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ADDRESS BY THE HONORABLE ANTHONY M. SOLOMON,
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AT WORLD AFFAIRS COUNCIL OF NORTHERN CALIFORNIA LUNCHEON SEMINAR,
SAN FRANCISCO, CALIFORNIA, TUESDAY, NOVEMBER 12, 1968

CHALLENGES IN UNITED STATES TRADE POLICY

In a round-up speech on trade that I made in 1965 shortly after I took office as Assistant Secretary of State for Economic Affairs, I talked about the challenges then facing United States trade policy. These challenges, as I saw them, came from three directions. The first was the future pattern of our trade relations with the rich industrial nations of the free world. The challenge was whether the Kennedy Round of trade negotiations then underway in Geneva could be brought to a successful conclusion or would bog down, peter out, and be followed by a revival of protectionism. The second challenge was how we in the U. S. and the other industrial countries proposed to deal with the trade problems of the more than 100 independent nations of the developing world, the low-income countries for whom trade has not, as a general matter, been an engine of growth. And the third challenge was our trade relations with the Communist countries of Eastern Europe and the USSR. The question here was whether the policies we had followed for two decades continued to serve our interests, or whether changes in the Communist world and in the world at large had made some aspects of that policy obsolete.

Progress in meeting these challenges has been mixed. The Kennedy Round was a brilliant success, achieving tariff reductions of greater depth and breadth than ever before. Together with other rich countries we have reached agreement on new trade policies to help the poor countries, but there are hurdles ahead before these can be made effective. And we have had setbacks rather than gains in East-West trade policy.

Today I would like to review with you some of the challenges to international trade in these three areas that will face the new Administration.

The most immediate and critical issue is the powerful drive for quota protection that got underway shortly after the Kennedy Round was concluded last year. During the cliff-hanging episodes of the Kennedy Round negotiations, we had feared that the failure of that ambitious effort would provoke a protectionist reaction. In the event, it was our success that had that result. It is probably the case that in trade policy, standing still is not an equilibrium position ... either we go forward toward freer trade or we will be pushed back. The achievements of the Kennedy Round were unprecedented; so too is the strength of the protectionist push we are now sustaining. Among the quota-seekers are not only the small traditional protectionist industries, but also large and basic industries like steel and textiles.

The fundamental issue here, as I see it, is whether these industries are seeking temporary amelioration of a difficult situation or permanent protection. Our trade policy is not inflexible. We do not say to industries or sectors of industries whose markets are being disrupted by flooding imports: "Competition is our life style. You must sink or swim." All trading countries have a valid interest in assuring that no industry or sector is run down precipitately by reason of import competition.

We have a range of measures available to us to help affected industries. We can provide adjustment assistance, that is, technical aid, loans, or loan guarantees to business firms under competitive pressure from imports; and subsistence allowances, relocation expenses, and retraining opportunities for workers. The adjustment assistance provisions of the Trade Expansion Act of 1962 were designed for this purpose, but the criteria proved too rigid to be workable. We proposed liberalized criteria in this year's trade bill, but Congress did not act on our recommendation although this particular provision of the trade bill was not controversial. I hope the new Administration and the new Congress will enact it.

Adjustment assistance, even on liberalized criteria, may not be an adequate remedy in some cases. We may find it necessary to invoke the escape clause as well, that is, to curtail imports by quota or tariff protection for a temporary period during which the affected industry can make necessary adjustments to become competitive. The Trade Expansion Act of 1962 tightened the escape clause rules, requiring applicants for such relief to prove that imports were increasing, that tariff concessions were the major cause of the increase in imports, and that the increase in imports was the major cause of injury. It is my personal view that the criteria should be modified. The crucial issue is the effect of increased imports on the domestic industry, and not whether the import increase resulted in major part from tariff concessions. It would seem to me to be sufficient to require proof that the increase in imports has been the major cause of significant injury.

At the same time, I do not think we should provide escape clause relief for the entire output of an industry when the weak points may be only a few products. Where the industry is basically healthy but sustaining significant injury from imports in a few product lines, we should provide temporary protection only for those selected products. I believe this to be the case in the textile industry.

Nor do I believe we should make permanent, by periodically renewing an escape clause action, what is intended to be a temporary adjustment period. After all, invoking the escape clause to help one industry is not without its costs to other industries and to the U. S. consumer. The international rules oblige countries to pay compensation for trade concessions they withdraw, or to face retaliation.

The third option to secure temporary relief from excessive import competition is to persuade the major foreign suppliers of a particular commodity to exercise voluntary export restraint, that is, to moderate the flow of exports that are proving disruptive. The number of cases where this is feasible is quite limited. In a few cases, the foreign governments or the industries of the supplying countries may be prepared to do this, rather than to press their competitive advantage too far ... making inevitable an escape clause action or worse ... if the export restraint requested of them is not excessive and is for a reasonable period of time. Recourse to this option means that we do not have to pay compensation or face retaliation.

All these measures for relief: adjustment assistance, escape clause action, or voluntary export restraint are forms of transitional assistance, whereas the protective quotas that some industries have been pressing Congress to legislate are permanent protection. If we enact permanent quota protection for industry, especially for an industry as basic as steel, or for man-made textiles, we will pay heavily for such action. We will face retaliation on a major scale and in precisely those industries which have a strong export record and potential. We should bear in mind President Johnson's warning: "A vicious cycle of trade restrictions harms most the nation which trades most, and America is that nation."

Nor should we forget that the industrial users here in the United States of protected products will pay higher prices for these products, and their competitive position in both the domestic and the international market will be undermined as a result. We need imports as a brake on domestic prices, in the interests of our consumers and producers.

I personally believe that we will see reasonable voluntary export restraints on steel in place before the end of the year. My office has served as the coordinating point in the Executive Branch for these complicated consultations. It will be very much harder to negotiate voluntary restraints in wool and synthetic textiles. Unlike steel, where the negotiations are proceeding with the representatives of foreign industry directly, a textile arrangement would have to be a government-to-government agreement because both the companies involved and the countries in which they produce are far too numerous.

If the new Administration and the Congress should be persuaded to provide permanent, rather than transitional, protection to these industries -- which in my view would be ultimately recognized as an error but prove difficult to undo -- then I think some mechanism for varying these quotas in relation to price movements or for surveillance of domestic prices in these industries will have to be devised to protect the U. S. consumer and industrial users from rising prices that protection would otherwise bring in train.

Let me leave the issue of protectionism and turn now to another major challenge that faces our trade policy ... the challenge of non-tariff barriers. With the significant reduction in tariff barriers effected in the Kennedy Round, non-tariff barriers have come into prominence. These include such diverse measures as preferences to domestic suppliers in government procurement, health and safety measures that are used with protectionist intent, burdensome customs formalities and valuation procedures, labelling requirements to discourage imports, and various government aides to industry. At U. S. initiative, the GATT -- the General Agreement on Tariffs and Trade -- is studying this question and the related question of subsidies. It is working on an inventory of non-tariff barriers, how they affect trade, and how negotiations for their removal might be conducted. Let me note first that we have little cause to be self-righteous. The array of U. S. non-tariff barriers in industry and complex protective devices in agriculture is not insignificant. It will require protracted international and bilateral negotiations, taking new forms, to chip away at these varied obstacles to trade.

Among the non-tariff measures that are exciting attention, the issue of border taxes is particularly lively. Border taxes affect both imports and exports. On the import side, a border tax is a charge imposed on imports to place a tax burden on them equivalent to that which similar domestic goods bear. On the export side, a border tax adjustment is an exemption or rebate to exporters from domestic taxes. Under GATT rules, not all taxes qualify for adjustment at the border. Those regarded as eligible are indirect or consumption taxes, such as excise, sales, and turnover taxes. Direct taxes on business profits are not eligible for border adjustment.

Border tax adjustments are not new. They have been imposed for two decades; they are sanctioned by the GATT; and they are deeply embedded in practice. But they have become more visible, as tariffs have gone down and border adjustment rates have gone up.

American businessmen have become deeply concerned by the recent sharp increase in border taxes and the prospect of further increases, in one European country after another, as these countries shift from turnover taxes to value added taxes. Thus the border adjustment rates rose in Germany this year, with the shift from turnover to value added tax, because the rates previously applied at the border had not fully reflected the tax incidence on domestic goods. Both turnover and value added taxes are indirect taxes that can be levied and rebated under GATT rules.

The widespread and increasing use of indirect taxes has required us to look carefully at the GATT rules. We think these rules -- which sanction levies and rebates for indirect taxes but permit no comparable adjustment for direct taxes on business profits -- give a competitive edge to countries whose fiscal systems rely heavily on indirect taxes. Something is amiss when GATT rules enable countries to stimulate exports and impede imports simply by altering their tax structures.

At U. S. urging a GATT Working Party was established this year to make a wide-ranging examination of the border tax issue. The issues are complex, involving technical questions of tax shifting and actual government and business practice. We are hopeful that from this exploration new rules and procedures will emerge, and fuzzy areas -- the question of hidden taxes -- will be clarified. Our objective is to ensure that border tax adjustment rules do not work in the direction of promoting one kind of tax system over another but, rather, are neutral in their effects on the flow of international trade.

Although the problem is a real one, I think the public discussion indicates that some aspects of it are misunderstood, partly because of the terminology "border taxes". The U. S. also has indirect taxes which are adjusted at the border. Our Federal excise taxes on manufactured goods, like motor vehicles, fishing equipment, tires and tubes, are levied on imports as well as on domestic products and are remitted or rebated on exports. Over forty states in the U. S. levy sales taxes, ranging in some states to as high as 6%, and these too are imposed on imports and are not applied, or are rebated, to exports. The value-added tax which is the system that most European countries are adopting is essentially a sales tax in its design and economic effects. If the Europeans converted the value-added tax to a retail sales tax, the economic effect on imports and exports would be what it is now. It is true, however, that the value-added tax rates in Europe are substantially higher than our sales taxes, ranging as high as 20% for France. But, as

pointed out by Treasury officials at Congressional hearings, the fact is that European countries are high tax countries compared to the United States. Not only are their mass sales taxes higher, but so too are their social security taxes -- which are not levied at the border or rebated to exporters -- and their direct taxes on business profits are appreciable.

We have substantial unfinished business in the field of agriculture which has proved particularly resistant to trade liberalization. The average income of the farm sector in rich countries tends to be below that of other sectors in their economies. High price supports to improve farm income raise domestic agricultural prices well above world price so that barriers are necessary to keep out cheaper imports and subsidies are necessary to move over-priced goods into export. In principle, farm incomes can be improved in ways that are not trade inhibiting, for example, by direct income payments to farmers that do not raise prices above world levels or unduly stimulate production. But price supports are preferred by governments -- as well as farmers -- for many reasons, including the fact that, unlike income or deficiency payments, price supports are paid by the consumer and are not a direct charge on the government budget.

In the European Economic Community, high price supports without any production control are proving very expensive. Large surpluses are emerging which must be stored or subsidized for export. The present policy is not self-correcting. It is damaging to others and invites retaliation. The EEC is considering policy changes, including production controls for commodities in surplus and land retirement programs for small farms. It is in their interest as well as ours that they also lower their high support levels, and that together we devise cooperative, rather than competitive arrangements, for the disposal of surpluses.

Finally, in this area of trade relations among the industrial countries, an important challenge is whether an international consensus can be reached on across-the-board trade measures that would be taken by countries in stubborn balance of payments surplus or deficit to assist the international adjustment process. Some experts think this is unnecessary and would rely only on exchange rate movements. Others are beginning to think that adjustment measures in the trade account would be a useful tool in themselves.

I should like to turn now to trade policies affecting the developing countries. In the vigorous post-war expansion in international trade, the trade of the developing countries has lagged. The basic reason is their overwhelming dependence on the export of raw materials, particularly agricultural products, that have not been a dynamic or dependable source of foreign exchange. Demand

for many of their key exports, like coffee and tea, is relatively sluggish, while their markets for other key products are being eroded by synthetics and by the increasing agricultural self-sufficiency and protectionism of the advanced countries. Compounding the problem of slow growth are the wide and destabilizing swings in price to which their commodity exports are subject.

There is no one solution to the commodity problems of the developing countries. They need help in curbing overproduction where this is the primary cause of depressed prices; they need help in improving their efficiency so they can meet the competition of synthetics on a price and quality basis; they need improved access to the markets of the developed countries. For some commodities international agreements regulating production, trade, and prices may be both feasible and desirable. The International Coffee Agreement, which was renewed and strengthened this year, is a case in point.

In this connection, I should note that the World Bank and the International Monetary Fund are actively exploring appropriate measures they can take to help improve and stabilize the commodity earnings of the developing countries. I very much hope that these key international agencies will play an active part both in developing and in supporting remedies to the intractable commodity problems of the developing countries.

Nevertheless, even under the most optimistic assumptions as to what may be possible to improve and stabilize earnings in commodity trade, it is reasonably clear that the developing countries must diversify their exports. They still depend on a few primary products for more than 85% of their earnings from trade. The basic solution for their trade problem is to reduce their excessive reliance on raw material exports by increasing the volume of their exports of processed and manufactured goods.

The developing countries want to get into the manufacturing business; and in the past ten years they have increased their exports of fabricated goods at a rapid rate. But these exports still constitute less than 15% of their total export earnings. Moreover, the commodity composition of these exports tends to be narrow -- concentrated in sensitive and regulated products like cotton textiles -- and only a relative handful of the poor countries are involved.

The trade proposal that has evoked wide and enthusiastic support among the poor countries is for temporary tariff preferences in all the advanced countries for the manufactured products from all

the developing countries. The case for such preferences is that they would give the poor countries a tariff advantage for a period of time over the exports of the mature countries with which they feel unable to compete.

Initially we resisted the proposal. Our traditional trade policy has been based on the principle of non-discrimination. But we recognized the force of the argument advanced by the low-income countries, that equal treatment is for equals. It is difficult to maintain that in the field of processed and manufactured goods, Ghana is the competitive equal of Germany in the U. S. market and Ecuador is the competitive equal of the U. S. in the German market.

Even more important, we felt that a system of generalized preferences would have the merit of replacing the growing network of special preferential arrangements between certain developed countries and certain favored less developed countries. Thus the developing countries of the British Commonwealth receive preferences in the United Kingdom market. And the former African colonies of European Economic Community countries receive preferential treatment in the EEC market. Moreover, the EEC was actively negotiating new preferential arrangements with other countries in East and West Africa. Such arrangements discriminate among the poor countries themselves, favoring a few at the expense of others. One area of the developing world -- Latin America -- which has historically had no trade preferences in any market was faced with discrimination against its exports nearly everywhere. And U. S. exports were also disadvantaged because the recipients of special preferences extended reverse preferences to Europe.

The growing risk of further proliferation of special trade arrangements of this kind was from our viewpoint an unfortunate development both politically and economically. It threatened to fragment world trade; it increased the pressures from Latin America for exclusive trade arrangements with the U. S.; it was a retrogression to special spheres of influence.

We determined, therefore, to explore with other countries the possibilities of developing a system of generalized preferences that could check the growth of, and in time replace, the special preferential arrangements.

We have arrived at a broad consensus among the rich and the poor countries. At the United Nations Conference on Trade and Development this Spring, the 122 participating nations unanimously agreed to seek the early establishment of a mutually acceptable system of generalized, non-reciprocal, and non-discriminatory preferences extended by the rich countries for the benefit of all the poor countries.

Much work remains to be done before the essential elements of a preference scheme can be elaborated with sufficient detail to form the basis for legislative proposals here and in other advanced countries. Some of the key unresolved issues include the product coverage of a preference scheme, the depth of tariff cut, the safeguards necessary to prevent dislocation in developed country markets, the duration of the arrangement, and the issue of reverse preferences. On this last issue, we have insisted that reverse preferences now enjoyed by the advanced European countries in poor country markets must be phased out if a generalized scheme is to come into force. The U. S. cannot be expected to provide preferential access to countries that discriminate against our exports in favor of other industrialized countries.

I have dwelt at some length on this subject of generalized preferences because it will be a major trade issue facing the new Administration and a controversial one.

Some who wish to help improve the trade earnings of the developing countries contend that a preferable alternative would be a concerted effort by the rich countries to eliminate the tariff and quota barriers on goods, both agricultural and industrial, that the developing countries can now market on a competitive basis. Textiles is a case in point. The issue as they see it is not equal treatment versus preferential treatment; the issue is access. But the unwillingness in practice of the industrial countries to give that access is clear.

Others suggest that we would be well advised to forget generalized preferences and opt instead for special U.S.- Latin American preferences, particularly in basic commodities. I do not find this alternative persuasive. Many key Latin American export commodities, such as coffee, cocoa, bananas, tin, enter the U. S. market duty-free. To give Latin America special benefits from the sale of these commodities in our market, we would have to install preferential tariffs or quotas where none now exist, and these would lock out other poor countries in Asia and Africa dependent on the U. S. market.

I have always felt that the best way to assist the developing countries is for all the rich countries to join together in a common effort to help all the low-income countries.

The developing countries are facing massive problems in their efforts to modernize their economies. Population is pressing hard against resources; debt service payments are absorbing an increasing share of their export receipts; the terms of aid are hardening as its volume has diminished. Whatever the rich countries may be able to do to improve the trade prospects of the poor countries should not be a further cause for diminishing aid. The developing countries need both trade and aid.

I will touch only briefly on our trade relations with the Communist world. Our objectives have been twofold: to maintain effective international control over the export of strategic goods to the Communist countries of Europe and Asia; and at the same time to encourage trade in non-strategic goods with Communist Europe, believing that increased peaceful trade with Eastern Europe at this point in its evolution could be a force for constructive change.

We have said many times that the best way we have of influencing the countries of Eastern Europe to evolve in ways compatible with our goals of peace and freedom is to bring their peoples into close and more pervasive contacts with our free society -- through cultural exchange, tourism, and trade in peaceful goods.

We have noted that the economic effects of our stricter trade and credit controls have not been to deprive Eastern Europe of goods -- others can and do supply them as well as we -- but to deny to our farmers and manufacturers an opportunity to compete in the markets of Eastern Europe.

In the emotional atmosphere of the Viet-Nam war, the Congress and the American people have not been prepared to move ahead with trade liberalization -- and the Soviet occupation of Czechoslovakia has put a further damper on efforts at bridge-building.

Yet in a perverse way, the events in Czechoslovakia have been proof of the liberalizing effects of trade contacts with the West.

We cannot ignore what has happened in Czechoslovakia. But I believe that for the longer term, it is in our interest to do what we can to erode the iron curtain. Trade is one instrument to that end. When the Viet-Nam war is over, the question of peaceful trade with Eastern Europe should become again an operational question for the new Administration and Congress.

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