries, the representative of Pakistan said that the Council had an important rôle to play in overseeing commitments in regard to protectionism and increased trade liberalization, *inter alia* in the textile area, as well as strict observance of the rules of the Multi-Fibre Arrangement, in accordance with undertakings given at the Ministerial session of November 1982.

In the view of the representative of Pakistan, neither the regulations defining new rules of origin applicable to textile imports into the US, nor the countervailing investigations opened against thirteen developing countries take account of the objectives of the Ministerial declaration on the MFA. He underlined that recourse to restrictions additional to those already provided by the MFA was strictly limited by Article 9 of that instrument. The new rules of origin alone could affect trade representing \$3 billion.

Several developed countries, in particular the European Community and Japan, shared the concern of developing countries regarding the new United States rules of origin, the complexity of which could give rise to problems of interpretation and have a protectionist impact. The EEC asked the US to withdraw the new rules, and expressed the view that, with respect to countervailing duties, the essential issue

lay in the United States' acceptance of the criterion of injury to countries not parties to the Code on Subsidies and Countervailing Duties.

The United States representative recalled that his country's regulations on rules of origin had been amended; their implementation had been postponed; concerning the countervailing duty petitions, the time-limit for presenting preliminary determinations has been extended. Nevertheless, he stressed that United States textile imports were continuing to rise.

At the request of Finland, the Council decided to establish a panel to examine the anti-dumping duty imposed by the

New Zealand authorities on imports of *electrical transformers from Finland*, since bilateral consultations on the matter had failed to yield a satisfactory result.

The Council adopted the report of the working party on the *Australia/New Zealand closer economic relations trade agreement*; in line with usual practice regarding regional arrangements, the parties to this agreement are to report to the Council every two years on its implementation.

The Chairman of the Council announced that informal consultations are continuing on trade in counterfeit products.

* (This is the text of an item that appeared in the GATT Newsletter Focus September/October 1984.)