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REPORT

drawn up on behalf of the Committee on External Economic Relations

on the delineation and further development of GATT and of the free trade principle underlying the GATT system and possible consequences for the EEC and GATT

Rapporteur: Mr Hans-Joachim SEELER

PE 83.551/fin.

English Edition

By resolutions adopted by the European Parliament on 14 December 1979(1) and 14 May 1982(2) the Committee on External Economic Relations was instructed to report on the possibilities on the further development of GATT.

On 2 December 1982 the Committee on External Economic Relations appointed Mr Seeler rapporteur.

At its meetings of 23 February, 23 March, 26 May, 14 June and 23 June 1983 the Committee on External Economic Relations considered the draft report. It adopted the motion for a resolution as a whole unanimously on 23 June 1983.

The following took part in the vote: Sir Fred Catherwood, Chairman; Mr van Aerssen, Vice-Chairman; Mr Seeler, rapporteur; Mr Blumenfeld, Mr Bonaccini (deputising for Mr Galuzzi), Mr Gauthier, Mr Jonker, Mr Lemmer, Mr Mertens (deputising for Mr Majonica), Mr Radoux, Mr Rieger, Mr Welsh (deputising for Mr Spencer).

The report was deposited on 28 June 1983.

(1) OJ C 4 of 7.1.1980, p.55

(2) OJ C 149 of 14.6.1982, p.117

C O N T E N T S

	<u>Page</u>
A. MOTION FOR A RESOLUTION	5
B. EXPLANATORY STATEMENT	16
I. Introduction	16
II. General Agreement	17
(1) Objectives	17
(2) Current problems and outstanding questions at the GATT ministerial conference of November 1982	17
(3) Possible arrangements.....	22
III. Free trade	23
(1) Definition	23
(2) The impact on the EEC	23
(3) Restrictions on free trade	24
(4) Unilateral state intervention in free trade	29
(5) Multilateral and bilateral contractual restrictions on free trade	32
(6) Protectionism and regulatory intervention in free trade	36
IV. Adjustment of EEC policies to regulated free trade within GATT	40
V. GATT adjustment - the necessary steps	46

A.

The Committee on External Economic Relations hereby submits to the European Parliament the following motion for a resolution, together with explanatory statement:

Motion for a Resolution

on the delineation and further development of GATT and of the free trade principle underlying the GATT system and possible consequences for the EEC and GATT

The European Parliament,

has, in formulating the proposals outlined below, been guided by the following considerations:

- A. the European Community earns about 25% of its gross national product from exports, with half of this figure coming from exports to non-Community member states. The maintenance and further development of free world trade is thus of decisive importance for the evolution of the European Community and for the preservation and creation of jobs,
- B. none of the countries of the European Community are currently able to solve their economic problems by themselves. They have to rely on each other and will only succeed in overcoming their economic problems to the extent that they are successful in developing common interests and placing these before individual national considerations,
- C. the basis of the European Community's trade policy is Articles 110 - 116 of the EEC Treaty which call on the Member States to contribute to 'the harmonious development of world trade, the progressive abolition of restrictions on international trade and the lowering of custom barriers' and which state that 'Member States shall, in respect of all matters of particular interest to the common market, proceed within the framework of international organizations of an economic character only by common action',

- D. the valuable role played by the General Agreement on Tariffs and Trade in the development and growth of world trade and the vital contribution of the European Community in bringing about successive rounds of trade liberalization measures,
- E. also the role of the Organization for Economic Cooperation and Development and its potential for coordinating the economic policies of the major industrialized democracies,
- F. commitment to free world trade and rejection of all forms of protectionism are not enough in themselves to influence world trade in such a way that the differing economic conditions in the industrial and developing countries are taken into account, while allowing, as far as possible, its free and unrestricted development,
- G. free trade based on fair competition which respects the principles of the social market economy must be regarded as a fundamental principle of the world economy. This principle will permit measures, in conformity with the rules of GATT, designed to organize and regulate free trade, such as duties, quotas and adjustment or transitional aids,
- H. differing economic conditions will inevitably reflect themselves in varying degrees of adherence by countries to a free trade system, but the free and unrestricted development of the world economy should be the overriding goal of international economic policy. Impermissible protectionism must be clearly distinguished from measures to influence or regulate world trade which are motivated by current or future political, economic or social needs, and are clearly recognized under GATT rules,
- I. an effective free trade policy needs to be backed up by a Community industrial policy in order to maximize the positive impact it has in strengthening the internal market and thus stimulating productivity and improving the employment situation in Europe. It is essential to develop a forward-looking structural policy in order, on the one hand, successfully to develop and export new technologies while on the other, bringing about the rapid restructuring of industries which are at present in a state of crisis or threatened with adverse conditions in future;

- K. structural change and economic growth, the safeguarding and creation of jobs on the one hand, and external trade on the other, are closely interlinked in the Community as a result of the high level of international economic interpenetration,
- L. changes in the structure of production and employment are influenced by changes in the level and structure of world demand,
- M. GATT has proved its worth and must be further developed as the basis of the free world trade. The negotiations conducted over the last few years within the framework of GATT have succeeded in bringing about a liberalization of trade without, however, providing solutions for important problems such as the need to satisfy the legitimate demands of the developing countries as regards their position in world trade. Moreover, the current crisis places GATT very much at risk, as the Geneva GATT Conference in November 1982 clearly demonstrated;
- N. a considerable proportion of international trade is dominated by multinational companies which often manage to avoid effective state or Community control,
- O. in this connection, Parliament also refers to the following reports on
- 'The impact of the CAP on the external relations of the European Community'
(Sir Fred Catherwood - Doc. 1-248/83)
 - 'EEC-US trade relations in the steel sector'
(Mr Spencer - PE 80.268/rev.),
- and

- its resolution of 16 November 1982 on the GATT Ministerial Conference(1),
- its resolution of 13 October 1981 on enterprises and governments in international economic activity(2),
- the report drawn up by the Committee on External Economic Relations (Doc. 1-493/83),

Having regard to these considerations, the European Parliament resolves as follows:

- 1(a) The General Agreement on Tariffs and Trade (GATT) has proved an extremely valuable international institution, and must now be developed and strengthened at a time of recession and declining world trade. It should be noted that the GATT system was established at a time of currency stability and that the principles of free trade which it enshrines are dependant on a coherent framework of currency values that truly reflect purchasing power parities.
- (b) The essential aims of any further development of GATT should be to safeguard and promote measures:
 - (i) to open up market opportunities throughout the industrialized and developing world, and restore growth in world trade;
 - (ii) to support an effective world division of labour based on the concept of optimising the allocation of resources by free and fair exchange, in accordance with the principles of comparative advantage;

(1) OJ C 334, 20.12.1982, p. 25 ff

(2) OJ C 287, 9.11.1981, p. 25 ff

- (iii) to facilitate the economic development of poorer countries by encouraging free access to world markets;
 - (iv) to ease the structural adjustment of economies in order to maximize employment and growth;
 - (v) to provide for the employment and welfare of both workers and employers by improving the functioning of the open trading system;
- (c) This further development should also take account of the fact that GATT was designed to meet the needs of trade between countries with similar economic structures, and only gradually were special provisions introduced in favour of developing countries;
- (d) It should hence focus on the development of industry in the more advanced developing countries in particular and also on the creation of special structures geared exclusively or mainly to exports, as in Japan for example;
2. The principles of non-discrimination, reciprocity of concessions and free access to markets should be maintained. Efforts to replace the principle of multilaterality with bilateral reciprocity (balancing the trade between individual trading partners) should be rejected;
 3. The developing countries should become subject to the GATT rules for free world trade as and when their industries have reached a competitive stage of development
 4. The further development of GATT must aim to remove non-tariff trade barriers by standardizing the technical and environmental specifications for products, since these affect manufacturing costs and hence competitiveness;

5. New non-tariff measures having the effect of further restricting or distorting international trade should not be allowed. Existing trade barriers that have been approved by GATT should be systematically eliminated. An agreement simply requiring the registration of trade-restricting measures is inadequate as a first step. Monitoring of existing quantitative restrictions and other non-tariff trade barriers for compatibility with GATT rules is required;
6. Precise criteria should be laid down for voluntary restraint agreements and quotas, together with selective recourse to the protective clauses, permitting them only for a certain period of time and under exceptional circumstances;
7. Provision should be made for the establishment of a special GATT committee for agriculture to examine the growing problems in international agricultural trade, including the problems connected with tropical products;
8. Steps should be taken to prepare a study on the importance of trade in textiles and clothing, the impact of existing restrictions under the world textile agreement, and the impact of the expiry of the current restrictive measures;
9. Subsidies must be defined more precisely in GATT, with a clear distinction to be drawn between subsidies to ease the transition and adjustment to changed structures and subsidies designed to preserve structures and admissible under GATT rules;
10. Trade in services should be brought under the GATT rules;
11. An improved procedure for settling disputes should be devised to ensure that the parties involved in a dispute reach an amicable settlement. Where an amicable settlement cannot be achieved, the GATT Council and the Director-General of GATT should have greater powers to mediate. In addition, the disciplinary measures provided for by GATT to deal with violations of the agreement should be improved and strengthened to ensure

that members of GATT comply with its rules. The applicability of safeguard measures requires in particular a concrete definition of the concept of 'market disruption';

12. International economic cooperation and coordination of national economic and monetary policies should be further developed and extended with the aim of eliminating imbalances in the world economy and hence promoting growth, trade and employment. Within the OECD and GATT the Community must press for the coordination of economic policy aimed at the steady recovery of industrial production and international trade, and the reduction of unemployment. Monetary stability should be restored by a strengthening of the European Monetary System and greater cooperation with the other major trading currencies. Efforts should be made to arrange a separate GATT Round on the trade problems between the developing countries and the industrialized nations - and also among the developing countries themselves - in order to achieve greater access to markets, in particular those of the industrialized nations and the more advanced developing countries;
13. Parliament should investigate the practicality of sending an ad hoc delegation to future GATT conferences as observers. This delegation would comprise members of the Committee on External Economic Relations and members of other committees whose terms of reference cover the subjects discussed at these conferences;
14. The external trade of the European Community will be based on fair competition which respects the principles of the social market economy;
15. The common European external trade policy must be strengthened. It must be compatible, at sectoral level and in relation to the Community's partners in world trade, with the strategies to be developed in future for Community industries. National import and export regulations in the Member States should be replaced in the near future by common European Community regulations;

16. Developing country participation in world trade should, as far as the Community is concerned, mean respecting commitments entered into within the framework of the Lomé Convention and the various cooperation agreements concluded with other countries, constant efforts in the appropriate forums of negotiations to meet the legitimate demands of these countries and constant efforts to help the poorest developing countries;
17. Efforts should be made to limit the organization of free trade to tariffs, other levies and quantitative quotas for goods; these measures should be limited in time and designed to restore competitiveness, allow structural adjustment or - if politically desirable - maintain certain structures - e.g. the coal and shipbuilding industries - without regard to competitiveness;
18. Export subsidies, tax concessions designed to secure an unjustified competitive advantage and all forms of dumping are rejected as incompatible with GATT rules and steps should be taken under GATT to combat these violations;
19. In addition to unilateral measures, bilateral and multilateral arrangements are also suitable for organizing free trade. These include the Generalized Preferences System, which, when further developed, may be expected to differentiate more significantly among the beneficiary states according to their state of development;
20. In the long term, a liberalization plan should be developed for world trade to replace the current practice of holding an annual review of tariff preferences within the framework of a 10-year basic programme. This plan should provide for a negotiated step-by-step reduction in tariffs and a staged reduction in quantitative restrictions, taking into account the economic conditions in the various countries concerned, in order to permit investment planning in the long term and - when necessary - to allow differing periods of adjustment;

21. Although the inclusion of investment in GATT is extremely controversial among the contracting nations, it considers that studies on this subject would be useful, as they may contribute to transparency in, and promotion of, world trade;
22. Contractual trade arrangements in the form of cooperation and association agreements with states and groups of states should be further developed to replace traditional trade agreements;
23. The European Community must take over from the Member States a greater share of the responsibility for external trade than in the past, with the aim of preventing distortion of competition between the Member States and improving the negotiating position of the Community by coordinating external economic relations;
24. Intra-Community trade barriers should be reduced further in order to increase the international competitiveness of the European Community. This will also enable the Community to cut its tariffs to third countries still further so as to secure in return a lowering of import barriers in those countries;
25. The adjustments dictated by external economic relations should be made to conform to the liberalization requirement of the EEC Treaty in order to put an end to the individual restrictive measures increasingly being taken by the Member States. Campaigns to promote the buying of national products and measures to identify the national origin of products should be counteracted;
26. The Commission is asked to supplement the European Community's development policy with an industrial policy for the internal market and to coordinate these policies;
27. The objectives of such an industrial policy will include the creation of a long-term international constructive division of labour and the establishment of international rules for such a division of labour and the concomitant structural adjustments in order to ensure that the social and economic consequences of free trade accord with the specified economic guidelines;

28. Such an industrial policy will include the following measures in particular:

- the coordination of national structural policies with the aim of gradually replacing these with a common European structural policy,
- the observation and analysis of developments in the world economy, the supply of information to industry and the development of early, preventive adjustment strategies,
- the creation of the legal bases required to improve and facilitate economic cooperation between European undertakings across national frontiers,
- the development of a set of instruments for small and medium-sized undertakings to help them improve their participation in external trade by securing new markets and cultivating existing markets,
- the coordination of the structural adjustment measures required, the focussing of these measures on transitional and adjustment aids and the limiting of structure-preserving subsidies to short transitional periods,
- studies on special consideration for trade in high-technology products in an effort to bring about the dismantling of high tariff barriers in the long term;
- the promotion of innovation by creating a 'Community know-how exchange', procuring risk capital and developing a common approach to advanced and further training;

- the laying down of binding measures at Community Level (and in cooperation with other third countries if they so desire) to control and ensure the transparency of market channels between companies - multinationals and their subsidiaries in particular - with regard to prices, re-importation and conditions of foreign investment, etc.;

29. The President of the European Parliament is instructed to forward this resolution to the Council and the Commission.

D.

EXPLANATORY STATEMENT

I. Introduction

1. Unobstructed European Community participation in world trade is of overwhelming importance, not only for the smooth running of economic activity and an impetus to its renewal, but also as a means of securing jobs and creating new ones. European Community exports in 1981 to third countries were worth \$ 303.5 million (USA: \$ 225.8 million) and its imports from third countries were worth \$ 338 million (US: \$271.2 million) (1).

2. World trade has been stagnating since the late 70s. The multiple reasons for this include the increases in energy prices, together with misguided investment policies in many countries creating an excessive debt burden, with the consequence that the exports of these countries are devoted more or less in their entirety to debt repayments. Other factors include inflation and unemployment. The adverse effects of many of these factors on world trade are tending to be mutually reinforced. The high debt burden induces many countries to restrict imports, thereby ultimately reducing exports, including those of the European Community. Energy prices, having risen enormously since the late 70s, account for a considerably higher share of gross national product than before. This share is then no longer available for internal consumption, and the consequence is a further rise in unemployment. Growing unemployment, however, means reduced purchasing power and thus a fall in consumption and in imports, usually accompanied by higher public debt.

3. These developments are leading many states to rely, regardless of the wider consequences, on more protectionism, i.e. on acting unilaterally to protect their own industry through subsidies, exchange-rate manipulations, import quotas, etc.

These measures are intended to increase exports and reduce imports as a means of solving domestic problems. This often means however that the problems are simply transferred to other states.

This raises the question as to whether the principle of free trade underlying the General Agreement on Tariffs and Trade (GATT) can be maintained in its current form, or whether and to what extent, changes and restrictions should be implemented to bring GATT into line with new developments in world trade(1).

(1) Agence Europe: Selected statistics No. 338, 22 November 1982

II. General Agreement on Tariffs and Trade (GATT) (2)

(1) Objectives

4. The objectives of GATT are clearly set out in the preamble to the statute. They include the raising of living standards, full employment with rising real incomes, securing world-wide supplies of resources, and growth of production and trade.

The means of achieving these objectives include the fundamental abolition, free of discrimination, of tariffs and other obstacles to trade on the basis of reciprocity and mutual advantage.

5. Liberalization of world trade has since registered considerable successes with the abolition of tariffs and the granting of most-favoured-nation status. On average over the years 1948 to 1980 the volume of world trade grew by 7% per year. In the Dillon, Kennedy and Tokyo Rounds, tariffs were reduced so substantially as an international obstacle to trade that they now constitute no more than a secondary problem.

(2) Current problems and outstanding questions at the GATT ministerial conference of November 1982

(a) Current problems

6. Although major progress in liberalizing world trade has been made under GATT, a number of obstacles to trade remain, especially in the non-tariff area. These include the controversy over the fixing of customs value, or the approximation of technical standards and abuses of protective measures and standards for imported products, such as health provisions, which have also assumed major importance within the European market. Impediments to free trade as set out in the GATT agreement also include distortions of competitiveness through national aids, the authorization of export cartels, dumping practices and tax concessions to promote exports such as the DISC system in the USA.

(1) At present 88 states are members of GATT; about 30 others apply its rules without being formal members.

(2) Of 30 October 1947 - in force as from 1 January 1948

World trade nevertheless underwent an expansion that would scarcely have been imaginable at the end of the Second World War, and which is one of the main sources of economic development in Europe and of the prosperity of the peoples of the European Community.

During the years of economic expansion and worldwide economic growth, it was relatively easy to expand the GATT rules and their application to world trade. This became more difficult as soon as world economic growth began to slow down in the early 70s, on the occasion of rising energy prices. It nevertheless remains the case that despite many infringements of its provisions and much evasion of its rules, GATT continued to operate in the ensuing decade as a wide-ranging and valuable impetus to world trade for all concerned.

7. The main problems at present for GATT, and for world trade in general, lie with the abovementioned non-tariff obstacles to trade, and with the growing numbers of self-limitation agreements (orderly marketing agreements) and the associated cartel-style dividing up of the market, as for example in the textiles, steel and, more recently, electronics industry (video recorders).

Nor will it do any longer to postulate full employment as one of the objectives of GATT. Free trade must be shaped for the future in such a way that, especially in times of crisis, it enables the necessary ongoing structural adjustments to take place in conditions that allow as many as jobs as possible to be retained and new ones created, thereby allowing due consideration to be given to the social side of the labour process.

8. The interests of the developing countries and of the so-called threshold countries must also be taken more firmly into consideration in the further development of GATT. When GATT was founded its main objective was to bring order to the industrialized world's trade. The developing countries and their needs made little impact on the main political considerations of the time.

In 1981 however these countries account for something like a quarter of the volume of world trade. The abolition of the colonial system placed many of these countries in the role of unilateral petitioners - a development

reflected in part IV of the GATT treaty negotiated in 1965. This allowed the developing countries to take unilateral protective measures to promote trade and development; it was matched by the agreement of the industrialized countries to forego reciprocity in trade-policy concessions. The one-sidedness of this development, which grants the developing countries full rights under GATT, but subjects them to scarcely any commitments, is increasingly coming to be seen as an undifferentiated and unsatisfactory concept. The 1979 Tokyo Round therefore contained an element of counterbalance, inasmuch as it stipulated more differentiated and more favourable treatment, reciprocity and increased participation by the developing countries in world trade.

9. The generalized preferences scheme subsequently established by most industrialized countries on a fixed-period, selective basis in favour of the developing countries was given a retrospective legal basis in this GATT decision in that in this part of the special provisions for the developing countries the principle of most-favoured-nation status was specifically abolished. At the same time the developing countries declared their willingness to continue to participate in GATT with a renewed commitment to its rights and duties.

If the further development of GATT requires that progress with development must be made subject to GATT rules, the need of the developing countries for rapid and unimpeded development must also be recognized.

The world trade system must also allow development in the Third World that is not oriented exclusively to the trading needs of the industrialized countries. The developing countries trade with each other needs to be encouraged by appropriate arrangements, and the developing countries must be enabled to process their raw materials themselves and export them as half-finished products in the context of a world division of labour. In this way the developing countries can create jobs and increased purchasing power on their internal markets, and at the same time raise the volume of their trade and also play a significant part in world trade as importers.

(b) Outstanding questions at the November 1982 GATT ministerial conference

10. The problems outlined above were at the centre of the GATT ministerial conference of 24/29 November 1982 in Geneva, which failed to bring a solution any nearer. This applies in particular to the questions raised above in connection with the developing countries.

11. Other unsolved problems include the selective application of the safeguard clause under Article XIX of GATT. Although this article does not stipulate general application, i.e. against all other partners to the Treaty, this follows from the application by analogy of the GATT principle of most-favoured-nation treatment, which by definition excludes selectively favourable treatment.

In practice, general application of this safeguard clause is extremely difficult, since 'market disturbances' caused by export measures could for example result from states that have renewed and redeveloped their industries and are therefore able to sell very cheaply on the world market. The European Community had thus already sought in the Tokyo Round to secure an agreement on the right to selective application of Article XIX. Agreement could not however be reached, for different industrialized countries were not prepared to accept a commitment to seek prior approval of the relevant GATT committee for selective safeguard measures, and also because the developing countries feared discrimination by the industrialized countries. In practice the majority of safeguard measures were arranged selectively and this will probably continue to be the case. It can hardly be expected that the industrial countries will forego the selective option, or allow it to become dependent on the authorization of the relevant GATT committee, for it is only in this way that they can continue to protect their industrial structures against sudden 'export offensives' by individual threshold countries and bring about appropriate structural adjustments.

12. A central problem is posed in particular by agricultural trade and the question of subsidies in this area. Under the Tokyo Round an agreement was secured between countries exporting agricultural products whereby they would pursuant to Article XVI (3) of GATT, refrain from subsidizing exports in such a way as to secure more than a fair share of world trade in a particular product.

The USA and other exporters of agricultural products take the view that the European Community has infringed this Tokyo-Round agreement by granting inadmissible subsidies. The USA seeks completely free trade in agricultural products. The European Community however is not prepared to compromise the basic principles of its agricultural policy. The relative openness with which subsidies are made available for agriculture in the Community makes the policy vulnerable to criticism. The EEC takes the view, however, that many other countries, including traditional exporters of agricultural products, also subsidize their agriculture to a high degree, in some cases even more intensively than the Community, though often by less transparent means. No agreement could be reached on this conflict in Geneva. Bilateral negotiations are to be held between the USA and the EEC to discuss the areas of conflict and seek ways of resolving them.

13. At the request of the United States, the item trade in services was also placed on the agenda of the Geneva Conference. This sector is becoming an increasingly important component of trade as a whole, especially between the industrialized countries. In the USA 75% of total employment potential is estimated to lie in the services sector. Services as a proportion of exports have meanwhile reached 13%. In the European Community the figure lies between 4 and 6%.

Agreement on the inclusion of services under the GATT could not be reached in Geneva. The developing countries resisted this, since they feared being swamped by the insurance and banking system of the industrialized countries. The only agreement that could be reached was that all states with important services interests could draw up a study on the problems of this sector. The study could serve as a basis for further consultations at the forthcoming GATT conference in Copenhagen.

14. Another major item at the Geneva Conference was the procedure on arbitration in disputes. At present, differences of view between GATT Treaty partners are resolved directly by the countries concerned. Where no bilateral solution can be reached however, these conflicts are referred to the courts of arbitration set up by the GATT Council, which forward their decisions to the Council. The members of the court of arbitration, who decide in their personal capacity, are chosen from countries that have no direct interest in the dispute at issue. At the Geneva Conference, possibilities were aired that would give the GATT secretariat a stronger role in arbitrating on disputes. In particular, proposals were debated for strengthening the role of the Director-General of GATT as arbitrator. A conclusive agreement on this matter could not, however, be reached.

(3) Possible arrangements

15. The Geneva Conference has made it clear that the advantages and usefulness of GATT are recognized by all participants. No one seriously wants to return to the days of competing nations seeking self-sufficiency and limiting trade to the minimum necessary, which would amount to a renewed impoverishment of world trade. On the other hand however, complete free trade unrestricted by any limitations or regulations, while theoretically conceivable, could hardly be achieved in practice. Every tariff, every preference, every quota, every national import regulation amounts to a restriction on free trade. It is therefore necessary to define free trade and to locate it in a social context. It is also essential, for political, economic and social reasons, to differentiate between necessary intervention and regulation of world trade, and unacceptable protectionism. It should be obvious from the diversity of a national economy or the scope of a customs union within a common market that the social cohesion brought about by freedom of competition and freedom in the economic process as a whole is beyond dispute. No one is any longer likely to come up with the idea of equating the market economy and freedom of trade with unregulated, unbridled economic liberalism, the impact of which would be devastating.

16. To apply this to world trade, or to the world economic order and the role played in it by the individual states, is to realize that nothing good can come at world level from whatever is bad for the national economy, and certainly not from making the right of the stronger the exclusive standard of economic and trade freedom. GATT has proved its worth as a precisely appropriate mechanism for setting the necessary limits to freedom of trade.

But as the Geneva Conference has made clear, GATT is not capable of operating as a mechanism for the satisfactory regulation of free trade in times of economic crisis. The step-by-step inclusion of the newly-developing industrial states, the so-called threshold countries, and the provision of the means to cope with the special situation and interests of the developing countries, is a task that GATT cannot fulfil in its present form. The objective must be to create a framework for free trade that takes the requirements of worldwide development into account and brings it into the ambit of the new world economic order.

The permissible ordering and regulation of free trade must, however, be clearly differentiated from inadmissible protectionism. The objective should be to secure support for the concept of maintaining and developing a socially relevant free trade. This should include in the long term strengthening the resistance of the world markets to fluctuations, in for example the currency sector, through what would amount to a world conjunctural policy. A start in this direction might be said to have been made with the international raw materials agreement with its anti-cyclical orientation and a new agreement on the law of the sea. Where currencies are concerned however there can be little expectation of an equivalent arrangement since the world monetary system lost the support of the Breton Woods system based on a stable dollar.

III. Free trade

(1) Definition

17. Even the most specialized textbooks generally avoid attempting a precise definition of world trade. This is because the classical ideal concept of world trade is seldom achieved in reality. In its basic meaning, free trade represents a condition of perfect competition in all markets that excludes any interference or restrictions by the state. Trade is thus defined in terms of the price mechanism of the market economy, the international division of labour and the theory of comparative advantage.

Under GATT it is sought to secure free trade through the principles of most-favoured-nation treatment and reciprocity. This means that on the one hand liberalizing concessions by one participant operate to the advantage of all other participants in world trade, and on the other that relaxations on trade are exchanged on a basis of mutual advantage.

(2) The impact on the EEC

18. Although free trade is not stipulated as a specific principle of the EEC Treaty, the underlying objective of eliminating obstacles to trade is set out both in the principles (Article 3) and in the objectives of commercial policy (Articles 110 and 113 of the EEC Treaty).

The European Community's policy of abolishing internal obstacles to trade in the furtherance of this objective, together with the accelerated reduction of the joint customs tariff vis-a-vis third countries, has been a decisive contribution to the economic success of the Member States. It was also a leading element in ensuring that the Dillon, Kennedy and Tokyo Rounds of GATT played a decisive role in abolishing obstacles to trade in leading industrialized and other third countries.

The cooperation and association agreement concluded by the EEC with third countries, together with the generalized preferences scheme, can also be seen as helping to strengthen free trade.

19. Despite - or perhaps more on account of - its liberal trade policies, growing problems are created for the Community in the present world economic crisis. There is no Community concept of trade and economic policy that can channel the growing pressure of competition from other third countries resulting from lower tariff restrictions so as to prevent healthy or vital branches of the Community economy from being destroyed. The lack of any such mechanism is increasingly leading individual Member States of the Community to adopt unilateral restrictive national measures which are not only detrimental to the EEC as a whole but are a hindrance to any long-term policy to improve the international division of labour.

(3) Restrictions on free trade

20. The social commitments of most market economies in the leading world trading nations today mean that economic readjustment procedures resulting from structural change cannot be left entirely to the play of market forces. The elimination of capacity in traditional areas of production, bankruptcies, and the consequent rise in unemployment and growing dependency on imports as a consequence of non-intervention by the state, are no longer politically acceptable.

21. This means that not only should protectionism not be encouraged, but that trading arrangements should be promoted to enable a continuous process of structural adjustment to take place where necessary. Trade must continue to be as free as possible, since it is often only under the impetus of free competition that innovation and rationalization can take place. This is usually the only possibility of, for example, compensating for the high costs in the European Community resulting from the high living standards and the advanced levels of social security.

Competition must not be restricted as soon as it begins to require structural change. Free trade and the attendant competition influence the size of undertakings and the capacity of a national economy to perform. Large markets clearly require performance and growth by firms. Trade restrictions constrict markets and have a correspondingly adverse economic impact.

22. Increased pressure of competition has an overwhelmingly favourable impact on economic structure in the long term. In numerous branches of industry, such as the aerospace and automobile sectors, in the electronics industry and the steel sector, a degressive pattern of costs resulting from the size of undertakings is playing an increasingly important role, and the optimum size of undertaking is being pushed steadily upwards by technological development. The degressive costs pattern of the larger undertaking reduces unit costs, thereby increasing competitiveness still further.

It is clear therefore that import restrictions in many Third-World countries have impeded the development of optimum-sized undertakings and held back or slowed down improvements in productivity. The competitiveness of these economies is thus partly regressive. The presence or absence of trade restrictions also explains for example why Hong Kong or Singapore, which have come round to free trade after going through a preparatory phase, have been able to achieve high growth rates, whereas other threshold countries like South Korea, Brazil and now, increasingly, Taiwan, are having to cope with growing difficulties.

23. Free trade squeezes unproductive undertakings out of the economic process and allows healthy firms to grow, thereby improving their productivity and, as a rule, creating new jobs.

Import restrictions on the other hand can help to step up production to meet demand on the internal market that is no longer met by imports. This kind of growth depends principally on maintaining or reviving essentially uneconomic undertakings. This kind of development does not help the national economy, it impedes necessary structural adjustments and creates new market distortions, and in the longer term it jeopardizes the stability of jobs, especially those in undertakings where healthy development is restricted by these measures.

24. There is a widely held view that free trade as set out in the GATT objectives is largely a spent force. In the USA in particular the trade deficit with Japan on account of Japanese import practices and EEC agricultural exports policy, together with the lack of free competition in trade in services, are repeatedly cited to justify this view. Consideration is being given to replacing free trade by so-called 'fair trade'. Fair trade also includes the principle of reciprocity in trade policy measures such as the structure of non-tariff barriers to trade. There is growing pressure on the United States Government to take reprisals in cases where US firms do not have the same access to foreign markets as exports from the countries concerned have in the USA.

Any such development would very quickly lead away from the multilateral principles of the world trade to bilateral exchange. The great advantage of non-discrimination underlying multilateral trade would be lost. The volume of world trade would fall significantly, almost certainly in a manner that would adversely affect the United States.

If the reciprocity principle is to be made a reality in this connection, it will require a comprehensive new compensation and sanctions mechanism to be established. A huge bureaucracy to scrutinize alleged infringements of free trade principles would be needed. The state would need to intervene in market economic processes and would thereby strengthen the emerging neo-mercantilist trend in the world economy. This would mean passing the social costs of adjusting the economy to the requirements of a changed framework in whole or in part onto other countries on beggar-my-neighbour principles. The adverse effects of any such policy would not be slow in coming, and would make serious inroads into the prosperity of many parts of the world that depends on the current advanced level and high volume of world trade.

25. Free trade must not only be restricted in relation to structural requirements, but must also take account of the peculiarities of trade with the state-trading countries. The state monopoly foreign trade undertakings in the state-trading countries centralize all flows of goods from Western countries, but generally have a free choice of trading partner in these countries. Of the 1098 headings in the Common Customs Tariff, the EEC had, by 1978, completely liberalized 772, and partially liberalized 99 in favour of the state-trading countries.

26. Since the responsibility for trade policy pursuant to Article 113 of the EEC Treaty now lies with the Community, the last bilateral trade treaties between the EEC and the state-trading countries expired in 1975. Since the state-trading countries themselves and COMECON do not recognize the Community officially in international law, the situation as regards EEC trade with this group of countries is not governed by treaty. In the interim, only trade treaties between the EEC and Romania and China have been concluded. The EEC has also concluded self-limitation agreements with some COMECON states in particular sectors, such as textiles and steel.

27. Since selling prices of goods produced in the state trading countries are determined in accordance with the economic plan and state-monopoly demand policy, trade with this group of countries obviously does not accord with the idea of free trade, and frequently requires intervention in the countries with free-market economies to correct the effects of dumping or other market distortions caused by state-trading countries.

28. The basic idea of GATT, i.e. free trade, is conceived in terms of trade between countries with similar economic and social structures and development. The rise of Japan in particular as a member of the group of industrialized nations and the emergence of former developing countries as so-called threshold countries (Brazil, Taiwan, South Korea, Mexico) with quite different structures have changed the basic framework conditions. Moreover, since the breakdown of the Bretton Woods system, world trade, as organized under GATT, has lost the basic element of support by a stable dollar. Of course, the importance of Japanese exports to the European Community should not be overestimated; only 5% of EEC imports from third countries originates in Japan. Moreover, from the Japanese viewpoint the EEC comes after the USA (25%), the Asian countries (16%) and the OPEC States (15%) in fourth place with only 11% of its external trade. This tendency is receding.

Problems arise in particular from the fact that Japan has placed considerable difficulties in the way of access to markets for imports from the EEC, including non-tariff barriers, thereby adding considerably to the difficulty for European exporters of securing balanced trade. At the same time, the advantages of the Japanese export offensive to the European market should not be overlooked. These export offensives have exercised considerable pressure on the European economy to adapt, and have helped to bring about concentration

in the iron and steel industry, in mechanical engineering, in motor vehicle production, shipbuilding and the production of electrical, optical and electronic goods. These products taken together account for some three quarters of Japanese exports of industrial goods. In these sectors Japan has often made much faster and more comprehensive use of technological developments involving structural changes than the Europeans.

29. In this connection however the question arises as to whether the export offensives by Japan and other threshold countries are fully compatible with free trade as aimed at under GATT. For it is often the case that these countries take advantage of research and development work carried out in the industrialized countries to create production capacities in narrowly restricted sectors that enable them to achieve cheap assembly-line output far in excess of demand on their internal markets. The surpluses are aimed at carefully chosen markets in other industrialized countries, where the corresponding branches of industry are eliminated by overwhelming pressure of competition.

Far from being a case of international division of labour, this is more like systematic international job-destruction. The walling-off of national markets in the threshold countries and Japan, together with massive unilateral enjoyment of sectoral competitive advantage, cannot be said to help in promoting general prosperity in accordance with the free trade objectives underlying GATT, and does not create opportunities for the necessary structural adjustments. Ways and means must be found of intervening in this connection.

30. This kind of radical division of labour and structural change raises the question as to whether free trade does not require a more significant social component than hitherto, i.e. whether the subsequent development of GATT should not be shaped so as to take new account of the social impact of trade and the division of labour.

In defining and regulating free trade, however, the cost of research and development of new technologies, and the protection of intellectual property against exploitation should not be overlooked.

31. The effects of concentration of production by cartels and monopolies, and the advantages that many multinational undertakings derive from their production lines, should be taken fully into account in the further development of GATT and in the shaping of socially relevant free trade. The advantages of these forms of production and trade should be controlled, to the extent necessary to maintain a viable social policy, in order to protect other established structures that cannot be changed in the short term without being damaged. It will be worth considering, by analogy with the regulation of free trade under GATT, the development of provisions to regulate the division of labour and structural adjustment as a means of complementing and directing the basic principles of free trade.

The manifold impact that the principle of free trade has on the structure of industry and commerce, the effects of unbridled trade on whole national economies, and thus on economic and social conditions in which nations and peoples live, requires, in addition to economic and structural components, as evaluation of the political and social impact of free trade.

32. The simple demand for free trade and its unconditional application and development is only one aspect of the functions and further development of GATT. The political, and above all the social, aspects of free trade must be considered more carefully than hitherto, and allowed to operate as a limiting factor on the free trade concept: in other words not every measure that helps to regulate and control absolutely unbridled free trade is necessarily an unacceptable form of protectionism.

4. Unilateral state intervention in free trade

33. The classic form of trade manipulation is to levy tariffs and other duties on imports - and less usually exports - of goods and services. These levies can ensure that the price of the imported goods rises until their competitiveness on the internal market is reduced to the desired extent. This form of intervention in trade is relatively easy to apply, leaving aside the often difficult problem of defining the goods concerned. It is flexible and can therefore be readily adapted to changing economic necessities, and it brings in budgetary revenue to the state. Tariffs and levies are thus the right mechanism for compensating for dumping or other competition-distorting practices by exporting states. Here however a clear distinction must be made

between subsidies and dumping practices on the one hand and the real level of costs in the exporting countries on the other. Lower wages and lower social expenditure except where these have been artificially depressed below the average for the exporting country - are legitimate factors of competition by local export industries. That the efforts of trade unions in these countries to improve wages and social security should also be supported is a separate issue.

34. Other mechanisms for influencing world trade include limiting quantities through quotas. This limits the extent of competition from imported goods. Pressure on domestic production can thus be kept within bounds, so that the latter can retain at least part of the internal market. This means however that pressure to bring about structural adjustment is correspondingly reduced.

35. A special role is played by the so-called non-tariff obstacles to trade. These include the most varied requirements to be met by the imported products, such as technical standards, environmental suitability, etc. They also include other measures by the state, such as reducing the number of customs posts, linguistic requirements for accompanying documents, special rules of origin, the requirement that imported goods must contain a specified amount of domestic components, etc.

Restrictions of market access of this kind are playing an increasingly important role in the Member States and form a serious obstacle to trade. As a steering mechanism for socially relevant free trade they are inappropriate.

Under the further development of GATT it will thus be urgently important to abolish these measures impeding trade or to expand and adapt existing rules.

36. A special impact is made on trade by state subsidies or tax reliefs and by all forms of dumping, as defined in Article VI of GATT.

Thus the conflict between the EEC and the USA on tax relief granted by the USA to certain exporting firms has only recently been patched up. The USA has stated its willingness to conform its DISC system (Domestic International Sales Corporation) to the GATT rules.

The Community must be constantly on a guard against dumping practices, especially by threshold and state-trading countries, but also by other industrialized countries. The Committee on External Economic Relations has already reported on this problem in detail (1), stressing the importance of taking action against these practices to protect the EEC states as a whole from economic losses.

37. A special form of intervention in free trade is artificial manipulation of exchange rates. Devaluation of the national currency cheapens exports and makes imports more expensive, provided trading partners do not retaliate. For the consumer it means an increase in the price of imported goods, with the result that demand for them will be reduced. Devaluation can reduce pressure of competition from foreign producers and also increase the competitiveness of the home export industry. This is certainly a less bureaucratic method than applying quotas, levying tariffs and applying other restrictions on imports, but in practice it means shifting the country's own economic problems onto its trading partners. Exchange rate alterations are only justified as a means of restoring balance when the national currency is wrongly valued, so as to restore appropriate conditions of competition.

If the national currency is devalued too steeply, moreover, the relaxation of pressure on the home market will only be temporary, since dearer imports will lead to higher price levels, so that the advantage gained from devaluation will ultimately be wiped out.

The Committee on External Economic Relations hopes to draw up a special report on this subject.

38. In the interests of completeness state intervention in the services sector should also be mentioned. This applies in particular to freight charges, which are often kept artificially low, by state-trading countries among others, thereby distorting free competition and influencing trade patterns. The problem of flags of convenience is also relevant here.

(1) See Doc. 1-422/81, WELSH report on Community anti-dumping measures

39. Apart from the subsidies required in special cases for strategically important industrial structures, tariffs and quotas on imported goods should be the only mechanisms used to shape socially relevant free trade. All other measures are inappropriate, and should not be pursued in the further development of GATT, whereas in many cases GATT should further develop joint rules, directives and provisions on behalf of its treaty states governing such matters as technical requirements for the environmental suitability of goods and services, etc.

40. Safeguard measures in the form of tariff increases on new quotas should, however, be implemented for a fixed period and subject to uniform criteria. Their main objective should be to enable necessary structural adjustments to be made. For the Community this means that programmes with precise indications as to the concrete adjustment measures and social policy requirements should be drawn up.

The basic guideline for such intervention should not be particular sectoral or group requirements but the benefit to the economy as a whole of effective competition that will secure a wide-ranging supply of goods and services at reasonable prices and create an impetus to technical progress and innovation.

5. Multilateral and bilateral contractual restrictions on free trade

41. In addition to the forms of national state intervention in trade outlined above, there exist numerous bilateral and multilateral means of influencing or restricting trade.

These include most-favoured nation status, preferences, trade agreements, cooperation and association agreements and, increasingly in recent years, self-limitation agreements.

42. A central importance attaches to most-favoured nation status as set out in Article 1 of GATT, which stipulates that advantages, favoured treatment, privileges or concessions that a contracting party grants in respect of a good originating in or earmarked for another country, must immediately and unconditionally be granted for all comparable goods originating or earmarked for the territory of the other contracting parties.

This is not a restriction on free trade but a means of promoting it. It is however, as the Treaty indicates, confined to the GATT Treaty partners and excludes non-Members from these privileges.

43. A similar positive though limited means of promoting free trade consists in the granting of preferences by a state or a group of states to one or more others. Such preferences generally include privileged opening of the relevant market to products originating in the beneficiary states. With its general preferences scheme in operation since 1971 the EEC is the first group of industrialized countries to comply, since the first World Trade Conference of 1964, with reiterated calls from UNCTAD for comprehensive tariff preferences for developing countries. These are intended to support the efforts of these countries to diversify their exports. Tariff preferences have also had the effect of counter-balancing the disadvantages of the developing countries in world trade resulting from tariff structures, since products in which the developing countries are especially competitive have been increasingly subject to significantly higher tariffs than typical products of industrial countries since the Tokyo Round of GATT. The generalized preferences scheme has given a strong impetus to Third-World exporters to the EEC, but has not lived up to expectations of a wide-ranging impact, since it is predominantly a limited number of advanced developing countries, i.e. the Asean threshold countries, that have derived the greatest advantage, whereas the least-developed third world countries have frequently fallen far short of their allotted tariff quotas. This unsatisfactory development has of course been taken into account in drawing up new projects for the generalized preferences scheme for the eighties, but the effectiveness of the measures taken is limited. For the industrial exports of the poorest countries would be unlikely to rise significantly even if tariffs were completely abolished, and in trade in agricultural products, where expansion is possible, the concessions made hitherto are insufficient.

44. The right course of action would be to abandon the essentially defensive approach adopted hitherto and to develop an offensive strategy aimed at obtaining reciprocal concessions from the advanced developing countries with the objective of securing partial implementation of the GATT principle of reciprocity, thereby creating more and not less trade.

Also disruptive to trade relations between the EEC and the developing countries is the practice of conducting annual revisions of tariff preferences under a fixed ten-year framework. A better approach would be a long-term liberalization plan leading gradually to freedom from tariffs for imports from Third-World countries to the Community in predetermined stages, by analogy with the abolition of tariffs and quantitative restrictions. This would give increased planning security to trading undertakings on both sides and reduce the risk of unproductive investment. It would also mean that different structures in individual EEC States could be matched by variable deadlines for implementation. At the same time the developing countries would also be required gradually to open up their markets, a process that could be varied to suit the different conditions prevailing in particular countries.

45. In addition to the generalized preferences scheme, general cooperation agreements and sectoral trading arrangements, the cooperation and association agreements form a major component of Community external trade policy that can help to influence trade patterns. Mention should first be made of the agreement with the ACP States, which originated from the special relationships of some Member States of the European Community to their former colonies, and have been moulded into a comprehensive mechanism of EEC policy towards the least developed countries.

The Community has further extended its trade cooperation with a number of countries as various as India, Yugoslavia, the Asean States and Brazil - to name only a few - through a series of non-preferential agreements.

46. Less successful than policy vis-a-vis the poorest countries is the record of EEC relations with the Mediterranean countries. The global policy decided upon at the Paris EEC Summit Conference of 1972 on relations with this group of countries, which led to association and cooperation agreements with Turkey, Malta and Cyprus, the Maghreb and Mashrek countries and Israel, has done little to fulfil the expectations it aroused of securing political stabilization in the region, consolidating the economies of the Mediterranean area and balanced and expanding trade between the EEC and these states. Moreover, the EEC has exposed itself to accusations not only from the non-associated developing countries, but also from other industrialized countries of having infringed the GATT principle of non-discrimination through these agreements.

The causes of the failure of the Mediterranean policy must be sought not only in the lack of adequate financing, but also in the failure of the Member States to set clear political objectives. Many Member States are inclined to conduct their relations with the countries of this region bilaterally and not through the Community framework. It has therefore not been possible to give the objectives of cooperation and development a content and importance compatible with the values and priorities that the Community has itself attributed to its relations with the Mediterranean States. The Community's relations with the Mediterranean countries will come under very severe strain if a solution cannot be found to the serious difficulty that will arise when Spain and Portugal accede to the Community as regards the integration of these countries into the EEC agricultural market on terms acceptable to all concerned parties.

The cooperation agreements that the Community has concluded with these countries are simply framework agreements that have to be completed.

47. The gradual winding-up of trade agreements, which have hitherto been the predominant type of treaty in Community relations with the non-associated states, in favour of cooperation agreements, is a welcome development. It enables the various aspects of external economic relations to be brought together, thereby avoiding contradictions and making it easier for conflicts of interests to be resolved by mutual agreement. Since these treaties were concluded it is still too early to give any conclusive evaluation of this new method of organizing trade.

48. The organization of free trade by way of cooperation policy moreover reveals a decisive defect. For the Community has still not succeeded in setting out a common line on negotiations on cooperation with the petroleum states. If the Community wishes to avoid the danger of an arbitrary, nationally oriented approach and thus also the danger of trade wars between individual Member States, it must find its way to a uniform and conclusive approach. It cannot otherwise bring its economic weight fully to bear, and thus take better advantage of more intensive division of labour with the developing and threshold countries.

49. An even stronger possibility of influencing free trade than the foregoing is provided by self-limitation agreements. This can be illustrated with the example of the Multifibre Arrangement. This imposes treaty restrictions on trade patterns in textiles in order to reduce disruption of national output and enable structures to be adapted to changed developments on the world market. But if this adaptation is not carried out, this will mean that the agreement has been used to maintain old undertakings that are no longer competitive in business, and that constantly require not only renewed subsidies but repeated extensions of the self-limitation agreement.

50. There can be no doubt that an agreement to regulate world trade in textiles is currently better than an arbitrary situation, which, in the present climate of world trade, would be bound to lead to competition in national protectionist measures. At all events however, the Community should as in the case of the generalized tariff preferences, pursue an offensive policy aimed at obtaining reciprocity, rather than falling back on defensive protectionist measures. An essential component of this must be a persistent strategy of positive adjustment that places subsidies on a degressive basis subject to deadlines and strict and verifiable conditions.

6. Protectionism and regulatory intervention in free trade

51. In this chapter the attempt will be made to pinpoint the limits of intervention in trade patterns necessary to secure political, economic and social components against protectionism that is inadmissible under the rules of GATT.

Protectionism is no new phenomenon. It was pursued under the name of mercantilism as deliberate economic policy in the 16th, 17th and 18th centuries by such countries as Spain and France, with the result that these countries remained economically backward, whereas states like the Netherlands, Britain and the USA that pursued a free-trade policy enjoyed more rapid economic growth.

The forces of protectionism have recently been winning new ground. Since profits are shrinking and industry is having to cope with stagnant demand and overcapacity, salvation is being sought in measures to restrict import competition.

52. The first to suffer from these measures are the most successful and competitive exporting countries, but they also hit developing countries that have become competitive in particular sectors, such as textiles. The fact that the developing countries are less able to buy goods from the industrialized countries the less the latter buy from them, has not stopped the traditional industrialized countries from restricting imports of textiles, clothing and electrical goods, as well as processed food stuffs from Third-World exporting countries.

53. Behind all protectionist measures lies the idea of keeping the home industry and the home market free of troublesome competition from outside. Competitive capacity is thus knowingly, and often unknowingly, neglected, with the result that exports are sooner or later affected, both on account of falling competitiveness and also because the protectionist measures force potential customers to reduce their exports with the result that their foreign-exchange earnings to pay for imports are reduced.

54. Protectionist policy is often regarded as an economic policy mechanism for reducing unemployment. The illogicality of this protectionist outlook on foreign trade lies in the fact that it is one-sided in as much as it views the economy only from the point of view of the producer and ignores the standpoint of the consumer.

Protectionism raises the prices of many goods since import competition is restricted or even eliminated. This adversely affects the consumer. Consumers are also workers in protected undertakings, although the protection is often illusory in that the higher incomes that the firm is able to pay because it can sell its output at high prices on account of protectionism, are quickly eroded by rising prices and growing inflation. It is the consumer at all events, who has to carry the burden of rising prices.

55. Protectionism also means strengthening the bureaucracy. The latter can often develop a life of its own and be exceedingly difficult to bring under control. Lastly, protectionism does not - and is not usually intended to - lead to firms producing under authentic free-market conditions, and is therefore an obstacle to growth of firms in viable areas of industry. In the

medium term this will reduce growth in incomes and jobs. The growing need for subsidies and rising price levels has to be covered at the expense of the consumer and tax-payer. At the same time, undertakings are given a reprieve from the need to adapt, to innovate, to rationalize, to make structural changes. This saves investment, and many undertakings can hold on to their markets because they are not exposed to pressure of competition from foreign rivals. Seen in this light, protectionism is not only fundamentally damaging to national economic development, but is also anti-social.

56. This may be politically desirable, and might even be acceptable if industrial capacity is just sufficient to supply the home market. If capacity is higher however, firms must turn to export markets, which means that they must be able to export competitively. Their prices must be viable on other countries' markets. This situation can be maintained as long as the industrialized countries enjoy a certain monopoly position on the world market. But as more Third-World countries develop and emerge as competitors able to offer comparable products at lower prices, the stiffer does competition become for the industrialized states. The industrial sectors affected lose their competitiveness on the world market. This leads to a fall in capacity utilization; nor does an internal market benefiting from protectionist measures compensate for this. The consequences are yet higher product prices, and the spread of the problem to other, still competitive undertakings, since exports by the latter are depressed because the emerging industrialised countries will only purchase from states whose markets provide outlets for their own products.

57. Protection is also used however to obstruct or slow down adjustment processes resulting from fair competition. This is usually justified on the grounds of job creation. But any trade policy that put non-adjustment at a premium would be bound to entail unacceptably high overall economic costs. The most that can be justified is provisional channelling of excessive pressure to adjust. Trade policy and structural policy measures can be envisaged subject to this condition. Structural policy measures should be aimed primarily at strengthening capacity to adjust, whereas trade policy should be used to forestall short-term distortions in the adjustment process by external economic influences.

58. Since protectionism distorts the structures of consumption, production and external trade, reduces overall economic prosperity and narrowly restricts the margin of growth of the economy, it should manifestly be the exception rather than the rule. This also applies not least on account of the threat to exports of counter measures.

Experience shows that it is always difficult, even if only in the short term, to reverse protectionist measures once they have been authorized. The more likely development is that they will not only be retained, but further strengthened. Nor should protectionist measures be allowed to be interpreted as an indication that the state has assumed responsibility for securing jobs, and that significant private initiatives have been made superfluous. Governments all too often tend to regard trade policy measures as a substitute for - and not as an adjunct to - structural policy measures.

59. The principle must therefore be adhered to of ensuring that specific and highly restrictive conditions are attached to measures designed to afford protection against external economic activity. This means that protectionist measures should be regularly authorized only on the basis of precisely fixed deadlines, and only as part of a comprehensive public and private sector adjustment programme. Regular controls must also be used to ensure that the sector concerned reacts by implementing appropriate adjustment measures, and is not allowed to default on this, as has occurred with for example the world textiles agreement. This also means that the scope of the measures implemented should as a rule be degressive. This would also go a long way towards relaxing the tension frequently associated with new temporary measures. Protection against precipitate structural adjustment for a fixed time period is at all events to be welcomed, in particular in times of economic recession and crisis, as a socially necessary restriction on free trade. All structural adjustment entails job losses. In 'normal' times these losses are balanced out by the creation of new jobs elsewhere, ie. in sectors that benefit from structural adjustment or that belong to areas with a strong capacity for innovation. The objective of this kind of protectionist measure however must always be to complete the necessary structural adjustment and not to maintain outdated structures that are no longer competitive.

60. Protectionism can also be justified as a means of securing a basic level of equipment and supplies in particular goods. Thus in the European Community, the priority given to covering food-supply requirements is one of the fundamental objectives of agricultural policy. The same also applies to raw materials and industrial products, and to services where overwhelming or complete dependence on third-country suppliers should be avoided. One example of this is the field of energy supplies and thus the securing of a certain independence of supplies originating in third countries in important raw materials. Without protectionist measures to maintain domestic energy sources, hard-coal mining in the 70s would, for example, have succumbed more or less completely to competition from cheap oil in the 70s. The European Community would have become economically and politically overwhelmingly dependent on energy imports and thus open to blackmail.

61. The need to maintain certain basic structures is another socio-political component of free trade. This applies for example to the shipbuilding industry. The European Community must not neglect to maintain a certain shipbuilding capacity. External trade is a fundamental element for economic stability in the European Community, and this in turn depends fundamentally on an efficient sea-transport system and a modern highcapacity merchant fleet.

62. In the strategically important sectors, also, in particular those of security and defence, intervention in free trade must be permitted. This applies both to maintaining production capacities and to restricting exports for political reasons.

These restrictions on free trade should however be kept within clearly defined limits, for the close integration of the Community in world trade and the strongly regional distribution of suppliers mean that the argument from security of supplies is generally only of limited economic justification. The subsidies necessary to protect such areas of industry from external competition can hardly ever be justified by comparison with the possible risks or with the extent and duration of probable interruptions in supplies.

IV. Adjustment of EEC policies to regulated free trade within GATT

63. The countries of the European Community account for about 50% of each

other's external trade. A further 25% of external trade is with industrialized third countries, in particular the USA and Japan. Changes in the volume and structure of this trade have led to relatively minor labour market problems.

Trade with Japan has however led to redirection towards certain specialized markets. It is above all the emergence of the threshold countries however, with their less skilled labour forces and relatively undemanding technologies in traditional areas of production that has placed the greatest pressure on the old industrialized countries and produced considerable pressure for labour-market adjustments in the EEC as elsewhere. These countries have of course also strongly increased their purchases from the EEC, but those made redundant in one branch of production are not necessarily qualified for immediate employment in another, expanding branch.

64. Since the 70s this change in world and domestic economic conditions has created a growing need for structural adjustment. The preparedness and capacity of industrial undertakings for adjustment has not however been adequate to the task in hand. This failure to secure adequate levels of structural adjustment has contributed to lower growth and employment rates.

Under conditions of free trade, adjustment of supply structures of the EEC economy to changed international relations of competition will require concentration on high-technology goods, further specialization of production and a willingness to abandon areas of production that are no longer competitive. This will in turn depend on raising productivity through increased investments, a more intensive research and development effort and increasing the skills of the labour force.

65. These considerations make it clear that a close connection exists between EEC trade policy and emerging EEC structural policy in the fields of agricultural, social and regional policy and in energy and industrial policy. Protectionist trade policy and structural policy aimed at maintaining sectoral distribution of production and employment can only reduce opportunities for shaping viable structures in terms of international competition and securing growing real incomes through higher productivity. An effective free trade policy in the European Community must be supported by a development and industrial policy at Community level.

66. The objective of a common industry policy must be to help bring about a constructive division of labour. The industrialized countries must use this division of labour to the advantage of their high-value technology, the developing countries to that of their lower costs. It would be absurd to be afraid of a rise in productivity. In the long term the classical labour supply in most industrialized states is approaching long-term exhaustion on demographic grounds alone, and this can only be offset by increased productivity.

67. Nor can world poverty be finally overcome except through a continuation of the development process, although here development cannot be a simple copy of that in industrialized states with their particular social structures, but must be built on the existing structures that have grown up among the peoples concerned. Only in this way can the repeated tendency of more development to mean more social upheaval, hunger and poverty be reversed, and development become a force to overcome hunger and poverty while stabilizing and consolidating existing social structures. "

68. The developing countries remain major raw materials suppliers to the Community. In a departure from the now out-dated pattern of North-South trade relations - raw materials against finished products - they are also increasingly emerging as participants in a substitution process as a consequence of the national division of labour. They are increasingly trading finished goods against finished goods. The developing countries are for example supplying consumer goods in exchange for investment goods that are invested inter alia in the consumer goods industries, thereby strengthening the international competitiveness of these branches of industry or indeed making it possible for the first time.

69. As a consequence of these developments the non-traditional exports of the developing countries have become the focal point of external trade conflicts between the Community and the Third-World states, for the developing countries are demanding not only tariff-free and unrestricted access to Community markets, but also tend to grant their export industries massive state subsidies of the most varied kinds. The Community states, for their part, recognize the needs of the developing countries for free access to markets at least in principle,

insofar as these accord with the liberalization objectives of the EEC treaty. Yet the credibility of Community and Member-State development policy is at stake in that it has repeatedly and explicitly urged Third-World countries to adopt a strategy of world market integration and export-oriented industrialization as a means of making a greater development impact than a public transfer of resources that could not be implemented as intended, either quantitatively or qualitatively.

70. Nor is it so much the absolute levels and current dimensions of processed goods imported from the Third World that is cause for concern, but rather the high growth rates of trade in such goods and the attendant prospects for future development. The disturbing fact is that those hardest hit by competition from developing countries tend to be in the less skilled jobs in crisis regions and to have little chance of finding a new job, and there is a follow-on effect on those branches of industry that in any event face strong pressure of competition from abroad and are also placed at a disadvantage by general changes in patterns of demand as a consequence of changing income structures.

71. The EEC states also deplore the lack of balance in their trade relations with the developing countries and in particular those with the threshold countries. The latter tend to maintain the high protectionist barriers with which they protect local suppliers against foreign competition even when the domestic branches of industry have grown out of the development stage and have demonstrated their international competitiveness by achieving impressive export successes in conditions of relatively free access to markets in the industrialized countries.

72. A further objective of Community industrial policy must be to put an end to national protectionist policies. The necessary structural adjustment process must be strengthened by joint tariff and fiscal policy measures. This is also necessary in order to be able to influence the market so as to regulate the rate of necessary structural change as a way of avoiding or compensating for an adverse social impact.

No such structural adjustment policy would be complete without consideration and analysis of world market developments. This would allow data to be assembled in good time so as to enable sectors affected by these developments

to implement an adjustment strategy as early as possible. This kind of preventive structural policy would require representation of the European Community in the Third World to be expanded as the only way of conducting the necessary in-depth monitoring and analysis of economic developments in these states.

73. It will also be necessary to strengthen the position of the Commission as regards Community industrial policy so as ultimately to secure a common structural policy as opposed to ten often highly divergent structural policies. Among other things this would mean harmonizing Community legislation on cartels, trade, companies and competition. The Community will not otherwise be in a long-term position to take full advantage of the opportunities open to it under GATT and to protect itself not only against dumping practices but also against cartels, in particular those of large international undertakings, thereby securing uninterrupted development of its own industrial structures and guarantees of jobs in the Community.

74. European structural policy must include development of a negotiating mechanism aimed in particular at enabling small and medium-sized undertakings to secure new markets, build up a clientele and carry out necessary product servicing. Implementation of structural promotion measures, insofar as the initiative is taken by the Member States, must be coordinated by the Commission to avoid competition in the granting of adjustment subsidies. In the medium term this will make consistent fiscal harmonization necessary, together with the development of a 'know-how exchange', risk-capital arrangement and joint planning of expansion and consolidation. Special importance will attach to expansion of European regional aid, for joint coordinated structural adjustment must be given priority and be concentrated above all on the weaker regions of the Community.

75. One of the reasons for the Japanese export success was and remains Japan's capacity to produce industrial products for export in very large quantities and therefore at highly favourable costs. In Europe many branches of industry are conceived on much too small a scale, to be able to produce at such low costs. Here, the objective must be to promote the step-by-step establishment of a joint European industrial structure as opposed to making repeated additions to numerous existing national structures. It is

unacceptable for trans-frontier cooperation between undertakings to be subject to repeated failures on account of continuing discrepancies in national legislation concerning taxation, social security and the constitution of companies.

76. If a European industrial policy is to succeed and to help secure the competitiveness of European industry and maintain jobs, together with high living standards and high real incomes, it must be supplemented by a common external trade policy. Although a common external trade policy should, to comply with the EEC Treaty, have long since been in existence, the fact is that it has only been achieved in part.

77. It is a valid principle that the answer to the challenge of world economic structural change - necessary and inevitable as it is - can only take the form of a positive, forward-looking strategy of adjustment and not that of an attempt to preserve outdated structures. Close connections do in fact exist between external trade, structural change and economic growth. The decisive factors for structural change, in addition to the rate of economic growth, are redirection of public and private demand and the introduction of new production procedures and new goods, together with agricultural policy measures.

Given the high level of the Community's external trade interpenetration, a close interrelationship between structural change, economic growth and external trade must be expected. Exports as a percentage of Community industrial production rose from 20% to over 25% in the 70s, and the import rate rose from 18% to 23%. For some smaller Member States these rates were even higher.

78. External trade interpretation is both a cause and an effect of internal economic structural change in the Community. Change in production and employment structures is influenced by changes in the level and structure of world demand. Changes in the volume of world trade and in internationally divergent economic cycles can result in wide variations in growth of demand for Community goods. Supply changes in competitor countries on EEC or third-country markets can also be responsible for structural changes. New product development and the establishment of new industries abroad offering attractive quality and prices to Community purchasers will force European

producers to make timely adjustments, i.e. either to implement their own product and production innovations or to give up production or transfer it to other locations where costs are lower. In this connection, technology transfers are bound to assume major importance. Deliveries of European investment goods, transfers of patents and licences, and Community direct investments would help to accelerate these processes. For European operators to forego such commitments would scarcely alleviate the negative impact within the Community, for it could only be expected that in that event the place of European suppliers or investors of capital would be taken by undertakings from other industrialized countries.

79. There can be no doubt that exports of technology save the recipient countries arduous and often costly development efforts, and in conjunction with low-cost conditions of production give them an initial advantage vis-à-vis the exporting countries, but in the medium term these advantages can only be maintained and exploited if their own research and development efforts lead to new product and production developments. It should also be noted that, particularly in times of reduced growth in real incomes, a shifting pattern of internal demand is likely. Producers are therefore more strongly impelled to take measures to maintain and increase their international competitiveness if they wish to avoid production and job losses.

V. GATT adjustment - the necessary steps

80. The foregoing will have shown the necessity of decisive promotion of Third-World development. This must include stricter observation of articles XXXVI to XXXVIII of GATT and more comprehensive implementation of the agreements they contain, including:

- improvements in export earnings
- improvements in access to markets
- strengthening of diversification efforts
- strengthening of financial aid, etc.,

for the developing countries.

81. Where efforts to promote the developing countries under GATT are stepped up, attention must be paid to the need for the developing countries to be bound under GATT rules to the extent that their development has led to an increase in their competitiveness.

82. The fuller development and adjustment of GATT and the redefinition of its fundamental principle of free trade will require the following additional developments:

- further abolition of non-tariff barriers to trade;
- a clearer definition and understanding of subsidies;
- the creation of clear criteria for the restriction of self-limitation agreements to fixed time periods and exceptional circumstances;
- inclusion of services under GATT rules, having special regard to the interests of developing countries;
- introduction of an improved arbitration procedure by strengthening the authority of the GATT secretariat and introduction of means of imposing sanctions;
- the calling of a special GATT round on trade problems of the developing countries.

The most difficult task for GATT however will be the search for a satisfactory definition of necessary protectionist measures so as to ensure that they allow the fundamental principle of free trade to be maintained to the greatest extent possible, while providing for the continuing adjustment of economic structures, with due regard to national economic conditions in the Member States of GATT and the need to secure more jobs and a fair division of labour.

