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The Problem of Trade Liberalization in Western Europe
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THE PROBLEM OF TRADE LIBERALIZATION IN WESTERN EUROPE Edward Marcus

At the October 1950 meeting in Paris, the Council of Ministers of the Organization for European Economic Cooperation (OEEC) agreed on the removal of 75 per cent of quantitative import restrictions on intra-OEEC trade, to become effective for most member countries February 1, 1951. The percentage goal is to apply to the 1948 value of each member's imports on private account, including imports from the overseas territories of the other members; purchases by government agencies are excluded.

This is the latest in a series of efforts to lessen the quantitative restrictions on trade that have grown up since the 1929 depression. In March 1948, the OEEC established the liberalization of intra-European trade as one of its major objectives. The first important stage was to eliminate by December 15, 1949 trade restrictions on 50 per cent of imports on private account. Although some exceptions were made for individual countries because of balance-of-payments difficulties--e.g., several members did not extend their liberalization measures to imports from Switzerland and the Belgium-Luxembourg Economic Union--yet, most members did reach the 50 per cent target. The various exclusions covered about 10 per cent of intra-OEEC trade.

Negotiations were then undertaken to achieve the next stage--the liberalizing of 60 per cent of imports on private account. The date set for this additional freeing of trade was October 4, 1950. A common list of commodities was drawn up; member countries were urged but not required to liberalize imports on this list so as to eliminate inequalities of treatment arising from uncoordinated selective freeing. In addition, efforts were begun leading to the next (75 per cent) liberalization stage. All the major trading countries met the 60 per cent requirement; only Iceland, Norway (for manufactured goods), Denmark, and Austria 1/ have been exempted. About 68.5 per cent of all OEEC imports on private account in 1948 are now no longer under quota.

As the past year's experiences have shown, however, there are many difficulties in carrying out the liberalization program, and discriminations are still possible despite the apparent simplicity of the liberalization formula. Some of these obstacles can be avoided if attention is paid to the spirit of the end objective, as well as to a literal fulfillment of the percentage goal; others can be avoided by a closer definition of the means of compliance; but others cannot be avoided unless all restrictions on current visible and invisible trade are removed.

1/ Because of her EPU deficit, Austria was allowed to liberalize less than 60 per cent of "Food and Feeding Stuffs" and "Manufactured Goods," although 66 per cent of all imports had been freed (1948 values). Turkey fell short by one per cent in the manufactured goods category.

The goal of liberalization

It is usually taken for granted that quota restrictions on trade should be removed as soon as feasible. By removing trade restrictions, markets are thrown open to competition; the division of labor and accompanying specialization are thus aided, which leads to lower costs and selling prices. Import quotas, in particular, obstruct such an objective; when only a fixed (maximum) volume of imports is permitted, the incentive is destroyed for foreigners to cut prices in order to expand their sales in the protected market. Moreover, the basis of allocating the quota among the foreign suppliers tends to freeze the distribution to some historic date, thus hindering the dynamic trade shifts that are always in process.

This does not mean that import quotas are always a pernicious influence. In a world as exhausted economically as was post-war Europe, rigid limitations on imports may have been the most effective way of protecting the balance of payments, particularly since the potential import excess was localized to one region--e.g., the dollar area. Now that several years of recovery of production and trade have passed, however, there is some evidence that, under the guise of balance-of-payments difficulties--difficulties which are either much less than in 1945-1946 or no longer present--quotas are being retained in order to continue protection to domestic industries. A fundamental cleavage exists between the moderates of the "dirigisme" philosophy and those who hope for a return to free multilateral trading relationships. The former tend to place domestic stability before greater competitiveness, arguing that the home industries must be strengthened before exposing them to the blasts of foreign competition. On the other side, those urging freer trade feel that it is only by achieving greater competitiveness on an international scale that the necessary stimulus exists to evoke the efforts necessary to make a country's industries viable without state aid.

The liberalization formula

Superficially, the measure of liberalization is a simple formula. Not only must the over-all figure of 75 per cent be achieved (certain exceptions are discussed below), but for each of three categories--food and feeding stuffs, raw materials, and manufactured goods--at least 60 per cent of the 1948 value must also be freed. The obstacles come in the application of this formula, and in a few instances nominal adherence has masked actual evasion.

Since none of the member countries is self-sufficient, many imports are non-competitive with home production, particularly those products coming from the member countries' overseas territories. Such products--for example, rubber, cocoa, and tin--form so large a proportion of total imports that their inclusion within the liberalization requirements enables a country to meet the percentage goal, but reduces the stimulus for continental OEEC trade. In this manner a country wishing to maintain protection for its own industries could continue to do so by limiting quotas to that portion of its imports that is competitive while freeing those that are not. However, as the percentage to be freed is increased, less scope remains for such manoeuvres. In the earlier stages of liberalization, the OEEC commented disappointedly on the smaller degree of liberalization of imports of finished products, in contrast to the relatively greater freeing of imports of raw materials; but the requirement that 60 per cent of each major category be liberalized has mitigated this tendency.

One pitfall in the liberalization formula is the bias introduced by the existence of quotas in 1948. Thus, assuming full freedom of admission, a country would have imported $100 of "A" products and $200 of "B" products. Because of quotas in 1948, applying only to the "B" products, imports were reduced to but $25, so that total imports were but $125. Hence, according to the formula, 80 per cent ($100 of the $125 total) of imports were not under quota, thus meeting the highest goal. Yet, as can be seen, two-thirds of the potential import trade had been placed under quota. In fact, the more effective the quota restrictions were in 1948 (that is, the greater the diminution of imports), the lower would be the proportion of actual imports not liberalized, and the greater the proportion of liberalized trade.

Another danger, important where there has been a shift in the trade composition since 1948, can be illustrated thus: asume category "A" imports of $100 in 1948 and $300 in 1950, whereas "B" imports amounted to $300 in 1948, but, were reduced to $100 in 1950 because of expanded domestic supplies. By liberalizing the "B" items, 75 per cent of the 1948 trade would have been freed from quotas, but only 25 per cent of the 1950 trade. By such selective removals, it is possible to lessen the effect on current trade, while meeting the requirements in terms of 1948 figures.

On the other hand, use of 1948 as the base, rather than, say, the current year, eliminates any possibility that increased quotas might paradoxically produce an apparently greater degree of liberalization. A simple example may illustrate the point: assume that imports in 1948 were $100 A, $100 B, $100 C, and $100 D. To achieve 75 per cent liberalization, using the base year, only one of these four categories can be left under quota; continued application of restrictions to two or more will mean that less than 75 per cent are quota-free. If the current year's data were the base, and if it were desired to place two categories under quota, the objective could be achieved by imposing very stringent import maxima. Thus, were A and B to be limited to $25 each, while C and D continued to come in as before ($100 each), total trade would drop to $250, of which $200 or 80 per cent would still be free using the current year as a base, whereas but 50 per cent of trade would on the 1948 base have been liberalized.

A member country whose exports are few in number may experience little benefit from liberalization if its particular export items happen to be in the non-liberalized category of another member country's imports. The effects of a country's liberalization on supplying countries depend on the representativeness of the latter's supplies in the total. Thus, the Swedish second-round liberalization applied to only 10.5 per cent of Iceland's 1948 supplies but to 100 per cent of Ireland's 1948 shipments, while the average for Sweden's imports from all OEEC countries was 60 per cent of 1948 imports. If the impact on Iceland's exports of liberalization by its other main OEEC customers was similarly unfavorable, it is possible that the net effect on Iceland of the efforts to liberalize trade would be to stimulate imports into Iceland, while doing little to help increase Icelandic exports, thus hurting the balance of payments on current account. Such a possibility would, of course, be greater the more competitive a country's exports were with the production of the importing OEEC members. In view of such a possibility, provision is made in the Code of the Liberalisation of Trade (cf. the appendix to this article) either for modification of the liberalization instituted by the injured country, or for additional negotiations with the other member countries to achieve a more equitable effect of their liberalization measures. Iceland is the only country that has been exempted from the liberalization requirement because of the unequal effects of the other Members' removal of trade restrictions.

Government buying

In the trade liberalization formula, the base used is private trade. Imports by a government agency are excluded. Consequently, "75 per cent liberalization" in fact represents a somewhat smaller proportion of total trade than the figure implies, the importance of this reduction depending on the ratio of government to total trade. Thus, in 1948, the proportion of all imports from OEEC countries that was on government account was 3 per cent for the Netherlands (but as high as 42 per cent in the case of its agricultural imports), 8 per cent for Sweden, 21-1/2 per cent for France, and 31 per cent for the United Kingdom.

In many instances, the government has entered as a buyer in order specifically to practice trade discrimination; the Netherlands Government, for example, in a memorandum to OEEC 1/ advanced as one reason for public purchasing "the necessity of restrictions on imports from hard currency sources." Hence, the private trade would tend to be weighted by those items which the government would not want to control.

Evasions

One of the easiest means of evading the intent of increased liberalization is to free from import quotas those items on which the tariff is so high that little increase of imports would ensue. Complaints

1/ January 18, 1950, TC(49)83/03 ADD 2., p. 1. RESTRICTED.

have been filed with OEEC against several of the members, specifying the particular items on which it is felt that the duty is excessive. A Working Party was instructed to investigate these complaints, but because of inadequate cooperation from the alleged offenders, the diversion of energies to the current negotiations under GATT, and the extent of the investigation that would be required, little or nothing was accomplished. 1/ "It appears that most countries have limited their proposals to those commodities in which domestic producers will suffer least from free competition with other participating countries." 2/ Should substantial tariff reductions result from the current discussions at Torquay, this particular obstacle might be removed.

Another ruse was to administer the exchange control mechanism so as to hamper payment for any increased imports resulting from liberalization. Hence, as part of the definition of liberalization, it was necessary to specify that the foreign currencies required for the imports should be automatically allocated. 3/

Invisibles

Although liberalization efforts are also being made for current account invisibles, less success has been achieved than with visible trade. For many countries, continued restrictions on invisible exports may not work a hardship, since the effects of other country's controls on its receipts may be balanced by its own counter-restrictions on payments. But where invisibles are an important means of paying for imports--e.g., Norwegian shipping, Swiss tourism--limitation of other country's liberalization to their visible trade amounts to discrimination against these countries. Thus, normally, part of Norway's visible import surplus would be paid for by shipping earnings. If, however, other countries restrict either the freedom to ship on Norwegian vessels or the transfer to Norway of shipping service receipts, then trade liberalization would work a hardship; imports of visibles into Norway would rise, without a corresponding rise of Norwegian shipping earnings from abroad. The end result would be a deterioration of the Norwegian current account.

1/ Cf. the Report by Working Party No. 3 of the Examination of Certain Import Duties, October 3, 1950, TC(50)85. RESTRICTED.

2/ OEEC release, October 28, 1949 C(49)167, p. 5. RESTRICTED.

3/ Cf. the OEEC Code of the Liberalisation of Trade, August 23, 1950, C(50)258, Annex A, Par. 1. RESTRICTED

Because of its international ramifications, petroleum presents payments problems if the trade liberalization is to cover that commodity. Much of the petroleum imports into Western Europe comes from OEEC overseas' territories, and therefore is included within the framework of liberalization. But the supplying company frequently is US-owned, so that payment for the products is not to an OEEC country, but to the dollar area. Thus, imports from the Dutch West Indies might come from US-controlled companies, and require payment in U. S. dollars. To liberalize the trade would thus increase the dollar drain, whereas the continuance of trade restrictions could channel purchases to companies controlled in OEEC countries. To attain the latter alternative, an amendment adopted by the Council at its September 19, 1950 meeting, provides that only those petroleum imports originating in member countries and their overseas territories and payable in the currency of a member country are to be included in the computation of the liberalization formula.

Post-Korean difficulties

Immediately after the outbreak of hostilities in Korea, German imports, particularly from the British, French and Netherlands' overseas territories, rose sharply, resulting in a large intra-OEEC deficit. Consequently, it was necessary for Germany to undertake internal measures to restrict credit; it was feared that this action might result in curtailing the volume of Germany's imports, from other sources as well as from those areas which had experienced the previous increase in shipments. Countries whose German trade was a particularly important factor might thus suffer disproportionately, and would incur a worsened visible trade balance. To prevent such an outcome, Netherlands, Denmark, and Turkey were authorized at the October 1950 meeting to delay the third round of liberalization (to 75 per cent) until April 30, 1951, because of the importance of their exports to Germany. This delay would postpone the increase in these three countries' imports, thus lessening the deterioration of the balance of payments on current account; at the same time, since it was believed that the main depressing effects of the German credit restrictions would be short-lived, this "breathing spell" would be long enough to tide over the supplying countries until German import orders increased again.

The post-Korean boom in raw material prices, increasing European import prices much more than export prices, has threatened to upset the equilibrium that was emerging in the first half of 1950. Most of these items come from the overseas' territories of the OEEC countries, and thus come within the framework of the trade liberalization formula. Hence, to prevent deterioration of the visible trade balance of importing countries, it might be necessary to permit continued restrictions against overseas areas, or, against less desired imports from other areas. The

October meeting permitted some reintroduction of quantitative restrictions, if defense preparations resulted in "special difficulties." 1/

Appraisal

Do all these difficulties and opportunities for evasion so far discussed add up to a nullification of the goal of freer trade within Europe? The answer is neither an unqualified "yes" nor "no." To some extent these practices have lessened the hoped-for benefits, but, on the other hand, trade does move more freely within Western Europe than it did before 1949.

In general, it can be said that the difficulties are the quirks inevitable whenever a new, complicated administrative system is put into effect. It is only through actual operation that the flaws in the original plan appear, which can then be corrected by subsequent measures. To illustrate, evasion via the foreign exchange control machinery was overlooked in the original scheme, but has now been precluded by subsequent regulation.

For the exceptions that are now granted to various countries there are various good reasons. Norway was granted permission to liberalize less than the required 60 per cent only for manufactured goods. This exception was partly because of Norwegian balance-of-payments difficulties, and partly because of the importance of shipping imports--ships constituted some 40 per cent of the imports of manufactured goods in 1948. Ships, of course, are capital goods, and the Norwegian demand to reconstitute its fleet is still heavy; to free this item from controls would so stimulate imports as to create a serious drain of reserves, while adding nothing to available domestic supplies of consumers' goods; thus, the loss of reserves would not be offset--as for imports of consumers' goods--by a corresponding reduction of consumer purchasing power. To retain quotas on ship purchases, and yet meet the 60 per cent requirement, would mean that all other Norwegian imports of manufactured goods would have to be freed. Hence the decision to accept a lower figure. 2/ Balance-of-payments difficulties compelled Denmark to apply for an exemption from the 60 per cent stage, and postponement of the 75 per cent stage to April 30, 1951. Iceland and Austria were the other two exceptions, the former because the other member countries' removal of quotas did not affect enough Icelandic supplies, the latter because of its deficit position in EPU.

1/ Cf. OEEC Release, October 29, 1950 C(50)305, p. 4, amendment to article 8(b) of the Code of the Liberalisation of Trade. RESTRICTED.

2/ OEEC release, December 5, 1950 C(50)348. RESTRICTED.

The writer has seen no evidence that active consideration has been given to possible changes in the basic formula for defining liberalization. There are, however, certain possible changes which could go far to eliminate some of the objections which have been made against the present formula. For example, in addition to taking 1948 trade as a base for the calculations, a supplementary requirement might be based on the immediately preceding 12 months' trade. This would avoid the weakening of force of the formula in cases where trade shifts have occurred. In addition to the freeing of 75 per cent of 1948 imports, a further stipulation could be that 60 per cent of the immediately preceding twelve months' imports must also be liberated. In this way, slight swings in the trade pattern would not require additional corrective action, but a sharp change, such that 75 per cent of 1948 trade now covered, for example, less than 60 per cent of current trade, would require additional liberalization measures.

A further extension might specify that in addition to the percentage of commodity trade to be liberalized, a lower percentage--e.g., 50 per cent--of trade with each member country would also have to be aided. This would avoid the risk of a particular country liberalizing its trade without receiving corresponding benefits for its own exports.

Other problems, such as restrictions on invisibles, State purchasing, and high import duties are being attacked now. The most serious obstacle to effective liberalization is probably the protective nature of the European tariff structure; the more successful the outcome of the current negotiations at Torquay, the less important this issue will become. Other difficulties may diminish as the over-all payments positions improve; thus, restrictions on tourist travel will undoubtedly be lessened as the reserves of the OEEC countries increase.

Because trade liberalization was instituted during the same period that the participating countries devalued their countries, it is difficult to determine statistically how influential the steps so far taken have been. Thus, the physical volume of intra-OEEC trade rose from 90 per cent of the 1938 volume in the first half of 1949 to 116 per cent in the first half of 1950, or an increase of almost 30 per cent, whereas the volume of imports from the rest of the world rose from 96 per cent of the 1938 volume to 97 per cent, or up but 1 per cent. Much of the increase in intra-OEEC trade resulted from the substitution of imports from OEEC countries for imports from non- (or less-) devaluing areas; 1/ at the same time trade liberalization also worked to increase

1/ Devaluation would also have aided an increase in the volume of exports to the (now) higher-price (and thus more profitable) markets of the non- (or less-) devaluing areas. If this increase had been obtained by shifting exports from (the now less profitable) OEEC markets, this would tend to lessen the volume of intra-OEEC trade, offsetting somewhat the expansionary effects of substitution discussed in the text.

intra-OEEC trade. We can deduce this much: the shift in trade as a result of last year's devaluations was not frustrated by the presence of import restrictions. We cannot go further and assert how much of the improvement in intra-European trade was attributable to the relaxation of these restrictions.

Appendix

Code of the Liberalisation of Trade 1/

Art. 3—Where the country's economic and financial situation justifies such a course, it need not take the full degree of liberalization specified by the Code, although it can still enjoy the benefits of other members' liberalization. (cf. Art. 14).

Art. 4—"Each member shall avoid any discrimination as between one Member country and another...as from 1st February, 1951, in respect of imports of any commodity originating in these countries." The Organization will determine how to apply this non-discrimination provision to imports not liberalized.

Art. 5—Members of customs unions or monetary systems may apply more generous liberalization measures among each other than to other OEEC members.

Art. 6—Discrimination may be invoked, despite article 4, if liberalization does not aid a particular member country, e.g., if some other member, in its liberalization, does not cover important commodities exported by the former. Such a condition would be examined by the OEEC for further determination.

Art. 6—(bis)—Discrimination as in art. 6 may be invoked if a member suffers from another member's "dumping" policy.

Art. 8—Special difficulties due to defense preparations, including those resulting from raw material shortages, may also permit the withdrawal or suspension of liberalisation measures.

Art. 9—Government import monopolies should comply with Ch. IV, sec. D of the Havana Charter. The latter specifies non-discriminatory purchasing "in accordance with commercial considerations...and... in accordance with customary business practice..."

Art. 14—This article describes the role of the Organization in enforcing and investigating complaints. The Organization is also to determine whether a Member country is justified in invoking the provisions of Article 3.

1/ This is a summary of the main provisions of the Code adopted by the OEEC Council at its August 18, 1950 meeting, including amendments adopted subsequent to that date. The text of the Code was issued by the OEEC on August 23, 1950 C(50)258 Restricted. The most important group of amendments was adopted at the October 27, 1950 Council meeting (cf. the OEEC release, October 29, 1950 C(50)305. Restricted).

Art. 15—The Organization is to keep under review developments that would affect the Code and its effects on Members. It "shall consider the position of any Member country taking part in the /European Payments/ Union whose cumulative accounting surpluses exceeds 75% of its quota, with a view to ascertaining the causes underlying this development and to making appropriate recommendations."

Art. 16—If a Member considers that liberalization measures are being frustrated by import duties, it may refer the matter to the Organization for determination.

Art. 17—A Member whose exports are hurt because of discrimination resulting from the other Members' choice of liberalized commodities may refer the matter to the Organization for determination, provided it has failed to obtain satisfaction by direct negotiation. Failing another solution, permission may be granted to the complaining Member releasing it from its liberalization obligations.

Art. 20—"Member countries shall be required to justify quantitative import restrictions maintained /against other Members/ after 31st January, 1951."