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Global Protectionism: Trends and Implications

National Intelligence Council–
Directorate of Intelligence
Joint Memorandum

This Memorandum was prepared jointly by the National Intelligence Council (Major Issues) and the Directorate of Intelligence (Country Annexes). Comments are welcome and should be addressed to [redacted] Analytic Group, National Intelligence Council, [redacted] Directorate of Intelligence, [redacted]

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Global Protectionism: Trends and Implications

Scope Note

Information available as of 29 March 1983 was used in the preparation of this Memorandum.

The prolonged global economic recession has given a boost to protectionist sentiment. Record unemployment in all major industrial countries has prompted calls to insulate national markets from foreign products and to promote exports. The issue of protectionism is a dynamic one that generates a wide range of concerns and questions—it is constantly debated at the abstract level of free trade versus protection; it is fiercely contested at the practical level where many parties vie to protect their interests; and it raises fears of a trade war reminiscent of the 1930s.

This Memorandum first addresses the changing nature of trade problems over the past decade and dangers for the future. This is done in a question-and-answer format to highlight the most policy-relevant aspects of this highly complex issue. Second, it examines current protectionist pressures and trends in major industrial countries and in key less developed countries.

The paper draws heavily on the judgments of CIA analysts. Sources include open literature, embassy reporting, and UN, International Monetary Fund, Organization for Economic Cooperation and Development (OECD), and country statistical publications.

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Global Protectionism: Trends and Implications

Key Judgments

- During the past decade the trading environment has changed in many ways that make the issue of protectionism more difficult for policymakers to deal with:

  — Economic growth has slowed considerably, making adjustments to trade problems more socially painful and politically sensitive.

  — Foreign trade has become more important to the health of all the industrial-country economies. As a result, imports are more disruptive to the industrial adjustment process, and exports are more important to ensuring economic growth.

  — Multilateral trade liberalization agreements have lost their force as a tool in the battle against protectionism.

  — The introduction of flexible exchange rates has meant that currency movements play a much greater role in determining relative trade performance. Because exchange rates are influenced by factors other than trade flows and thus often move contrary to changes in competitiveness, their movements have greatly stimulated protectionist pressures.

- Despite the changed environment and the increased protectionist sentiment and trade frictions spawned by the lengthy global recession, the relatively open global trading system that emerged in the 1950s and 1960s remains essentially intact. A trade war reminiscent of the 1930s seems highly unlikely despite the constant rhetoric raising fears of such an event:

  — Post-1973 protective actions have not significantly affected the growth of overall world trade volume, which since 1973 has continued to outpace economic expansion by the same rate it did during the previous two decades.

  — The relatively large drop in international trade in the second half of 1982 did not reflect the effects of protectionism but rather large cuts in imports by financially strapped less developed countries (LDCs) and generally reduced economic activity.

— New protective actions have not exceeded by much—if at all—the trade-boosting impact of such liberalization moves as continually reduced tariffs.

- Indeed, considering the intense protectionist pressure arising from the highest unemployment levels since the 1930s, actions taken so far by industrial-country governments have been relatively limited.

  — The United States and the European Community countries have taken some highly publicized steps to limit selected imports; the EC moves are aimed at Japan and the more advanced LDCs.

  — France is the most vocal advocate of a more restrictive trade policy, although President Mitterrand recently removed from his Cabinet the most outspoken proponents of protectionism.

  — West Germany and the United Kingdom retain their strong commitment to free trade but have increased protectionism somewhat in the face of mounting unemployment and to achieve a common EC front.

- In the next five years, the most serious protectionist danger we see is that efforts by industrial countries to inhibit import surges in basic manufactures will spread to high-technology products:

  — If that happens, competition would be curtailed in the crucial early phase of the product cycle, slowing economic efficiency and limiting the most dynamic sector of economic growth.

  — The recent EC–Japanese trade accord provides an early warning of this protectionist tendency.

  — Strong economic growth offers the best means of alleviating these protectionist pressures.

- Future international trade negotiations are more likely to emphasize harmonizing national laws than further liberalizing trade restrictions:

  — The reduction of trade barriers and the increase in trade interdependence occurring in the past few decades have reduced to the politically acceptable minimum the ability of industrial countries to protect their domestic industries.

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— Mutual economic dependence, however, will probably increase even more as companies turn to direct foreign investment to overcome remaining national trade barriers.

— This, combined with new factors making the market access issue more complex (for example, the rising trade in services), suggests that pressure will grow on industrial countries to negotiate international accords that permit the entry of foreign goods, services, and investment into national markets under relatively equal conditions or at least under restrictions that other countries accept as relatively equitable.

— The major danger will be that the compromise standards will end up close to the most restrictive set of industrial country regulations.

- The United States will be at a growing disadvantage in dealing with foreign protectionist practices:

— As tariffs have been reduced, the West European countries have increasingly relied on more subtle means of protecting their industries. The Japanese have always done so. These measures have proved very difficult to negotiate away.

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Major Issues

Nature of the Problem

1. How can the protectionist issue best be viewed? No easy answer can be provided especially since as a practical policy matter protectionism is a rather murky, highly subjective issue and is viewed from many perspectives.

Type of action. From a theoretical point of view, protectionism is any action taken by governments or private groups that distorts trade patterns away from what would have occurred under free market conditions. In practice, however, almost every government economic, social, or financial move has an impact on international trade flows and relative competitiveness—whether intended or not:

- Macroeconomic policies in the short-to-medium run most often have a greater impact on trade than such clear-cut trade actions as changes in tariffs and quantitative restrictions. For example, although monetary policies are directed at stimulating or slowing domestic economic activity, they also substantially influence import demand and alter the price competitiveness of a country's goods and services by their effect on exchange rates. Such trade differences can be eliminated only through a convergence of macroeconomic policies among industrial countries, a goal that still seems a long way off.

- Government regulations often provide a country with a competitive edge (or disadvantage), even when the laws treat domestic and foreign traders in the same fashion. Differences in tax laws or safety regulations among countries, for example, make one country's market more or less accessible than those of others.

- Differences in the manner governments work with their private sector also result in unequal trade opportunities. Some governments (Tokyo and Paris, for example) are more inclined than others to grant financial assistance to industry and to allow (or not to interfere with) companies to pursue cartel-like or other practices that protect domestic markets from foreign competition. In some cases, especially Japan, the government lacks the ability or willingness to alter (and sometimes encourages) those protectionist practices that have become a normal part of the social-cultural environment. The inherently strong cooperation between the Japanese Government and private industry also leads to "targeting" the development of new product lines and export surges in these products.

- Government actions designed to restrain trade, however, are not always considered by other countries as an attempt to tilt trading relations "unfairly" in the initiating country's favor. For example, the recent moves by debt-laden less developed countries (LDCs) to cut imports and boost exports are regarded by others as a necessary move in dealing with a financial crisis.

- Finally, the private sector alone can thwart trade competition; for example, when multinational companies try to use their supranational power to establish international export cartels (such as diamonds, steel, and oil) or to set prices in an artificial manner in intracorporate transactions. Some 15 to 25 percent of trade in manufactures involves intrafirm shipments.

Areas of interest. Until recent years, protectionist issues centered mainly on trade problems related to declining or slow-growth industries and agriculture. Now there is a growing interest in high-technology products and services as well. Greater attention also is being focused on trade distortions caused by impediments to foreign direct investment. In all, these new areas of interest have made trade issues more complex and, as such, more difficult to come to grips with in policy discussions.

Views of Protectionism

Protectionism is most often perceived as foreign practices that:

- *Allow "too much" protection against foreign goods and services.*
- *Disrupt domestic markets in a "highly adverse" manner.*
- *Result in "unfair" competition.*

Major forms of "unfair" competition include:

- ***Direct:***
  - *Tax subsidies on exports and export financing.*
  - *"Dumping" goods in foreign markets at prices far below those charged domestically.*
  - *"Buy national" purchasing policies.*
  - *Favoritism toward nationals in investment incentives and regulations.*
  - *Local content laws.*
  - *Tied economic assistance.*

- ***Indirect:***
  - *Tax concessions or subsidies for private- or state-owned industries and for high-technology growth or "senile" industries.*
  - *Special fiscal benefits for "depressed" regions.*
  - *Price controls on major industrial inputs—oil, gas, and so forth.*
  - *Commodity cartels; among major producing countries and those sanctioned by the government for depressed industries—EC and Japan.*

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Impact. It seems most useful to view the impact of trade distortions at two levels:

- *Jockeying among groups to protect their interests.* The unrelenting process of economic change creates constant gainers and losers among power groups, a continuous stream of trade frictions among countries, some new trade barriers, and losses in economic efficiency, but its impact normally falls far short of seriously disrupting overall trade (see box).
- *Overall trade.* The possibility exists that protectionist actions will reach a threshold whereby they are seriously crimping trade flows and substantially slowing expected adjustments to the industrial structure. Such a circumstance existed during the 1930s.

Changing Nature of Trade Issues

2. Has the trade environment changed significantly since the early 1970s? Clearly, the answer is yes as a result of:

- The end of the period (1950-73) when economic growth was extraordinarily rapid. This has meant that adjustments to changing trade patterns have become more socially painful and politically upsetting.

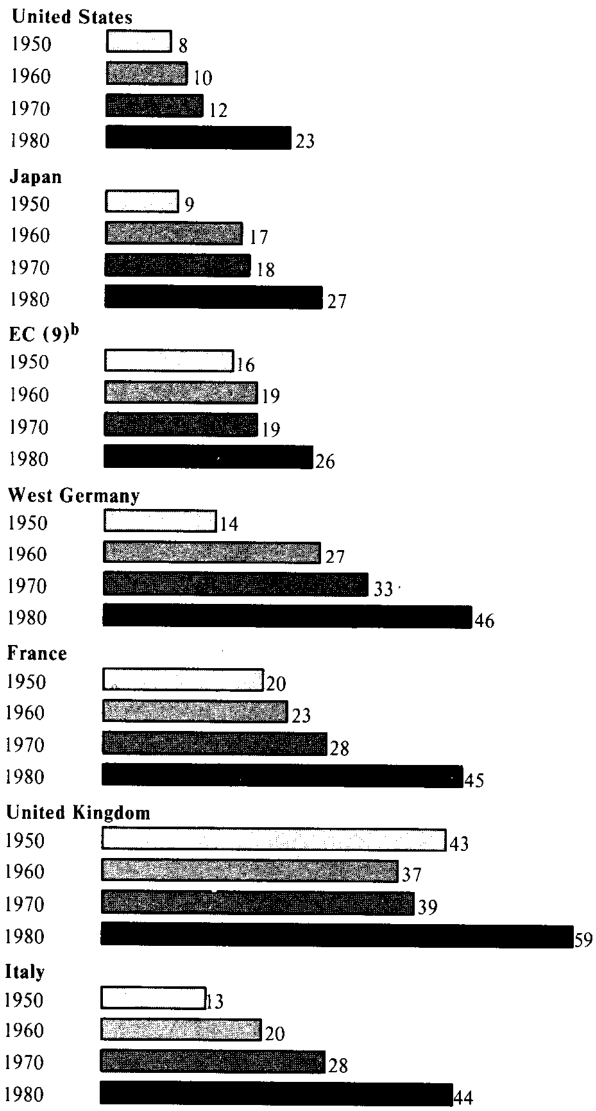
- The end of the period (1945-70) when the United States was able and willing to encourage imports, permit discrimination against its exports, and allow the dollar to remain "overvalued." As the West Europeans and the Japanese regained their economic strength and trade competitiveness, trade frictions increased.

- The growing importance of foreign trade to each industrial country's economy during the past 30 years and especially in the 1970s (see figure 1). This has meant that imports have become a more disruptive element in the industrial adjustment process and that exports have become a more important factor in ensuring economic growth. In balancing these two influences, governments have become increasingly circumspect and subtle in applying protectionist actions because they fear retaliation.

- The loss of potency of multilateral trade liberalization agreements as a tool in the battle against protectionism. Most of the highly visible unilateral restrictions—tariffs—have been reduced to the point (among industrial countries) at which they no longer significantly restrain trade. The remaining barriers are considerably more difficult to remove.

Figure 1
Growing Interdependence

Exports as a percent of production of goods[a]



[a] Value added in agriculture and industry.
[b] Excluding intra-EC trade.

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- The introduction of a flexible foreign exchange regime in the early 1970s. Currency movements now play a much increased role in determining relative trade performance among industrial countries. Because these fluctuations are influenced by capital as well as trade flows, exchange rate changes often run contrary to changes in trade competitiveness. This situation has greatly stimulated protectionist pressures, most notably in regard to trends in yen-dollar rates.

- The rapid rise of efficient and aggressive new trade competitors since the mid-1960s. Japan is now challenging the United States and Western Europe in high-technology goods and industrial management know-how, while South Korea, Taiwan, Hong Kong, and Singapore are quickly moving up the economic ladder to more sophisticated goods.

- The powerful and dynamic technological changes, especially in microelectronics, that are accelerating ongoing shifts in industrial structures. With much more competition at the sophisticated end of the product range, many of the trade frictions are coming and going quickly, and market domination in many product lines is lasting for only a short period.

3. Has international trade become increasingly constrained by protectionist actions since the early 1970s? In the aggregate, probably not. To answer this question, it is necessary to gauge the level of protectionism in the early 1970s and the changes since then.

Most observers consider the world trading system of the early 1970s to have been rather open, especially when compared with what existed in the intrawar years. The major achievements between World War II and the early 1970s include a sharp reduction in industrial-country tariffs (see figure 2) and the establishment of the European Common Market and the US-Canadian free trade region for motor vehicles. The fact that industrial-country trade grew much

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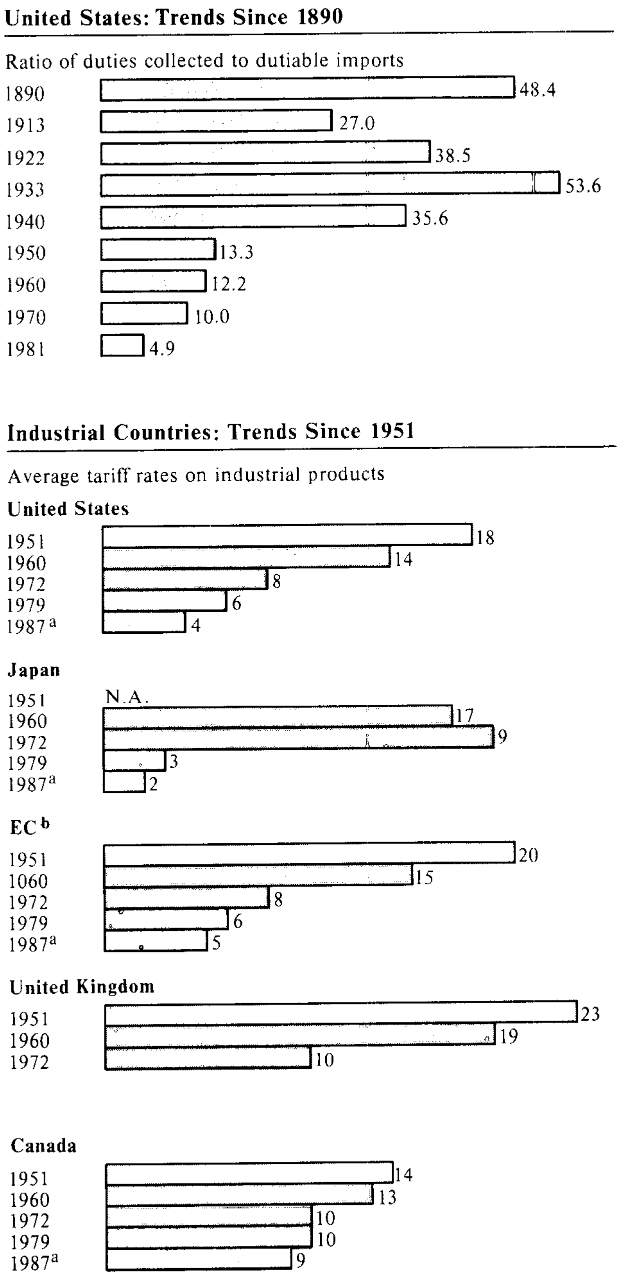
Figure 2
Tariff Trends



[a] Rates agreed to under Tokyo Round trade negotiations.
[b] Before 1972, tariffs are based on the average of the six member states weighted by imports; thereafter, community-wide tariffs are used.

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faster than output clearly supports the perception of openness. Between 1960 and 1973 the volume of industrial-country exports increased about 70 percent faster than the group's real GNP.

Since the early 1970s the record on trade practices has been mixed. Increased emphasis has been placed on regulating sudden surges of imports and on providing financial and other incentives to exporters, practices widely referred to as "new protectionism" or "neomercantilism." The most striking protectionist tendency has been the attempted reduction of import surges in manufactures through quantitative restrictions under the guise of "orderly marketing agreements", "voluntary" export restraints, and similar arrangements. Color television sets and automobiles were the major new product lines restrained in such a manner while controls on textiles, apparel, shoes, and steel were broadened and tightened. The National Institute of Economic and Social Research in London estimates that 21 percent of world trade in manufactures was covered by nontariff restrictions in 1979 compared to 13 percent in 1974. New barriers since 1979, especially on automobiles, have probably pushed that estimate to near 30 percent. Although this indicator provides a sense of how much trade is covered by nontariff barriers, it does not measure changes in the overall impact of protectionism.

Some increase may also have taken place in export subsidies, although such trends are hard to measure. Much of the assistance is indirect and difficult to trace; for example, central banks sometimes guarantee export loans, thereby allowing sellers to provide loans at below-market interest rates. Another means by which governments indirectly improve private industry competitiveness is through subsidies to industry. The European, Japanese, and Canadian Governments provide relatively more subsidies than does the United States (see figure 3). The more visible form of export assistance, the direct provision of suppliers credits at less-than-market rates, has fluctuated with interest rate trends. The subsidy element of loans

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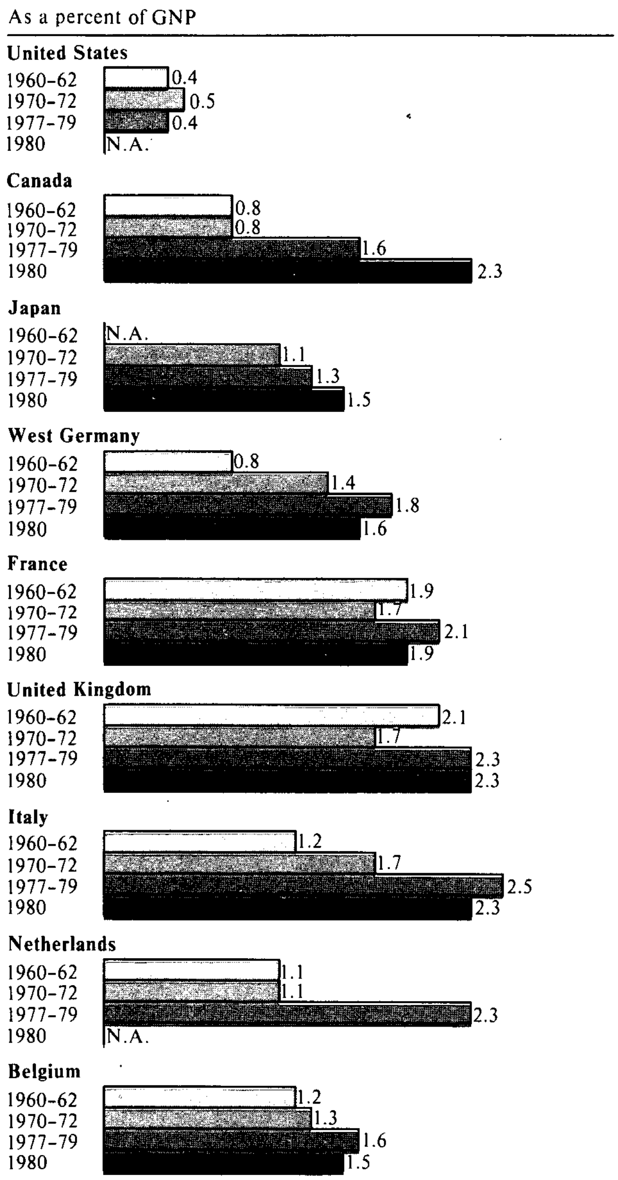
Figure 3
Government Subsidies to Industry[a]



[a] OECD estimates: subsidies defined as all grants on current account made by government to private industries and public corporations; grants made by the public authorities to government enterprises in compensation for operating losses when these losses are clearly the consequence of the policy of the government to maintain prices at a level below costs of production.

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declined with real interest rates throughout much of the 1970s and rose again after 1979. According to one estimate prepared for the National Bureau of Economic Research, the total volume of export credit subsidies of the seven leading industrial countries rose from $330 million in 1976 to $3.5 billion in 1980.

At the same time new trade distortion measures were being put in place, other trade restrictions were being eased:
- Tariffs were cut under the Kennedy and Nixon (Tokyo) rounds of multinational trade negotiations (MTN).
- Japan continued to gradually open its market.
- Competition in the mineral trade grew because the vertically integrated structure of production and marketing was being reduced substantially.
- The United States eliminated its low-priced oil advantage.

On balance, these countertrends seem to offset each other in terms of the relative growth of world trade. Between the peaks of the business cycle in 1973 and 1979, the volume of industrial-country exports rose about 70 percent faster than the group's real GNP, the same relationship that held between 1960 and 1973 (see figure 4). In addition, the volume of non-OPEC LDC exports accelerated significantly mainly because of increased sales of manufactures by the newly industrializing countries (NICs). In fact, LDCs continued to increase their share of industrial-country markets for manufactures despite rising nontariff protection.

4. What costs have resulted from protectionist actions taken since the early 1970s? This often-asked question cannot be answered with any precision, and, in fact, it tends to focus attention on the wrong issue. In economic terms, the various neomercantilist moves clearly have been costly. Consumers must pay higher prices for protected goods, and capital is directed to the protected industries because profits are propped up. Without protection, additional capital would have been invested in the more efficient industries. However, in practical political terms, government officials

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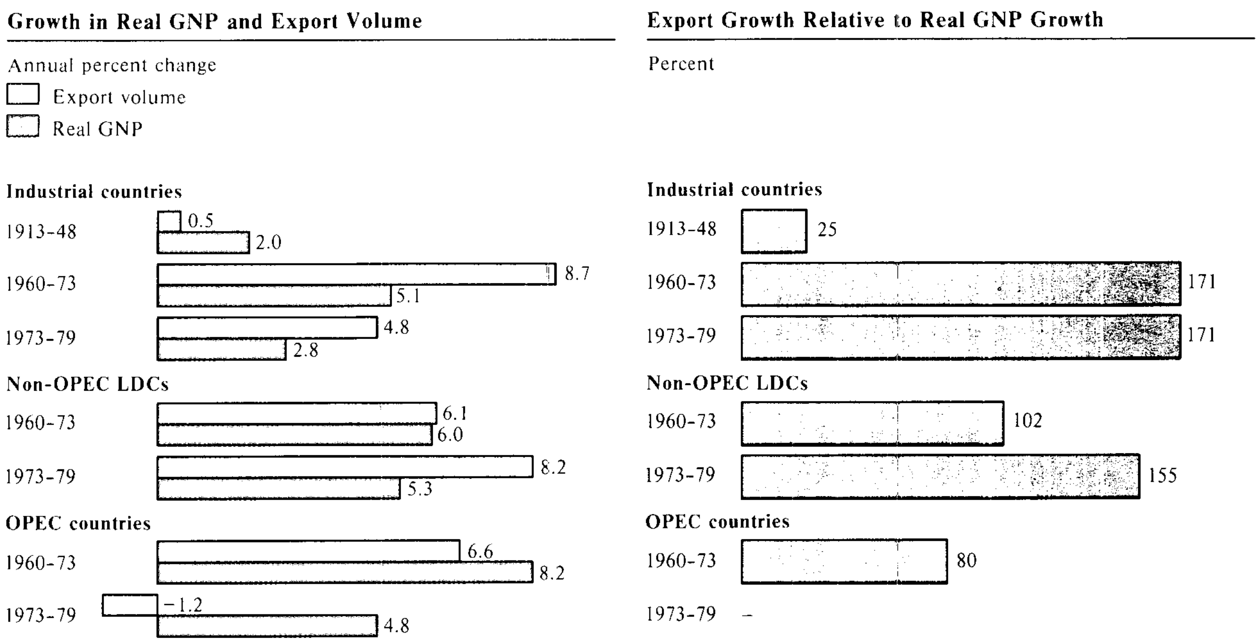
Figure 4
Trends in Output and Exports



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have felt compelled to respond to industries and groups hurt by sudden and large shifts in trade trends. The dilemma facing policymakers is how to allow the needed industrial adjustments to occur while minimizing the disruption to domestic business and workers. That balancing act often requires accepting some higher economic costs in order to achieve a less disruptive adjustment process.

Although industrial countries have responded to this balancing act in an ad hoc and certainly far from perfect manner, the overall results to date have been more satisfactory than not and indeed have been the most that could be expected considering the difficult and uncertain post-1973 circumstances. Protectionist actions, although slowing industrial adjustments, have fallen far short of halting them. Output of textiles, steel, and ships have continued to shift to more efficient and lower cost producers. Despite the tight restrictions on textiles, for example, LDCs have continued to make deep inroads into industrial-country markets. Those LDCs that were restrained have upgraded their product lines in those items being controlled and moved into other and often more sophisticated products. Sale of the controlled products have shifted to nonrestrained LDC exporters, thereby spreading the benefits of trade to more countries.

5. Has the increased tendency of foreign governments to employ nontariff trade barriers affected the US trade bargaining position in any important way? Yes. It has created a distinct negotiating disadvantage. The United States, more than most industrial countries, emphasizes the rule of law over discretionary acts. Thus, while US protectionist actions are highly transparent, other countries, to one degree or another, depend more heavily on behind-the-scenes arrangements. For example, European Community (EC) producers have negotiated numerous informal quantitative restrictions with Japanese exporters with the tacit approval of their governments. EC mechanisms for resolving "dumping" and foreign subsidy cases are handled by the EC Commission in a discretionary manner and without written record. In contrast, the US process is highly judicial, open, and recorded. The Japanese protection system is by far the most opaque in that it is based mainly on verbal and nonpublicized agreements among interested parties. Moreover, most Japanese protectionist practices arise from strong social-cultural traditions and independent bureaucratic actions. Given this difference in protective means, the United States is at a disadvantage in trade bargaining, especially now that protectionist devices such as tariffs have been largely eliminated.

Protectionism in This Recession

6. Has protectionist sentiment increased in this recession? Clearly yes. Recessions always increase protectionist pressures, although this time the rising sentiment probably is greater than usual. Such an outcome seems natural with unemployment at record post-depression levels (see box). Governments also seem to be showing an increased protectionist inclination because of the significant limits they face in applying such traditional antirecessionary tools as fiscal and monetary policy.

7. Will strong protectionist sentiment persist into 1984? Most likely yes, no matter how the global economy fares. Unemployment throughout the industrial world will remain painfully high. Even with a robust economic recovery, most private forecasters expect US unemployment to remain near 10 percent this year, while European joblessness, currently averaging about 11 percent, may continue to rise well into 1984.

Although a recovery would greatly ease pessimism concerning future unemployment rates, the impact on trade balances will create another source of protectionist sentiment, principally in the United States. US exports of goods and services will not begin to move up significantly for many months because of slow economic growth in foreign markets and the continuing influence of a strong dollar. The US market share among industrial countries by mid-1982 had already dipped to the lowest level since 1977 (see figure 5). Imports meanwhile would soar to feed the US economic upturn.

Toward the end of 1983 currency shifts could fuel West European protectionism. Massive US trade deficits could cause the dollar to weaken against other major currencies. In fact, the dollar already has weakened somewhat partly in anticipation of an increasing US trade deficit. While a further dollar slide could be delayed for many months by capital inflows related to global financial and other uncertainties or by high US interest rates, the growing deficits would eventually weaken the dollar. Indeed, the longer capital movements keep up the dollar, the larger will be the US trade deficit and the steeper will be the dollar's eventual slide. Whenever the US dollar does weaken, other countries would soon find that their export markets were being lost to more price competitive US goods. Plagued by continued high unemployment, many foreign government and business leaders (especially in Western Europe) might charge that the United States is undertaking a competitive devaluation to boost exports and might be tempted to do the same.

Two long festering issues are likely to continue to receive the most attention:

- *Japan's trade practices.* Pressure against Tokyo will remain high especially because we expect Japan's trade and current account surplus to reach $30-35 billion and $15-20 billion, respectively, in 1983.

Protectionist Sentiment in the Six Leading Non-US Industrial Countries

The following questions were asked in public opinion surveys sponsored by the US Information Agency from 1974 to 1982:

Some countries favor free trade—that is, fewer restrictions on the freedom of countries to buy from and sell to each other. Other countries favor restrictions on free trade to protect their own products against foreign competition.

1. Which view do you think your country supports—free trade or protectionism?

2. And which view do you personally support—free trade or protectionism?

Trends

- *Personal view of respondents as to protectionism versus free trade:*

  — *Those surveyed in Canada, France, Japan, and the United Kingdom displayed a decreasing emphasis on protectionism between 1974 and 1979 and increased support from 1979 and 1982.*

  — *Views changed little in West Germany and Italy between 1974 and 1982.*

- *Respondents' view as to their country's support for protectionism or free trade.*

  — *Views changed little in Canada, France, West Germany, and Italy between 1974 and 1982.*

  — *Since 1976 an increasing number of Japanese surveyed see their country supporting protectionism.*

  — *From 1974 through 1979 UK views changed little, but between 1979 and 1982 those surveyed believed there was a reduced emphasis on protectionism, probably reflecting attitudes of the Thatcher government.*

Situation in 1982

- *Percent of respondents favoring protectionism:*

	Personal View	*View of Country*
Italy	*23*	*15*
West Germany	*26*	*24*
France	*37*	*32*
United Kingdom	*42*	*30*
Japan	*44*	*61*
Canada	*51*	*41*

  — *A wide range of views exists on protectionism among the six industrial countries, especially in the case of the respondents' view of their country's trade practices. By far, Japan is considered to be the most protectionist by its citizens.*

  — *Respondents perceive their country (government) as being less protectionist than themselves, except in Japan where clearly the opposite case holds.*

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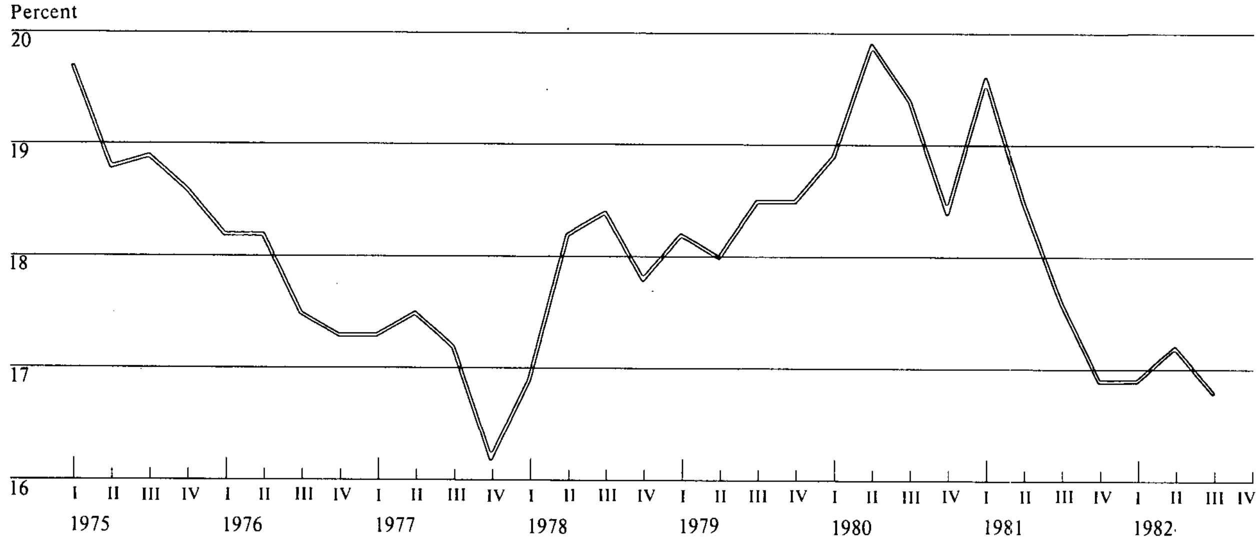
Figure 5
US Share of OECD Exports
Constant 1975 US $



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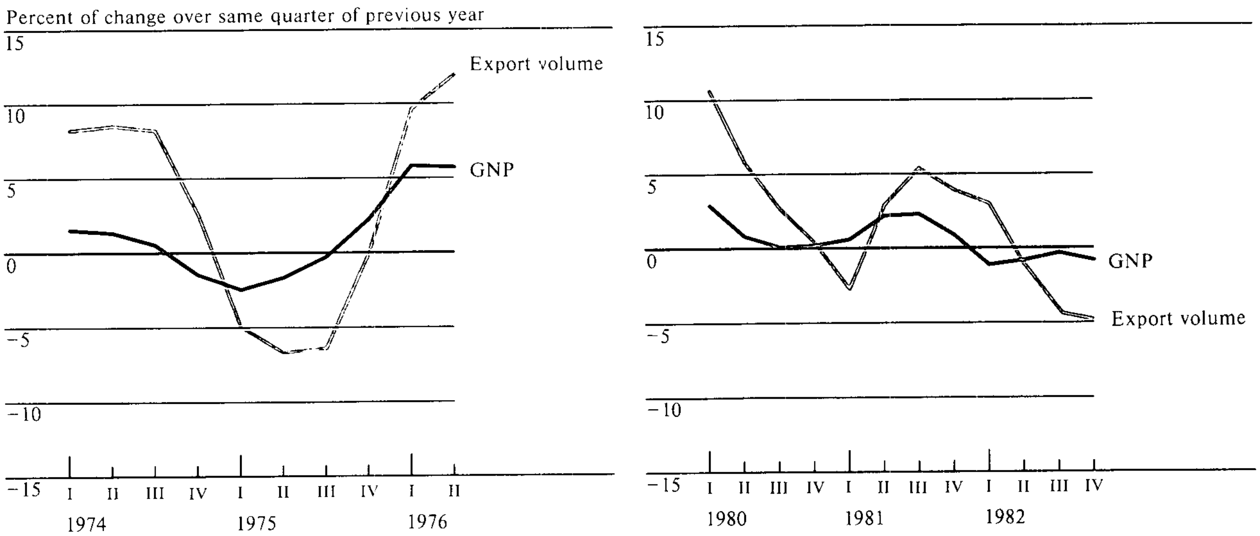
- *US-EC differences on agricultural matters.* Although the highly protective nature of the EC's Common Agricultural Policy (CAP) has long been a sore point in Atlantic relations, these differences have grown sharper in recent years because the EC has been increasing its export subsidies on agricultural products and expanding exports and because US agricultural surpluses have been rising. The current low world prices for farm goods have further aggravated the quarrel.

Close behind these will probably be the relatively new issue of liberalizing trade in services. With exports of services becoming increasingly important to the United States, pressure will grow to knock down existing barriers and see that new ones do not arise.

8. In what country is protectionist sentiment likely to be the strongest? Except for European moves to contain Japanese export drives, the United States now seems the most likely source of such actions. Its market is the most open for foreign goods, and it provides fewer subsidies to exporters than other countries. As a consequence, the United States might react to the Japanese failure to open its markets sufficiently, to EC intransigence on the agricultural subsidy issue, or to the expected burgeoning of its trade deficits. Japan is unlikely to initiate new barriers and thereby create even greater animosity toward its trade practices. Significant new intra-European barriers seem unlikely, mainly because each European country relies on other countries of the region for two-thirds of its trade. LDCs are unlikely to play much of a role. Most already impose highly restrictive import barriers, and developed countries probably would not oppose tighter LDC import controls because they realize such actions are needed to overcome severe financial difficulties.

Figure 6
OECD: Cyclical Trends of Real GNP and Export Volume



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9. To what degree is this recession's strong protectionist sentiment being translated into action? So far we believe protectionist sentiment has been largely contained. "Beggar-thy-neighbor" moves have been limited, especially considering the duration of the downturn, the high level of unused capacity, and the record post–World War II rates of unemployment. Some additional nontariff import restraints have been put in place in Western Europe and North America mainly to protect basic industries such as steel and automobiles. They have been primarily aimed at Japan and the Far Eastern NICs. At the same time, the liberalization of trade has persisted. Tariffs are being cut as planned under the MTN accord, Japan has continued to open its market gradually, an accord has been reached among Organization for Economic Cooperation and Development (OECD) members to further harmonize government-subsidized interest rates on export contracts, and poor economic conditions have increased competition in such markets as oil.

So far, there is no discernible evidence that recent protectionist actions by industrial countries are hindering overall trade flows. Like the 1974-75 recession and previous business cycles, changes in the volume of OECD exports have far exceeded and somewhat lagged real GNP trends in the dual economic downturns of the post 1979 recessionary period (see figure 6). As a result of an especially sharp trade downturn in the last quarter of 1982, the decline in OECD exports relative to the changes in real GNP is turning out to be greater in 1982 than was the case in 1975. Such an outcome, however, is to be expected. The volume of OECD exports to LDCs, oil-exporting countries, and East European countries rose throughout the 1974-75 period but fell this time around. The reduced demand of the non-OECD countries reflects the change in their foreign financial position.

The Dangers in the Longer Term

10. What are the chances of a protectionist trade war reminiscent of the one in the 1930s? We believe they are very low despite the constant public warnings of such a possibility. A devastating trade war would more likely follow a severe economic slide than cause it. The high tariffs and other trade barriers of the 1920s probably accelerated the post-1929 economic decline, but it was the economic desperation of the early 1930s that led nations to impose almost insurmountable barriers, devalue their currencies, and engage heavily in bilateral trade arrangements. Thus, with economic depression a very low probability, the chances of a trade war are equally low. Indeed, the reminiscences of the 1930s continue to provide a positive feedback in guarding against such a disaster.

Under less dire global economic circumstances, it is difficult to envisage a plausible sequence of events whereby strong protectionist activity by a major industrial country would trigger *widespread* countermeasures. In general, the cost of disentangling economic relations among most industrial countries is too high. It would be particularly self-defeating for a West European country to become involved in intraregional trade wars because of the highly integrated nature of the region. In addition, the need for unanimous EC trade decisions and the political desire to maintain the EC structure place great restraints on EC moves against members and outsiders alike. The Japanese are likely to try to avoid a spiraling trade war because of the heavy reliance of their largest and most dynamic industries on export markets. The possibility exists that an industrial country would initiate drastic protectionist moves (when there is no depression) as a consequence of severe economic troubles at home made worse by political factors; France, for example, continues to present such a danger, although the recent Cabinet shuffle points toward continued relative moderation.

11. Will the level of trade frictions occurring since the early 1970s persist? Clearly yes. Anything like the 1950-73 era, when trade liberalization rather easily overcame protectionist tendencies, is not likely to be repeated. As we have seen, these years resulted from a unique set of fortuitous circumstances, including the benevolent use of US economic power. The more normal post-1973 level of frictions created by the jockeying among interest groups will continue to be heightened by the deepening of global economic integration and the disruptive effects of dynamic exporters such as Japan in high-technology goods and those LDCs that are quickly moving up the economic ladder to more sophisticated export items. The most that can be expected in the next few years is an easing of some key aspects of the protectionist problem as a result of the lower unemployment that will accompany strong economic growth.

The occasional flareup in long-lasting trade differences, moreover, should not entirely be thought of in a negative context. These highly publicized bouts are needed from time to time to reinvigorate the forces against protectionism and to place restraints on countries that are taking advantage of "accepted" protectionist practices to bolster their own trade position. For example, the current US-EC agricultural squabble may well end, at least temporarily, in explicit or implicit arrangements that, at a minimum, will help slow the rise in EC output of exportable farm goods.

12. Will the recent and expected increase in barter or countertrade do much damage to the free trade regime? Probably not much. Countertrade—selling a plant (or a pipeline) in exchange for a portion of the output of the facility—and barter arrangements—the swapping of goods—are symptoms rather than causes of deep-seated problems. Much of such trade is East-West and reflects the inability of the East to compete effectively on world markets and their hard currency stringencies. Within the Western world, there have also been temporary surges in these arrangements; for example, when oil-consuming countries scrambled to secure supplies in the 1970s and when times have been bad economically. With goods difficult to sell on world markets and foreign exchange reserves nearing depletion, countries view barter trade as the only way to sustain exports (and therefore employment) and to obtain needed goods. For example, the Jamaican Government recently exchanged alumina for US trucks, and Iran and Indonesia are now bartering oil for industrial goods. Because such trading arrangements are a means of last resort, however, their use diminishes rapidly once economic conditions begin to improve.

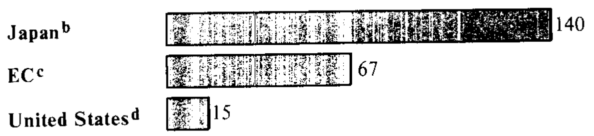
Barter trade arrangements would spread rapidly in the unlikely event of a world depression or a breakdown of the international financial system. Under these exceptional circumstances, barter trade would be better than nothing. During the early 1930s, the proliferation of bilateral barter arrangements by continental European countries mainly reflected efforts to revive international commerce that had been stifled by trade and exchange controls.

13. What are the chances that industrial countries will use currency devaluations in attempting to improve their competitive trade positions? Probably slight, barring an economic depression. A competitive devaluation by an industrial country would be hard to sustain unless the government made its currency internationally inconvertible by fully regulating capital movements in and out of the country. Otherwise, market forces would soon overcome an artificially established exchange rate. Imposition of such drastic controls would be wrenching because of the highly integrated nature of global financial markets and therefore are thought of as a means of last resort. Industrial-country governments could force a currency devaluation through expansionary monetary policies, but most leaders are well aware that the resulting rise in domestic inflation would soon negate the competitive price gains, require another devaluation, and create a vicious circle.

The suspicion that some governments are manipulating their currencies to gain a competitive edge nonetheless will remain because currency rates are often out of sync with fundamental competitive trends. In addition, the idea expressed in some quarters that some European countries are deliberately devaluing their currencies is growing out of the debate that such a move is the most politically feasible means of reducing high real wages. Devaluation without compensating workers for increased domestic prices is viewed by some as a politically easier means of

Figure 7
Estimated Costs to Consumers and Taxpayers of Agricultural Support Programs[a], 1978-80

As a percent of the value of products at world prices



[a] Excludes budget outlays on income maintainance, research, infrastructure, and foreign food aid.
[b] Rice accounts for two-thirds.
[c] Distributed widely.
[d] Dairy products and sugar account for most.

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reducing real wages than cutting nominal wages. To one degree or another, the United Kingdom, France, and especially Sweden in the past year or so have been accused of such exchange rate manipulation.

14. Will the US-EC agricultural wrangle continue as a major irritant in bilateral trade relations? Yes. The issue will persist for a while, although it will probably ease temporarily as the global economy recovers. As long as the EC continues to support its high-cost producers at prices that far exceed those of the United States (for example, more than twice the price in the case of wheat), the dispute will remain. The chances are small that the Europeans will bring their price support program in line with world prices because such a move would mean the elimination of most of the region's grain farmers. As in other countries, EC farmers have political clout that goes well beyond their numbers. The only major influences limiting EC agricultural subsidies are constant US pressure and the enormity of the related budget outlays (see figure 7). Although consumers provide a large portion of the subsidies through high prices, they have not voiced strenuous objections because they are used to the high prices.

Once world grain stocks are reduced and prices rise, the difference between internal EC and world prices is likely to narrow. This factor, when combined with better conditions for US farmers, will tend to reduce, for the moment, the longstanding US-EC agricultural dispute.

15. What is the most significant protectionist danger in the next few years? A creeping cartelization of world markets for manufactures under the guise of safeguarding industry from sudden surges in imports. The pattern for this kind of market division is well established after 10 years of increasing constraints on basic industries such as textiles, apparel, steel, automobiles, ships, and consumer electronics. Much experience has been gained in negotiating and operating quantitative restrictions. The EC has established a bureaucracy to monitor imports that are rising rapidly, and the Japanese have been doing the same thing on a less formal basis for some time. Moreover, EC and Japanese private firms, often with implicit government encouragement, have agreed to arrangements that reduce competition. Steel is the most striking case. EC and Japanese steel producers, for instance, have been working together for several years to establish global market shares and minimum prices. In these and other cases, the Japanese have agreed to informal limitations on their exports because they realize the alternative would be less flexible official controls. EC producers view the arrangements as providing market shares and profits that are higher than would have been available under free competition. In all, these agreements accommodate the sense of "orderly markets" preferred by many private firms in Japan and Western Europe, especially in France.

The key problem for the future is that these arrangements could spread to the dynamic high-technology fields that provide the cutting edge of economic advancement. Such a possibility seems most likely in Western Europe. Europeans openly admit they are far behind the United States and Japan in high-technology products and argue they need quantitative restrictions to catch up. The recent EC-Japanese agreement that restrains Japanese exports of video cassette tape recorders (VTRs) and television tubes and adjusts the export prices of these goods to the Community level is a manifestation of this current European pessimism. The agreement also created serious protectionist dangers for the near term in that it called for joint monitoring of Japanese exports of such products as numerically controlled machine tools, forklift trucks, and quartz watches. Such import monitoring efforts could develop into a systematic apparatus whereby pressure is brought to bear on the European Community to request that other countries moderate their sales drive. Under these circumstances, foreign firms or even countries would begin to scrutinize carefully their exports to avoid the possibility of pressure for additional restraints, thus making the monitoring effort an export deterrence system. Many high-technology products from Japan could be caught in this bureaucratic web. The United States and some other developed countries might then be compelled to employ similar procedures to stop Japan from diverting products to their markets. The Japanese meanwhile would probably respond by agreeing to the best orderly marketing agreements they could obtain and by investing in plants abroad to produce the restrained goods. The situation could then drift toward agreements that essentially divide up world markets, where much of the competition for the markets is restrained because it takes place behind national trade barriers and where some of the dynamic aspects of international trade in high technology are lost.

16. Will trade continue to grow faster than GNP during this decade? Probably yes, although the gap may narrow somewhat. For the next five years or so, rising foreign direct investment in manufacturing facilities will provide a major boost to trade. Bouts with protectionist pressures in recent years have been tilting corporate strategies toward establishing plants abroad and away from exporting directly from domestic plants. As in the past, a large portion of the manufactured components feeding foreign assembly lines will come from plants in the investor's country. This pattern of trade following investment was clearly evident in the large US investments in West European manufacturing facilities in the 1960s. For the next few years, it will probably be spurred by EC and Japanese investment in the United States and Japanese investments in the European Community, trends that are already well established.

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At the same time, international trade will be slowed by the falloff in the pace of industrial country exports to oil-exporting countries and to financially strapped non-oil-exporting LDCs. The trade impact of EC integration also will probably slow because much of the initial gains have been attained. The pace of intraregional trade might not slacken too much, if Spain joins the common market and, more important, if European efforts to merge companies from several countries into entities large enough to compete effectively on world markets are successful.

The future pace of LDC exports is the most difficult to gauge. The NICs will probably continue to make significant inroads into industrial-country markets as they expand output of more sophisticated manufactures. Few other LDCs, however, are likely to become as important traders as the NICs. Although some oil exporters will be able to expand their sales of petrochemicals, most LDCs lack the human skills, discipline, and management capabilities to emulate the record of the NICs.

Some Policy Implications

17. Are major new trade bargaining tendencies likely to evolve? Yes. Greater emphasis will be placed on "harmonizing" national laws, preventing export surges, and handling issues on a bilateral level. The era of international trade liberalization characterized by a series of multilateral tariff-cutting rounds probably has ended. The industrial countries have achieved about the most open trading system possible through the removal of transparent barriers such as tariffs. Many interest groups are now feeling unusually naked in terms of protection from foreign competition. Although these groups will probably be stymied in their efforts to enact much higher trade barriers because of their country's significant reliance on exports, they probably will have sufficient political clout to prevent a significant further dismantling of trade barriers and export incentives. European governments are likely to be especially reluctant to press for substantial liberalization given the real and imagined lack of global competitiveness of their countries.

Although the idea of "harmonizing" national laws so that no country has an "unfair" trade advantage has been discussed for many years and sometimes acted on, the notion will probably receive much more attention this decade. Such standardization efforts do not require trade liberalization, even though they can sometimes have that effect, as for example in the case of the recent change in Japanese customs inspection procedures. "Harmonization" is especially important in the growing service trade—for example, finance, transportation, insurance—which tends to be more regulated by governments than trade in goods.

Achieving "harmonization" agreements, however, will involve more complex and time-consuming efforts than was the case in tariff-cutting rounds. Many of the laws to be standardized were designed to meet domestic economic and social objectives and often were an outgrowth of discussions that took little cognizance of foreign trade (for example, statutes aimed at boosting economic activity of depressed regions). The diverse nature of the areas that could be harmonized will mean many separate negotiating tracks. Solutions will mainly take the form of government commitments to codes of behavior, which lack the precision that can be achieved in tariff bargains. Finally, "harmonization" efforts often will require tackling trade and investment issues simultaneously because the two topics are so intertwined.

Much of the "harmonization" discussion will probably be in areas where a common measuring rod can be devised:
- Export credit subsidies; a subject where considerable progress has already been made.
- Direct subsidies for exports; for example, in EC agriculture.
- Direct government budget support for companies deeply involved in international trade—aircraft, steel, and so forth.
- Investment incentives and local content laws.
- Antitrust laws especially in regard to market sharing arrangements between private enterprises that take place with or without government involvement.

A *key* problem in all these cases will be preventing negotiated compromises that tilt the new standards toward the most restrictive set of country regulations.

Preventing the spread of governmental efforts to dampen import surges will be particularly difficult because of the social and political costs of adjusting to rapidly changing competitive factors. In the case of maturing industries, the emphasis will continue to be placed on finding means that help reduce the social pains without slowing the adjustment process; for example, generous redundancy payments and on-the-job retraining programs.

To prevent quantitative restrictions from creeping into high-technology products and thus serving as an "infant industry," protection will be especially difficult. Industrial countries that think they are well behind in high-technology competition, as Europe now does, will contend they have no choice but to impose import restrictions until they catch up. Perhaps the most that can be achieved under these circumstances is limiting the damage by applying "moral suasion" constantly and by attempting to make restrictions as temporary as possible. Because the competitive nature of high technology can change rapidly, especially compared with the enduring problems of mature industries such as steel, it may be easier to negotiate arrangements with time limitations.

Greater emphasis, meanwhile, will probably be placed on bilateral approaches or exchanges among small groups of countries, with the multilateral trade rounds losing favor. Reaching "harmonization" agreements will be easier to achieve on a bilateral basis or among major industrial countries because of the difficulties in equating the widely different national laws and practices. In any case, meetings encompassing most nations have become unwieldy and highly polemic. This tilt toward bilateral exchanges does not mean that multilateral conclaves will not be called or be useful. Such larger meetings will be needed to limit the damage to the international trading system caused by constant protectionist pressures. Bringing countries together and having them repledge their allegiance to free trade does help stiffen the backbone of national governments. Multilateral agreements will also be helpful in setting general guidelines under which, for example, "harmonization" agreements can be negotiated on a bilateral basis.

18. How serious a problem will trade issues be for US policymakers? They will be particularly vexing. Domestic pressure remains strong for other countries to open their markets more fully and to reduce their "unfair" competition. Frustrations will continue at a high level because of the difficult problems in reaching "harmonization" agreements. As a result, the United States may find it necessary to use its substantial leverage—partially closing domestic markets or providing export subsidies—to spur a compromise. Such actions, however, would be fraught with danger since there is no way to tell in advance if they would lead to countermoves or to a hardening of attitudes.

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Country Annexes

European Community

Double-digit unemployment and growing import competition in both declining traditional industries and developing high-technology industries are prompting the EC to increase protectionist measures. The Community is relying primarily on export restraint agreements to limit imports. In addition, it appears to be making increasing use of antidumping and countervailing duties. With real economic growth likely to remain sluggish in 1983 and the unemployment rate expected to reach 12 percent later this year, strong protectionist pressures will persist.

The EC has concentrated its protective efforts against Japan and the newly industrializing countries (NICs). Little pressure exists to add new restrictions on US industrial access to the Community because the dollar's appreciation has reduced the competitiveness of US products. Nevertheless, pressure for limiting imports of US agricultural goods is certain to grow if the United States continues to sell subsidized agricultural commodities to third-country markets that the EC considers its traditional domain.

EC Trade Policy

In general, the EC has been an advocate of free trade. In previous multilateral trade negotiations the EC agreed to reduce its Common Customs Tariff (CCT) by 7 percent in the Dillon Round (1960-62) and by another 37.5 percent in the Kennedy Round (1964-67). When the cuts agreed to during the Tokyo Round (1973-79) are fully implemented in 1987, the average tariff on dutiable industrial products in the Community will drop to about 7 percent compared to approximately 5 percent for Japan and 6 percent for the United States. In addition, the EC introduced the generalized system of preferences (GSP) in 1971—the first major trading power to do so. In 1977 it signed an industrial free-trade accord with the six members of the European Free Trade Association (EFTA), thus eliminating tariffs on domestically produced industrial goods within most of Western Europe. With the conclusion of the 1975 Lome Convention, the EC agreed to grant duty-free access to most industrial exports from 63 African, Caribbean, and Pacific countries and during the 1970s concluded preferential trade agreements with most countries bordering the Mediterranean. 25X1

The EC has promoted trade liberalization efforts because trade is the life blood of the Community. As the world's largest trading block, the EC accounts for more than one-third of world exports, considerably 25X1 more than the United States and Japan put together. Manufactured goods account for nearly 80 percent of the Community's total exports and almost 45 percent of the world's exports of manufactured goods. More than half of member states' trade is with one another while about 20 percent is with EFTA countries. 25X1

Despite its general free-trade orientation, the Community has protected certain domestic industries. For example, the EC's Common Agricultural Policy (CAP) with its variable import levy system has been a 25X1 major barrier to foreign agricultural goods. While the average CCT level may be relatively low, the EC maintains relatively high tariff rates on many "sensitive" products such as semiconductors (17 percent) and automobiles (10 percent). 25X1

The EC and its individual members also have utilized nontariff barriers (NTBs) to restrict imports. At the Community level, the Multifiber Arrangement (MFA), originally formulated in 1973 with GATT approval, has been increasingly relied upon to protect the Community's textile industry. In 1978 the EC negotiated voluntary export restraint agreements (VERs) with 15 of its principal steel suppliers. 25X1

Since 1955 Italy has limited imports of Japanese automobiles to 2,200 vehicles per year, and successive French governments have unilaterally limited the Japanese share of the French automobile market to no

European Community: The Players in Trade Policy Development

The development of EC trade policy is a complex process that involves the interaction of member country representatives among themselves as well as with the Community's own bureaucracy. This entire process takes place at various levels and may even include meetings of the EC heads of government.

The Commission *serves as the executive arm of the Community. It is composed of EC civil servants who, at least in theory, are working for the best interests of the Community as a whole, not their national governments. The Commission initiates policy proposals and carries out agreed EC policies. At international meetings it acts as the official EC spokesman and negotiates on behalf of the Ten.*

The Council of Ministers *is the primary decisionmaking organ of the EC; it approves Commission proposals, as well as proposals of its own, usually by consensus. It is composed of ministerial level representatives of the national governments.*

The 113 Committee*—named after Article 113 of the Treaty of Rome—acts as the go-between for the Council and the Commission. It is composed of member country representatives and helps interpret Council decisions so that the Commission can accurately implement EC policies. The Committee assists the Commission in negotiations on trade and tariff matters with third countries.*

[redacted] 25X1

more than 3 percent. British manufacturers have negotiated "prudent market agreements" with their Japanese counterparts since 1975; the auto agreement limits Japan to no more than 11 percent of the British market. In mid-1981 West Germany gained Japanese agreement to limit growth in auto sales to 10 percent per year. [redacted] 25X1

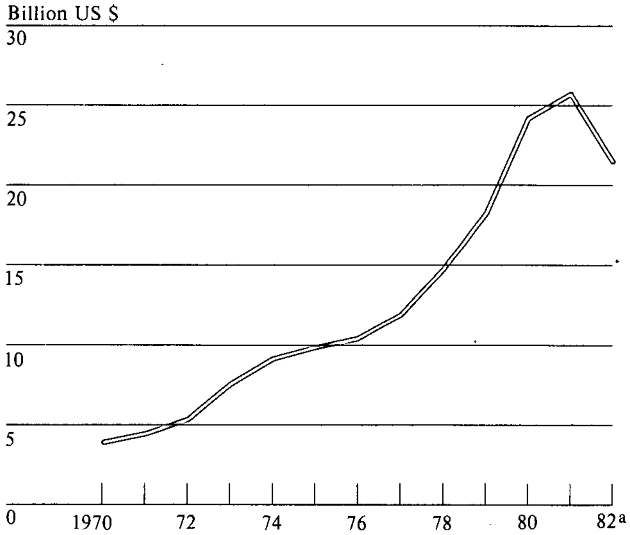
Mounting Protectionist Pressure

With EC industrial production down 3.7 percent in 1982 compared to 1980 and the unemployment rate now more than 10 percent, the EC Commission is under increasing pressure from industry and member governments to further limit foreign access to EC markets. The hardest hit industries—steel, textiles, and automobiles—are crying the loudest. Last year, employment in the steel industry was down more than 30 percent from the peak 1974 level and production was off 29 percent for the same period. In the textile industry nearly one-third of the work force has been laid off since 1973, while auto employment is down 15 percent from the boom year of 1979. [redacted] 25X1

Within the EC, France is the most vocal advocate of a more restrictive trade policy and wants to use increased restrictions to improve its deteriorating trade balance. The French trade deficit grew to nearly $14 billion in 1982—compared to $9.3 billion in 1981—while the balances of most other EC countries showed modest improvement. [redacted] 25X1

Although the most aggressive, France is not alone in advocating EC protectionism. The British and Belgian Governments have strongly advocated limits on steel imports, and the Dutch are calling for higher tariffs on electronic products. Although Bonn has not actively supported efforts to restrict access to the EC market, neither has it strenuously opposed new measures. [redacted] 25X1

EC: Agricultural Exports



[a] Estimated.

[redacted]

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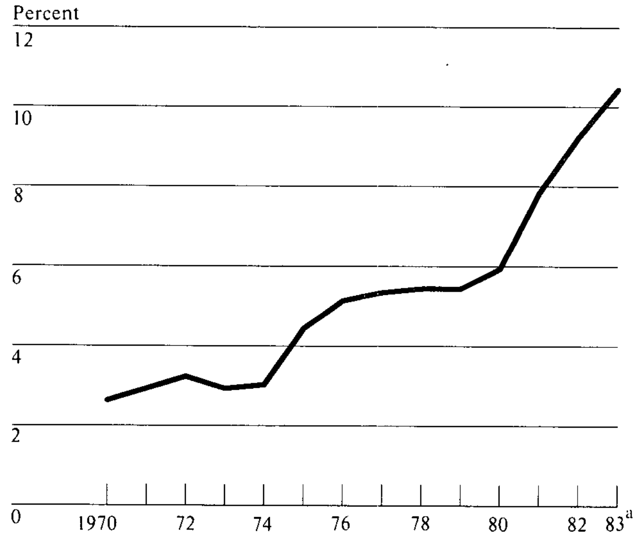
EC: Unemployment Trends



[a] Estimated.

[redacted] 25X1

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Recent Measures

EC trade policy has become increasingly protectionist in the past six months. At the November GATT ministerial the EC refused to endorse a pledge proposed by the United States not to introduce any new barriers to trade. The Community instead agreed only to refrain from taking or maintaining any measures inconsistent with GATT. Moreover, at the EC heads of government meeting in December, the Ten effectively endorsed a more protectionist stance. Although no specific measures were announced, the leaders apparently gave the go-ahead to an earlier French proposal to seek export restraints on selected Japanese products. [redacted]

EC protectionism is increasingly in the form of new NTBs—particularly VERs. The CCT cannot be raised arbitrarily to fit the trade policy objectives of the Community because all Ten members are signatories to the GATT. The GATT allows for an increase in the duties on covered products only if the Community grants its trading partners corresponding compensatory concessions. VERs, however, are not expressly banned by the GATT. [redacted] 25X1

The EC has directed its recent protectionist measures primarily against those countries, namely Japan and the NICs, that it believes pose the greatest competitive threat to domestic producers. In mid-February, Commission officials secured from Tokyo a three-year VER covering a number of "sensitive" products. Many of these products are produced by the industries the Community is counting on to provide the new jobs necessary to reduce unemployment. The restraint agreement covers color television sets, color television 25X1
picture tubes, numerically controlled machine tools, quartz watches, video tape recorders (VTRs), passenger cars, light commercial vehicles, motorcycles, and forklift trucks. [redacted] 25X1

European Community:
World and Regional Trade Balances

Billion US $

	1970	1975	1980	1981	1982 [a]
World	**−3.9**	**−3.5**	**−57.8**	**−27.5**	**−24.0**
Developed countries	1.3	2.8	−19.0	−10.4	−6.7
United States	−3.0	−8.4	−23.6	−13.8	−10.6
Japan	−0.3	−3.1	−11.0	−11.6	−11.1
Other	4.6	14.3	15.7	15.1	15.0
LDCs	−6.0	−14.1	−43.5	−20.4	−14.1
Oil-exporting LDCs	−5.5	−15.7	−39.7	−21.6	−12.4
Non-oil-exporting LDCs	−0.5	1.6	−3.8	1.2	−1.7
Communist countries	0.3	5.3	−3.5	−4.9	−9.5
Other	0.6	2.5	8.1	8.2	6.2

[a] Estimated.

[redacted] 25X1

In general, the agreement does not include specific quantitative limitations but only calls for Japan to moderate its export shipments. The Community interprets this to mean Japan will not attempt to increase its market share in these products above that of 1982. Specific quantitative limits only exist for color television tubes and VTRs. Japanese exports of large color picture tubes will be restricted to 900,000 units because of existing excess capacity in the EC industry. Small picture tubes are not covered by the agreement since the EC does not produce this size tube. [redacted]

On VTRs, the agreement calls for a guaranteed market of 1.2 million units for EC producers and limits Japanese exports to 4.6 million units per year. If the EC market exceeds 5.8 million sets, the excess will go to domestic producers. This arrangement should halt the rapid rise in Japanese penetration of the EC VTR market—last year Japanese exports of VTRs to the Community jumped about 80 percent, giving Japan over 80 percent of the EC market. [redacted]

In return for Japanese export restraints, the EC has agreed to bring pressure on France to abolish its unique customs clearance requirements for VTRs. Last October, France introduced customs procedures requiring all imported VTRs to be cleared through a single location, the town of Poitiers in west central France. The measure was obviously aimed at slowing down imports from Japan, but it also raised complaints from its EC partners. Not only were Dutch and West German VTR exports likewise required to take this circuitous route, but the potential diversion of Japanese imports to other EC entry points raised fears of additional Japanese penetration in other domestic markets. [redacted] 25X1 25X1

The Community is also concentrating protectionist efforts against LDCs, particularly the NICs. Through use of the MFA, the Community is further tightening import quotas on textiles. The EC is seeking 10-percent quota reductions from Hong Kong and South Korea; it is not planning to increase quotas for poorer countries as an offset. Despite Turkey's association agreement with the EC, which gives it preferential trade treatment, the Community also is pressing Ankara to limit its cotton textile exports to the EC. [redacted] 25X1 25X1

Partially in response to US demands for EC limits on steel exports, the Community is attempting to further limit steel imports. Through VERs with 14 of its 15 major supplier countries the Commission is seeking to restrict steel imports to 87.5 percent of the 1980 level of 11.5 million tons; last year imports were held to 90.5 percent of the base year. Although some developed countries are included on this list of countries, the EC appears particularly intent on cutting back imports from the LDCs. To this end, the Community is actively pursuing antidumping investigations against Argentina and Brazil.

Prospects

With the EC-wide unemployment rate likely to reach 12 percent later in 1983, protectionist pressures within the Community are certain to remain strong. Nevertheless, we do not believe the Community is likely to adopt significant new trade restrictions in the near term. The conclusion of the VER agreement with Japan has appeased, at least temporarily, those EC members most vociferously calling for Community-wide import restrictions. Moreover, development of a common EC trade policy has never been easy. Now that the generally agreed problems of Japan, steel, and textiles have been addressed, the EC members probably will return to their usual fractious approach to trade policy development.

Individual EC countries, however, may well adopt new restrictive measures. Paris, for one, seems intent on more widely applying its French language requirement on the labeling of imports. This independent approach also is reflected in continued French resistance to EC pressure to revise its customs requirements on imported VTRs. Italian, British, French, and West German restrictions on Japanese autos also will not be superseded by the recent EC-Japan trade accord.

Implications for the United States

Despite increasing protectionist sentiment among the EC countries, the Community as a group has not yet attempted to restrict US access to the EC market and we believe it is unlikely to do so any time soon, at least not with regard to industrial products. Although the EC's trade deficit with the United States in 1982 was roughly as large as that with Japan—about $11 billion—the deficit with the United States has been cut in half since 1980, largely because of a strong dollar. EC industries such as steel and autos are not seriously threatened by US exports, and textiles are already regulated by the MFA. 25X1

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The Community, however, may move to limit imports of US agricultural products if the US-EC dispute over agricultural export subsidies intensifies. EC members, particularly France, have been infuriated by recent sales of subsidized US agricultural goods to third markets that the EC considers its traditional domain. US sales of subsidized wheat flour to Egypt have effectively blocked EC sales there. Last year, the Community supplied two-thirds of Egypt's wheat flour imports. 25X1

Should the United States make additional subsidized sales of agricultural products, EC talk of a head-to-head subsidy war would certainly be revived. Such an effort could, in our judgment, only be waged for a short time because of the Community's limited resources. Already more than 40 percent of the EC budget goes to agricultural export subsidies. As an alternative, the French appear to be pushing for restrictions on imports of US agricultural goods—last year the United States had an agricultural trade surplus of $6.6 billion with the EC. Specifically, French Agriculture Minister Cresson has warned that the EC may restrict imports of soybeans and corn gluten. At present, France is receiving little support for such proposals, but further subsidized sales by the United States could cause the other members to come around. 25X1

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West Germany

The West German Government, traditionally a vocal advocate of free trade, is being pressured by some labor unions and employer groups to adopt protectionist measures. Rising import penetration, record unemployment, and Bonn's perception of growing isolation within the EC on trade policy are working to sap government resistance. The new Kohl government is hoping that the growing economic optimism, especially in the United States and West Germany, will reduce the calls to erect import barriers. If the recovery falters, however, we believe Bonn will follow—although not lead—protectionist moves. [redacted]

Longtime Advocates of Free Trade

West German Government and business leaders have consistently spoken out for free trade; according to a GATT official, the West German market is the most open among the major trading nations. The West German Trade Union Confederation (DGB) also officially endorses free trade. West Germany's position arises in part from the belief that free trade benefits the economy, but it primarily is a result of necessity—exports account for nearly half of West German production of goods, and nearly one-fourth of West German workers depend on exports for their livelihoods. Some sectors depend greatly on exports—for example, autos for about 50 percent and machine tools for over 70 percent of sales. West Germans realize how vulnerable they are to retaliation should they erect trade barriers. Finally, as a country that has registered large trade surpluses year after year and that until recently enjoyed steady economic growth and low unemployment, West Germany has had little motivation to resort to trade restrictions. [redacted]

The government of West German Chancellor Helmut Kohl, reelected in March, has not wavered on free trade. Kohl has stated that West Germany will oppose "all protectionist trading tendencies" from within the EC; he also has promised to speak out against these trends at the Williamsburg Summit in May. Bonn has stressed that increased world trade is essential for lasting economic recovery. This view is shared by the government-sponsored Council of Economic Experts and by the five major economic research institutes. [redacted] 25X1

West German business leaders, representing the entire spectrum of private industry, traditionally have been strong proponents of free trade. Rolf Rodenstock, President of the Association of West German Industries (BDI), believes the fight against both open and hidden forms of protectionism, the elimination of competitive distortions introduced by subsidies, and 25X1 strict compliance with both the spirit and the letter of GATT regulations are essential. Otto Wolf von Amerongen, President of the West German chamber of commerce (DIHT), echoes Rodenstock as do leaders of the retail trade association and the wholesale and foreign trade associations. [redacted] 25X1

Obstacles to Penetrating the West German Market

With the exceptions of EC actions and an auto restraint agreement with Japan, West Germany has no blatant import limitation agreements. Nevertheless, West Germany has received some criticism for its trade practices. In particular, the exacting West German technical norms and testing procedures (DIN)—considered by many experts to be among the most detailed in the world—have been criticized sharply by the French, who term the standards a form of hidden protectionism. The United States is working with the West Germans to smooth standards-related problems, especially in areas where US manufacturers are encountering problems in selling their prod- 25X1 ucts. [redacted] 25X1

West German Government procurement, according to Embassy reporting, generally is conducted in accordance with, and in many areas even goes beyond, the provisions of the MTN (multilateral trade negotiations) government procurement code. Exceptions, according to press reporting, are in telecommunications, where "open" tenders always go to the West German firm Siemens. In addition, government tenders for vehicles are rarely advertised, and the national airline—Lufthansa—favors purchases from Airbus over Boeing or McDonnell Douglas. [redacted]

Government subsidies to domestic industry act to distort trade. West Germany subsidizes its high-cost domestic coal industry; aerospace, agriculture, and a gamut of industries in West Berlin also receive government funds. Most recently, Bonn has interceded in the steel industry to keep tottering Arbed Saarstahl afloat with loan guarantees. The move was justified on the grounds that employment in the locality was heavily dependent on this industry; another steel company, Korf, was allowed to go bankrupt. [redacted]

Export Promotion

According to the OECD, less than 1 percent of West Germany's 1980 exports were financed on preferential terms. This financing came through the Kreditanstalt fuer Wiederaufbau—used as the official executive agency for West Germany's capital aid to LDCs—and through Ausfuhrkredit GmbH (AKA). AKA is a consortium of some 60 commercial banks that refinances some West German supplier credits through a special rediscount facility at the Bundesbank. [redacted]

Bonn's principal trade promotion device is the private Hermes AG that provides export credit insurance acting as Bonn's agent; the government bears the ultimate risk. Hermes fees are set for the most part according to commercial criteria, without any direct element of subsidy. Controversy over the role of Hermes, which arose in the context of East-West trade, centered on whether the existence of quasi-government backing for export guarantees encouraged banks and suppliers to go ahead with credits that would not be justified if the risk had to be borne privately. The West Germans vigorously defend Hermes, asserting that although private enterprise should provide such guarantees, it cannot because West Germany's foreign trade is so large relative to the size of the banking system. (West German banks have an aggregate reserve for losses on the order of $9 billion, equal to only about one-sixth of the Hermes guarantees outstanding.) Bonn officials also note that since 1949 the government has made a net profit of about $750 million from the credit insurance operations, and they point out that self-financing guarantee systems 25X1
are not considered export subsidies according to GATT definitions. [redacted] 25X1

Protectionist Pressures From the EC

Despite Bonn's opposition to the use of formal trade barriers, the government has been feeling increasing presssure to compromise. For example, Bonn feels increasingly isolated as a bastion of free trade within the EC. A senior West German Economics Ministry 25X1
official stated [redacted] that his ministry doubts 25X1
that sufficient support can be mustered during the West German EC presidency to overcome French protectionist inclinations. At best, he said, West Germany hopes to hold the line against French and other member state pressures. France is West Germany's second-largest export market after the Netherlands, and French protectionism—both real and potential—has been a major source of concern of recent West German governments. The West Germans believe they can count on the support of Denmark, the Netherlands, and sometimes the United Kingdom in fending off protectionism. [redacted] 25X1

The most recent example of EC protectionist pressure on Bonn occurred during the GATT ministerial in November 1982. The West German delegation, for the sake of EC unity, caved in on a final communique far short of the ringing condemnation of protectionism for which the West German delegation had striven. In 1981 West Germany was drawn into the emergency European steel cartel to limit production and make possible higher prices although the West German steel industry is the most competitive in Europe and has done the most to rationalize its production facilities. [redacted] 25X1

Dealing With Japan

There has been wide publicity given to Japan's large surplus in trade with West Germany—$3 billion last year—and to Japanese penetration of the automobile, electronics, and photographic equipment markets. In mid-1981 West German Economics Minister Lambsdorff announced in Tokyo that a voluntary export restraint agreement had been reached with the Japanese Government and auto industry to limit the growth of auto sales to West Germany to 10 percent per year. Until then, Tokyo's sales in West Germany had been doubling annually, rising from a 2-percent share of the market in 1978 to a 10-percent share in 1980. We believe that Bonn was convinced that the Japanese export drive, having been halted elsewhere, would be directed at West Germany; Bonn therefore moved before the Japanese achieved too great a market penetration. [redacted]

[redacted]

Internal Pressure Building

West Germany is in its longest economic slump since World War II. Bankruptcies are averaging well over 1,000 per month, and the unemployment rate has moved above 10 percent. Coupled with EC pressures, calls for protection are increasingly coming from employer and labor organizations alike in the most affected industrial sectors. The West German Iron and Steel Association is pleading for government aid. Beyond citing the well-known plight of the West's steel industry generally, the Association claims its members face an unequal battle against their subsidized competitors in the Community and that EC regulations covering steel quotas, price levels, and imports have been unfairly and insufficiently enforced. The Association is calling on Bonn to pressure the EC Commission to stop subsidies, which it claims redistribute sales at the expense of West German plants. [redacted] 25X1

The unions whose workers have been most affected by imports have been the most outspoken in seeking protection—the textile workers, the metalworkers (who represent the automotive and consumer electronics sectors) and the leather workers. As in other West European countries, the West German textile industry has suffered steady losses in employment while import penetration has increased. The textile union was upset when Bonn announced in 1981 that it would not seek a more restrictive multifiber agreement (MFA) in the upcoming negotiations. When the head of the union was unsuccessful in persuading either Chancellor Schmidt or Economics Minister Lambsdorff that the industry needed more protection, the union organized a series of rallies to publicize its cause. The West German union also joined with other EC textile unions, held joint press conferences, and met with key EC officials just before the opening of the MFA negotiations. In the end, West Germany changed its position and joined other EC countries in setting lower import growth rates for textiles. The West German union chief claimed that without these extraordinary efforts the Bonn government would have remained adamant in resisting tighter controls. [redacted]

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The 2.6-million-member metalworkers' union, West Germany's largest, was instrumental in having Lambsdorff sent to Tokyo in 1981 to work out the voluntary restraint agreement on autos. The metalworkers in the consumer electronics end of the industry, where job losses and plant closings have sparked a great deal of press interest, have held a series of seminars to dramatize the plight of their industry. The union worked out a common statement with the consumer electronics manufacturers association calling for a three-year limit on imports. The West

German Government has thus far resisted the calls for protection, although the industry has regular consultations with the Japanese manufacturers on the level of imports in this sector.

The leatherworkers' union, whose members have been hard hit by import competition, has similarly sought publicity to try to influence the government. The union president also has lobbied top Economics Ministry officials. On the international front, the union has been talking with its European and US counterparts. Jointly, they have launched a campaign for a world shoe agreement, similar to the MFA

Outlook

Actions by Bonn in the last few years indicate that its traditional support of free trade has weakened slightly in the face of high unemployment at home and signs of increasing protectionism within the EC and elsewhere. Nonetheless, the Kohl government, the bulk of the West German bureaucracy—especially the conservative Economics Ministry—the business community, and the great majority of academics still see West German industry benefiting from free trade. Although some doubts have crept in during the recession, West Germans believe that their low inflation, reliable labor force, and the quality of their products will allow them to beat the competition—especially in Europe. Judging from articles in their press, the West Germans have greater doubts about keeping up with the United States and Japan, especially in the technology race. Even in this regard, suggestions for overcoming any disparities are largely in the direction of making West German management more dynamic and willing to adopt new production methods rather than calling for import barriers.

The drop in oil prices and signs that the US economy is gaining momentum give Bonn greater optimism that the West German economy will turn up later this year. These economic trends also brighten the outlook for the growth in world trade, which will further encourage Bonn to hold the line on protectionism. Only if the recovery stumbles might Bonn be forced to compromise its position and occasionally yield to protectionist pressure, but largely as countermeasures.

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France

The Mitterrand government's current aggressiveness on trade issues—which is unlikely to change significantly following the recent Cabinet shuffle—and the apparent ease with which Paris opts for protectionist solutions offer additional evidence, if such were needed, that the French are not committed free traders. The protectionist flurry demonstrates that they are still trying to reconcile an old hankering for autarky and controlled markets with new obligations they accepted with something less than full conviction. Their protectionist bent is strengthened by a feeling that the odds are stacked against them in international competition. A reversion to autarkic patterns of the past, however, is highly unlikely because of France's EC ties and the realization of most producers that they cannot depend solely on the national market. [redacted]

Mercantilist and Protectionist Tradition

The French are inclined by tradition and experience to view trade through mercantilist and protectionist lenses. Until the postwar era, the national economy was substantially closed. Imports of manufactures, discouraged by quotas and high customs duties, were relatively insignificant. Exports were directed as much toward captive markets in the colonies and other less developed areas as toward the industrialized countries. Within the country and in the colonial trade, French business enjoyed comfortable arrangements whereby markets were shared and competitive risks minimized. [redacted]

The mercantilist tradition continues to influence the formation of trade policy. In addition to the "normal" tendency of a French government to want to direct events, we believe several other factors are at work:

- **National pride**—a French presence on the industrial heights is seen as essential to French political stature. This has been one of the impulses behind state support for highly visible projects such as the Concorde, the Airbus, the nuclear industry, and various attempts to promote a fully competitive electronics industry. The state has assisted both development and external marketing efforts, providing capital, procurement preferences, operating grants, the underwriting of research and development costs, subsidized export credits, and Treasury loans at concessional rates to accompany commercial financing arrangements.

- **Uncertainty**—the French remain unsure about their ability to compete in international markets. French leaders believe that French exporters are handicapped by being relative latecomers to international trade. They are concerned, for example, by their exporters' lack of adequate distribution networks and service followthrough in industrialized markets. Thus, policymakers involved in these projects justify the government's role by contrasting its ability to take a longer view and greater risks with a private sector they still find shy of venture capital and an entrepreneurial spirit. [redacted]

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Government officials on both left and right publicly acknowledge that they see other dangers in open competition. For them, complete acceptance of an "international division of labor" could leave France caught in a vise, with more powerful competitors—such as the United States, Japan, and West Germany—in command of high-technology markets and the newly industrializing countries, with lower labor costs and newer facilities, in control of basic industries such as steel and textiles. The French fear that the result could be to relegate France to the position of a "subcontractor" unable to control its trading destiny. Growing inroads in the domestic market by a broad spectrum of foreign goods have served to reinforce this concern. [redacted]

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France: Selected Trade Deficits *(Billion US $, customs basis)*

	1979	1980	1981	1982
European Community	2.0	5.3	5.8	9.6
Of which:				
West Germany	2.6	4.0	4.2	5.8
Netherlands	1.2	1.9	2.5	2.1
Other OECD	3.2	4.6	5.3	6.6
Of which:				
Japan	1.1	1.7	1.7	2.1 [a]
United States	3.3	5.8	4.2	3.9
USSR	−0.8	1.1	1.5	1.4 [a]

[a] Annualized from 10 months of data.

[redacted]

The mercantilist inclinations of French policy have become stronger since the energy crisis of 1974. Faced with a persistent deficit in energy trade, French governments have not been willing to put their confidence in market forces. Confronted also by the lack of competitiveness of French goods, reflected in an increasing trade deficit with OECD countries, Paris has sought government-to-government deals with oil producers that assured quantities of oil for French refiners in return for exports of aircraft, armaments, and nuclear technology from state-supported industries. Paris has also pursued large government-sponsored public works contracts and turnkey projects in the oil-producing countries and the Soviet Bloc. Paris has complemented its selling effort by monitoring bilateral trade flows and, when confronted by a deficit, arguing loudly that the seller must take measures to redress it. [redacted]

For political and economic reasons, French governments have become increasingly reluctant to permit mounting job losses in industries such as textiles, steel, and shipbuilding to run their course. Measures designed to preserve jobs have included loans at preferential rates and direct financial participation to assist in restructuring as well as subsidies to induce viable industries to relocate and replace firms that could not be saved. By the late 1970s, for example, the government's stake in the steel industry became so significant as to amount to de facto nationalization. [redacted] 25X1

The protectionist efforts of French governments have encountered little serious political opposition. To the contrary, they have often been criticized for not doing enough. For example, the US Embassy in Paris reported before crucial legislative elections in 1978 that the Giscard-Barre government was under pressure by its Gaullist allies to adopt more aggressive export promotion programs and more effective protectionist measures. Similarly, the influential Employers Association (CNPF) called for the "reconquest of the domestic market" in an open letter to Giscard in early 1980. The CNPF urged that France "adopt an attitude closer to that of our large partners who, generally speaking, know better than we how to defend their national markets beyond appeals to the regulations." 25X1 In particular, the CNPF recommended that French firms give preference to French goods and asked Giscard to give his personal attention to the purchasing practices of government agencies. In fact, the government has never hesitated to accord preferences to French suppliers in important sectors such as electronics and telecommunications. [redacted] 25X1

The Socialists Take Up the Cudgel

French protectionist and mercantilist inclinations have taken on new vigor under the Socialists. In part, this is attributable to the persistence of economic hard times. The Socialists' predilection for planning and their support for an active role for the state reinforce such inclinations. [redacted] 25X1

On the export side, the Mitterrand government is continuing to try to identify markets, especially in high-technology areas, in which an effective French presence may be secured. Going beyond their predecessors, the Socialists are using the expanded nationalized industrial and banking sectors and substantially increased levels of government funding to achieve 25X1

Speaking of Protectionism . . .

"France cannot allow international competition to develop under conditions that would throw its economic structure into confusion, bring about the sudden collapse of whole sections of its industry or agriculture, put thousands of workers out of work, and jeopardize its independence by eliminating essential activities."

Raymond Barre
Prime Minister under Giscard

"I cannot accept that France should suffer from insidious protectionism practiced throughout the world, especially in the EC. Protectionism will be met with protectionism and a half."

Francois Mitterrand

"There are no outmoded industries, only outmoded technologies."

Jean-Pierre Chevenement
Mitterrand's former Industry Minister

"We have to create a generation of exporters in France. That's why I propose the creation of a 'Superior School of Exportation.' That's the way we do things in France. When we needed engineers, we created the Polytechnic. Later on, to modernize and strengthen public administration, we created the Superior School for Administration. If the conquest of foreign markets becomes—as I believe it must—an absolute priority, then we must give ourselves the tools."

Laurent Fabius
Mitterrand's new Industry Minister

"Beware of those who set up or consolidate commercial fiefdoms in the name of free trade. Does the massive subsidization of agricultural exports, such as practiced by the United States, really come from free trade convictions? It's easy to be an evangelist when one has a position of strength."

Michel Jobert
Mitterrand's former Foreign Trade Minister

success. Government funding of R&D, a preferential procurement policy, subsidized credits, and the use of the state's good offices are all seen as essential tools in the struggle for export markets. 25X1

On the protectionist side, the Socialists have embraced the earlier proposals to "reconquer" the domestic market. For the Socialists, previous governments erred in being too halfhearted. They reason that French basic industries—vital for national security and jobs—can be saved if the task of reorganizing and modernizing is carried out systematically and thoroughly. According to Embassy reporting, plans have already been developed to rescue a number of sectors—among them machine tools, shoes, textiles, and toys—and others are on the drawing board. These feature, in varying combinations, government assistance for investment through grants and loans at preferred rates, partial assumption of labor costs by the government, agreements to favor domestic suppliers, and preferential marketing arrangements. 25X1

The Socialists, no less than their predecessors, are mindful that the French market is too small to permit the development of a fully efficient and competitive manufacturing sector, and they emphasize that their plans for the "reconquest" must necessarily be taken within the context of the European Community. They have attempted to carry out this strategy both by encouraging major French firms to make offers for cooperation with, or the purchase of, competitors in other countries and by taking a more aggressive line in Community councils on trade policy vis-a-vis outsiders. Paris has complained for years about the reluctance of the EC Commission, backed by Bonn, to retaliate against those who take advantage of the Community's "openness." Whatever the rhetoric, however, French prospects for implementing French plans at the Community level are uncertain. Other EC governments may be skeptical about takeovers by French nationalized firms and do not fully support French views on dealing with third countries. 25X1

A Question of Timing

Socialist plans for strengthening French export capabilities and for reducing import penetration depend on 25X1 investment, retooling, and the development of new top-of-the-line products through increased R&D spending and, if required, purchasing foreign technology. This will take time, and more than one official has concluded that the gap between the anticipated result and France's current weak trading position will have to be bridged by greater recourse to protectionist tactics. The worsening trade deficit, brought about by an ill-advised stimulus package in 1981 and by the burden of mounting wage and social insurance costs on business, probably only had the effect of accelerating the implementation of protectionist measures. [redacted]

In line with this approach and in keeping with their insistence on looking at bilateral balances, the French have recently made highly visible gestures against Japan and the USSR. Japanese products were the target of a ruling that video tape recorders would have to clear customs at Poitiers, a city in west-central France with only a small customs post. Last fall, French imports of Soviet petroleum products were temporarily halted in advance of a major bilateral meeting between trade officials of the two countries. These gestures were intended to serve, as the irascible former Foreign Trade Minister, Michel Jobert, put it, as "shots across the bow." Somewhat more ominously, the French recently circulated a memorandum detailing the protectionist devices used by other EC members. [redacted]

Outlook

We think the French will continue to prod the Community to take steps to limit outside access to the Common Market. For industrial products, the targets are principally Japan, the newly industrializing countries, and the East Europeans. For agricultural products, it is primarily the United States. If necessary, Paris will simply block Commission measures aimed at liberalization, but France's political weight and the threat that Paris might resort to unilateral measures, will put pressure on the Commission. It is probable also that other EC members, beset with economic problems of their own, will find it convenient to let the French take the lead in advocating more restrictive trade measures, as they sometimes have in the past. [redacted]

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The French are most unlikely to abandon either their penchant for viewing trade in mercantilist terms or their willingness to resort to protectionism if circumstances dictate. The French course toward making good on their commitment to more open trade is likely to be erratic, with periods of heightened protectionism—as now—alternating with periods when relative success in international markets—as before 1974—makes a more liberal approach possible. [redacted]

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A reversion to the autarkic patterns of the past, however, is out of the question. Very few, other than the Communists, any longer seriously argue that France should try to go it alone. This is attributable in part to the country's inescapable dependence on energy and raw materials imports and in part to awareness of the limitations of relying solely on the national market. The possibility of retaliation against French exports thus acts as a brake on excesses of protectionist zeal. [redacted]

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United Kingdom

Trade protectionism is increasing in the United Kingdom despite Prime Minister Thatcher's vocal public support for and philosophical commitment to free market economic policies. Rising unemployment, increased import penetration, a considerable contraction of the UK's industrial base, and a deteriorating trade surplus have boosted public pressure for the government to take a more interventionist stand on trade. In the 1970s—before Thatcher took office—nontariff barriers became the main impediment to trade. While Thatcher has been less willing to impose restrictions on foreign goods and services, she has recently been forced by a still sluggish economy and a fast-approaching national election to take measures aimed at "preserving British jobs." We believe some additional measures are likely even should Thatcher win—as expected—because high unemployment will continue. [redacted]

London's Attitude Toward Protectionism

Thatcher's government has been an outspoken advocate of free trade since it took office in May 1979. It has pledged to reduce subsidies to industry and return publicly owned firms to private control as part of its effort to promote competition and efficiency. Chancellor of the Exchequer Howe and Trade Minister Peter Rees have, for the most part, resisted labor union, business, and opposition party calls for significant increases in trade restrictions. In elaborating the UK's position on GATT, Trade Minister Rees has stated that London supports:

- A consensus on reducing protectionism that—although stopping short of the US proposal for an immediate standstill—would significantly liberalize trade in manufactures.
- A study on reducing trade barriers in the newly industrializing countries (NICs).
- Limited and selective safeguard measures and increased transparency of voluntary restraint and industry-to-industry arrangements.
- Negotiations on agriculture including proposals to bring the Common Agricultural Policy of the European Community under GATT.
- New efforts at liberalizing trade in services. [redacted] 25X1

Despite the Thatcher government's public stance, there are a large number of trade-distorting policies used by the United Kingdom. According to a recent report by the quasi-official National Institute of Economic and Social Research, 48 percent of total trade was subject to some form of government management in 1980 versus 36 percent in 1974. The 1980 average for the EC was 45 percent, and only Italy, with 52 percent of its trade subject to some form of management, was higher than the United Kingdom. Perhaps most significant, the study found that over 17 percent of British manufactured goods were subject to restrictions in 1980 versus 0.2 percent in 1974. [redacted] 25X1 25X1

In our judgment, nontariff controls on trade were an inevitable result of the increased role of the government in economic and industrial management which took place in the years before Thatcher came to power. They were also a response to the decline in domestic and foreign sales of traditional industries as tariff walls were reduced under successive rounds of the GATT. The recession and rising unemployment have slowed Thatcher's effort to reduce subsidies, especially for many nationalized firms in traditional industries, keeping the level of managed trade high despite her philosophical commitment to free trade. However, she has thus far resisted the more extreme protectionist measures demanded by the opposition. [redacted] 25X1 25X1

General Tools of Protectionism

The United Kingdom draws a substantial degree of protection from its membership in the European

United Kingdom: Key Sectors Subject to Protectionism

Sector	Target	Employment (Percent Change May 79–Sep 82)	Output (Percent Change May 79–Dec 82)	Percent Change in Imports as a Share of the Domestic Market May 79–Sep 82	Examples of Protectionist Measures
Steel	Japan Eastern Europe European Community	−53	−38	25	Government ownership, $720 million subsidy in FY 1982, licensing-marketing agreements.
Coal	Eastern Europe United States	−10	0	−6	Government ownership, government purchasing policies, $1.5 billion subsidy in FY 1982.
Shipbuilding	Japan NICs	−33	−8	−54 [a]	Government ownership, government purchasing policies, $140 million subsidy in FY 1982.
Aircraft, aerospace	United States	−7	−7	19	Government ownership, government procurement policy, $900 million subsidy.
Autos	Japan Spain	−52	−36	15	Government ownership, $540 million subsidy in FY 1982, Japan limited to 11 percent of the market, voluntary export restraints (quota).
Textiles, clothing, footwear	Japan NICs United States	−13	−32	28	Multifiber arrangement, quotas.
Chemicals	United States	− 9	−11	10	High government participation, licensing and labeling restrictions.
Agriculture	United States European Community	−7	0	−6	Health and safety standards, labeling requirements, marketing board, buy national campaign, CAP (EC) tariffs and quotas.
Electronics, computers	Japan NICs	−12	−14	27	Heavy government participation, Large subsidies, buy national, VERs on TVs and VTRs.
Machine tools	Japan NICs United States	−28	−16	15	Growing subsidies, VER, buy national campaign.
Legal, financial services	European Community United States	−8	NA	NA	Licensing restrictions on banking, insurance, and legal services.
Engineering consulting services	Japan	−2	NA	NA	Subsidy to domestic design and engineering firms.

[a] Change is the result of replacement of ships lost during the Falklands crisis.

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Community. Community tariffs on some sensitive products, such as autos (10 percent) and semiconductors (17 percent), are relatively high. Variable import levies on agricultural products under the Common Agricultural Policy, however, are less beneficial to the United Kingdom as a small food producer than they are to other member states. The United Kingdom also looks to the Community for protection against imports of foreign steel, textiles, coal, and electronic goods (TVs, VTRs, stereos)—commodities coming principally from Japan and the NICs. British automakers have led the fight for more stringent EC controls on Japanese cars and trucks and on autos from Spain. London is also pushing for a producer agreement on aircraft with the European Community. [redacted]

The United Kingdom's most important trade protection measures are not formal barriers to foreign imports, however; rather, they are business subsidies, to both private and state firms. Tax subsidy rates on British manufactures, as a percent of asset prices, rose from an average 7.3 percent in 1973 to 10.9 percent in 1980 and 13.1 percent in 1981. Industrial subsidies and grants, including those to nationalized industries, accounted for 41.6 percent of government spending and 17.8 percent of GNP in FY 1982/83. Direct subsidies to private industry alone accounted for 4 percent of GNP last year. [redacted]

London also provides subsidized export financing through the Export Credits Guarantee Department (ECGD). Under this plan, British banks provide export credits in exchange for unconditional repayment guarantees, interest rate subsidies, and limited portfolio refinancing by the government. Between 80 percent and 100 percent of long-term contract values are supported under the program. A recent British Treasury report questions the cost-effectiveness of official subsidies to capital goods exports (10 percent of total exports) and suggests they be discontinued. According to Embassy reporting, Trade Secretary Lord Cockfield, however, opposes the Treasury position as well as US proposals for a flexible system on export credit interest rates. [redacted]

Nationalized firms enjoy virtual domestic monopolies in the steel, coal, shipbuilding, aerospace, and auto industries. The government also has a large stake in the chemical, computer, telecommunications, and petrochemical sectors. State firms generally are not subject to constraints on expenditure, research, development, or expansion and are often guaranteed sales to other government-owned firms regardless of price. Government-owned electrical plants, for example, are forced to buy coal from government-owned National Coal Board mines even though subsidized domestic prices are higher than import prices; the costs are passed on to consumers. [redacted] 25X1

Government policies on purchasing, licensing, labeling, and standards also act to restrict entry of foreign goods. British state companies do most of their purchasing in the United Kingdom; three domestic companies, for example, supply 60 percent of British telecommunications purchases. Local governments were encouraged to "buy national" on computer purchases in 1982 from the 25-percent government-owned computer manufacturer ICL. The United Kingdom has also expanded the domestic and export powers of its agricultural marketing organization. Health, safety, and labeling standards have been used to keep out milk, poultry, and some alcoholic beverages from the EC. Licensing practices have been used to restrict or ban imports of foreign services such as banking and insurance. The French claim that the United Kingdom uses customs regulations and reduced customs entry points to slow imports. [redacted]

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Quantitative restrictions are increasingly being used to reduce import penetration by Japan and the NICs. Japanese auto imports are held to 11 percent of the British market under a voluntary agreement. Color television sets, picture tubes, video tape recorders, machine tools, motorcycles, and forklift trucks are also covered by voluntary export agreements (VERs) between the British and the Japanese. [redacted] 25X1

Rising Protectionist Pressures

We believe the key factor behind the rise in protectionist pressures is the decline in manufacturing employment. A protracted recession, tight monetary 25X1

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policies, loss of export market shares, and import penetration contributed to a loss of 2.7 million jobs in industry between 1974 and 1982; of these, nearly 2 million were lost after Thatcher took office. Unemployment now stands at 3 million adult workers or 13 percent of the labor force.

Some industries have been hit even harder. Employment in the steel and auto sectors is half the 1979 level, and one-third of the workers in the shipbuilding industries have been laid off over the period. Sales of British machine tools are now 55 percent below their 1975 level, and imports now account for 40 percent of domestic sales compared with 28 percent in 1975. Japan has increased its share of the UK market more than 8 percentage points. Meanwhile, jobs in the industry are down nearly 30 percent.

Unions and trade associations like the Confederation of British Industry, which represents 300,000 British employers, want the government to increase aid to industries and take action to keep out foreign goods. Automakers and the unions want a quota on auto imports from Spain, and shipbuilding unions are pushing for more government aid, a scrap-and-build program, and financial incentives for purchasers of British-built ships. Steel and coal workers are demanding new subsidies to keep open plants and mines that are no longer competitive.

Thatcher's political opponents—with an eye to an election some time between June 1983 and May 1984—have made protectionism a key part of their programs. Most radical has been the proposal by Labor's shadow Chancellor of the Exchequer Peter Shore which calls for a mixture of devaluation and protectionism to reinforce a major reflationary program. The plan includes a 30-percent devaluation over two years, renationalization of British industry, and strict planning of production and trade. The Social Democratic–Liberal Alliance has stated a preference for a less radical plan calling for increased subsidies and trade constraints only in especially hard-hit sectors.

Recent Trends

Thatcher in our opinion has been forced to take a more pragmatic approach toward protectionism with an early election possible and unemployment still at record levels. Some of the government's most recent actions on trade clearly have been taken to show its concern about unemployment and thus attract votes. The most notable instance is the subsidy that accompanied London's December 1982 order to British Steel Corporation to continue production at all five of its plants, even though there is sufficient demand to support only four integrated steel plants.

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Major financial commitments have also been announced to support British production of high-technology goods. A $25 million grant went to British microchip manufacturer Inmos International, and London has reiterated its support for computer maker ICL by pressing local governments to boost spending on British computer and office equipment. The government has also told British Leyland—the nationalized auto company—to hold off its plans to shift to foreign suppliers. Another plan under study would subsidize British suppliers in order to match prices offered by foreign companies. In an effort to slow layoffs in the mines, London also is applying new pressures on electricity producers to buy more expensive domestic coal. This new pragmatism represents a substantial shift from Thatcher's earlier policies.

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One result of the increased pressure against Japanese goods has been a substantial increase in Japanese investment in the United Kingdom. Britain has allowed Japan to increase its direct investment in order to promote new employment even though it will eventually mean additional cash flow to Japan. Ten Japanese plants designed to produce color TVs, VTRs, or stereos (creating several thousand new jobs) have opened in the United Kingdom at an increasing

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rate since the mid-1970s. Joint ventures between British and Japanese auto and machine toolmakers are also being explored. [redacted]

Outlook and Impact on the United States

Pressures for protection are likely to rise because current levels of unemployment are expected to continue through the mid-1980s. A Thatcher victory at the polls, however, would probably result in substantially lower levels of British protectionism than under any other government. Under the Tories, subsidies and government ownership of industry would probably continue to be gradually reduced and some progress toward trade liberalization would be likely. A Labor government, on the other hand, would sharply increase both protectionism and government control of industry. The Social Democratic–Liberal Alliance would be in the middle, probably applying new nontariff barriers only in specific areas where import penetration is highest. Most of the protectionism contemplated would be directed against imports from Japan and the NICs. [redacted]

We expect only minor pressure on US exports will come directly from the United Kingdom. Most actions against US goods will be carried out in the context of the EC. Agricultural exports will be a prime area of contention, although London believes the EC has room to compromise. [redacted]

Chemicals and high-technology goods are areas of potential bilateral US-UK trade conflict. The United Kingdom is intent on developing its domestic industry and has already demonstrated its willingness to increase financial support and employ purchasing policies to aid in further expanding its computer industry. Thatcher views high-technology industries as important for developing the UK service sector and providing long-term employment growth as well as export earnings. To that end she can be expected to argue for the protection of an "infant industry." We believe she will, however, join the United States in pushing for liberalization of trade in services because she believes Britain has a competitive advantage in that area and will benefit from increased trade flows. [redacted]

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Italy

Italy, which is highly dependent on foreign trade, has contributed relatively little to rising EC protectionist pressures. Rome, however, makes substantial use of nontariff barriers, including quotas and import surveillance schemes, directed in large part against Japan. Industrial support policies also tend to inhibit imports, although claims of anticompetitive effects are probably exaggerated. Although there is some increase in domestic protectionist pressures, we doubt Rome will change its policies significantly. US exports are likely to remain little affected by Italian trade policy. [redacted]

Free Trade Advocacy

Both industry and government generally consider relatively free world trade essential to the development of the Italian economy. The General Confederation of Italian Industries—the organization that represents most private industrial concerns—is a strong supporter of free trade. All the major political parties—the Christian Democrats, the Socialists, and the Communists—maintain an antiprotectionist posture. In the preparatory documents for this month's Communist Party Congress, for example, the Communists called for "surmounting protectionist temptations and national egoism." Only an insignificant segment of the Socialist left looks favorably on protectionism. [redacted]

Import Barriers

Under the umbrella of EC restrictions, Italy has developed a moderate number of import restraints directed, in large part, at complementing Community protection. Italy's own contribution to rising protectionist sentiments within the EC has, in our judgment, been modest. Aside from initiatives on chemical fibers, Rome has not actively sponsored protective EC policies. Indeed, more often than not it has sided with West Germany in resisting stronger protectionist proposals. At last year's GATT Ministerial, Rome took an antiprotectionist stance. [redacted] 25X1

As a member of the EC, Italy subscribes to the Common Customs Tariff and the Common Agricultural Policy (CAP). As a result of the last MTN tariff-cutting exercise, Italy's average tariff will drop from about 18 percent in the early 1960s to about 5 percent at the end of 1987. [redacted] 25X1

With declines in tariffs, nontariff barriers—including quotas, import surveillance schemes, voluntary export restraints, import deposit programs, and border tax adjustments—have become more important. Quotas on products such as chemicals, textiles, clothing, machinery, and transportation equipment are aimed mostly at Japan and the Communist Bloc countries. Japan alone has 38 products subject to quotas, including passenger cars, motorcycles, and mopeds. [redacted] 25X1 25X1

Rome has frequently resorted to slowing import entry as a means of protectionism. National surveillance programs, in addition to EC-wide schemes, are one such tool. Products subject to import surveillance tend to be the same as those under quota, and Japan is once again most affected. The primary purpose of monitoring schemes is to send a warning to exporting countries. In addition, products under surveillance can be delayed by the graduated application of time-consuming administrative requirements for documentation. In the sensitive textile sector, for example, required documentation has ranged from a simple import declaration to a license application accompanied by technical information and product samples. 25X1

[redacted] 25X1

Rome has also made use of import deposit schemes to correct trade and balance-of-payments deficits. The most recent program was introduced in May 1981 and phased out in February 1982. It required a mandatory 90-day, noninterest-bearing deposit or bank guarantee equal to 30 percent of the value of the import order. Future trade and balance-of-payments problems could result in a new program despite EC opposition. [redacted]

In addition, Italy sometimes has tried to slow imports by limiting ports of entry. This has been the case for steel and textiles. In 1978, for example, steel entry points were cut from 29 to four while those for textiles were cut from 12 to six. Contrived disagreements over local content ratios and country of origin, as in the case of passenger cars and color televisions, also have been used to delay entry of EC products. [redacted]

Italy has recently come under attack for its government procurement practices. Some exporters, including US firms, have openly charged Rome with favoring local suppliers over foreign competitors. Foreign complaints about this type of discrimination, however, are probably exaggerated. "Domestic suppliers" are defined by Rome to include foreign subsidiaries and foreign merchandise distributed by domestic firms. A study by Brookings estimated that the magnitude of imports affected by discriminatory government procurement practices was inconsequential. [redacted]

Industrial Support

Italy's relative moderation in resorting to trade barriers has been offset by a strong bent toward industrial support policies. The aid, which consists mainly of interest subsidies and direct financial support, rose sharply in the mid-1970s, from an estimated $1.5 billion in 1974 to $5.7 billion in 1978. As a percentage of GNP, funding increased from 0.9 percent to 2.2 percent. The programs have been directed largely at the industrialization of Italy's underdeveloped southern regions, in support of failing firms, or at state-owned or -controlled enterprises. [redacted]

A major share of government transfers to industry has gone to finance the three main state industrial holding companies—IRI (heavy industry), ENI (energy), and EFIM (light industry). Rome has provided billions of dollars to operate the firms, which are a maze of about 1,000 companies employing over 700,000 people. Last year IRI, whose profit position has deteriorated since 1974, received about $3 billion from Rome. [redacted] 25X1

25X1

Rome also provides aid to revitalize firms through the Industrial Participations and Management Company (GEPI), an autonomous state agency created in 1971. GEPI was established to take over ailing but basically sound private companies, turn them into profit makers, and resell them to private owners. Through the end of 1981 GEPI had cost the Italian taxpayer nearly $1.6 billion. The agency has reorganized and disposed of about 80 firms and now has nearly 80 operating firms completely under its control. Another 100 are being operated as joint ventures with private sector firms. [redacted] 25X1

25X1

In addition to direct capital infusion, Rome provides interest subsidies, amounting to about $1 billion in 1980. Other investment incentives include tax exemptions and deductions, local infrastructure cost exemptions, and temporary suspensions of mandatory pension contributions. Most of the investment incentives are designed to stimulate economic growth in the Mezzogiorno, Italy's poor southern region. [redacted] 25X1

25X1

The impact on trade of Italian industrial aid is difficult to measure. Complaints that government funding provides Italian firms with an unfair competitive edge are, however, probably exaggerated because Rome's policies are generally not very effective:

- State firms frequently retain redundant labor for political reasons, and management is riddled with patronage and featherbedding.
- Bailouts are frequently economically irrational and are based on political considerations.
- Budgeted funds are frequently not disbursed. For example, a much publicized industrial reconstruction and reconversion plan was budgeted at about $2 billion for 1980-82, but no funds were ever distributed.

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In short, we believe Italian Government policies contribute little to rationalization and focus more on managing crises rather than solving them. At the same time, however, Rome has been fairly successful in avoiding alliances between labor and management in support of increased protection against imports. [redacted]

Moreover, Rome's current announced intent is to reduce the dimensions of industrial aid programs, partly in response to concern over an expanding budget deficit:

- GEPI has come under increased parliamentary pressure to divest itself more rapidly of financially sound firms.

- Some government funds, such as a fund for promoting investment and employment, have been given tougher disbursement guidelines. According to Embassy reporting, Rome is also considering slashing the funds' resources by about $1.4 billion during the latest round of budget cutting. [redacted] 25X1

Outlook

In our judgment, no substantial changes in Italian trade policy are likely in the near future, even though some domestic pressures for protectionism are increasing. Industries such as textiles, autos, footwear, and major household appliances have begun to clamor for more protection as competition from East European and Third World countries has increased. Rome has thus far dealt with the complaints without expanding protectionist policies. Complaints from the automobile industry, for example, have been handled by maintaining, rather than tightening, existing quotas on Japanese automobiles. [redacted] 25X1

US exports to Italy, about 2 percent of total US exports, have thus far been little affected by Italian policies. Any further government concessions to domestic pressure groups are likely to have little impact on US exports. Italy may, however, support measures within the EC that could have a more important 25X1
impact, but we do not expect Rome to take the lead in 25X1
sponsoring more protectionist moves within the EC. [redacted] 25X1

Japan

Mainly in response to US pressure over the mounting bilateral trade surplus, the Japanese Government has gradually taken steps to ease trade restrictions. While Tokyo has removed most formal barriers to foreign penetration, it still maintains a wide array of informal trade barriers, many of which are beyond the government's control. We do not expect Tokyo to take additional action such as easing agricultural quotas before national elections scheduled for this summer. Moreover, Japanese policies aimed at helping both depressed and dynamic new industries have resulted in legislation or other actions that inhibit imports. Negotiations with Tokyo are likely to get more difficult because those barriers are hard to identify and even harder to quantify. [redacted]

Formal Barriers

Japan has greatly reduced most formal import barriers—especially tariffs and quantitative restrictions—during the past 20 years. The number of goods covered by import quotas fell from more than 250 in the mid-1960s to only 27 this year. Of these, 22 are agricultural and fisheries products, with beef and citrus being the most important to the United States. According to GATT, the average Japanese tariff on dutiable industrial imports is now 7 percent. Tokyo has agreed to lower the average to 5 percent on 1 April 1987; US and EC tariffs will then average 6 and 7 percent. [redacted]

One US study estimates that the removal of remaining tariff and quota restrictions would add, at most, $2-3 billion to Japan's import bill, with half of the gain accruing to the United States. Our own estimates show similar results. For example, we project that if all agricultural quotas were eliminated, imports would increase by only $500-700 million. [redacted]

Tokyo has moved relatively slowly, however, to liberalize other formal restrictions. In the case of government procurement procedures, Japan finally agreed in December 1980 to include Nippon Telephone and Telegraph (NTT) among the public corporations covered by the MTN code on government procurement. As of September 1982, however, foreign sales still accounted for less than 1 percent of total NTT purchases. Similar results hold true in other areas of government procurement. [redacted] 25X1

Until recently Tokyo has also been reluctant to liberalize its standards and approval procedures. Approval problems, such as unequal inspection systems, have inhibited US sales of consumer items and other products. The most recent example has been Japanese use of more costly inspection systems for imported metal softball bats than for bats produced in Japan. 25X1 On other products, exporters to Japan charge that officials have deliberately delayed entry long enough to allow Japanese manufacturers to introduce a competitive product. [redacted] 25X1

The government still controls trading in a variety of products, including wheat, rice, barley, and tobacco. [redacted] government buying 25X1 practices have not limited imports of most of these state-traded items, but they have hurt the sale of US tobacco products [redacted] 25X1

Informal Barriers

Japan still maintains a wide array of informal trade 25X1 barriers. Its close-knit industrial structure and complex distribution system are formidable obstacles to foreign competition. Major industries—steel, automobiles, and segments of the electronics industry—are highly concentrated. The firms are frequently members of large, self-contained industrial groups—*keiretsu*—which provide most of their raw materials, intermediate products, and marketing channels. *Keiretsu* 25X1 members tend to purchase within the group unless substantial price and quality differences dictate otherwise. Even in such cases, group members may still feel pressured to purchase within the group. In fact, recent research by one leading US scholar suggests that *keiretsu* buying patterns are becoming more concentrated. [redacted]

Japan's highly segmented, multilayered distribution system also tends to inhibit imports. Even if foreign goods are price competitive, strong links between Japanese manufacturers, wholesalers, and retailers have proved to be major obstacles. In addition, long-held cultural attitudes provide an important barrier. [redacted]

Recent Government Policy Trends

Prime Minister Nakasone and his predecessor Prime Minister Suzuki have taken steps to ease trade barriers. Mainly in response to US pressure, Suzuki's administration put together trade packages in December 1981 and May 1982. They included an acceleration of tariff cuts agreed to in the Tokyo Round negotiations, unilateral cuts on nearly 1,900 items, commitments to improve customs procedures, establishment of the Office of Trade Ombudsman to deal with foreign complaints, and foreign participation on standards drafting committees. [redacted]

For his part, Prime Minister Nakasone has set a high priority on shoring up relations with the United States, especially on trade issues. He timed his early efforts to precede his trip to Washington in January. Almost immediately after taking office in November he asked the Cabinet to draw up measures to open the market further. The result was another package of tariff cuts in January, expanded quotas on agricultural products, an enhanced Office of Trade Ombudsman, promises to review all standards and certification systems, and measures designed to increase foreign sales of manufactured tobacco. [redacted]

Tokyo's efforts will have little visible impact on imports for some time to come, however. We believe the new tariff cuts will boost imports by no more than $1 billion annually, less than 1 percent of last year's total import bill. About one-third of the increase would benefit US suppliers. If properly implemented, some of the measures such as revising standards procedures are potentially significant. At a minimum, some of the aggravation of doing business in Japan should be reduced, although foreign companies burned in the past are not likely to respond quickly to changes. [redacted] 25X1 25X1

With national elections scheduled for this summer, we do not expect Nakasone to take significant action on sensitive trade issues. [redacted] 25X1 25X1

More Difficult Negotiations Ahead

With formal barriers slipping in importance as a trade issue, negotiations with Tokyo will probably become even more difficult. We believe Japan has a more diverse and integrated industrial policy than most other advanced countries and that this policy has inhibited imports. The tools are hard to identify, however, and harder to quantify because they involve longstanding relationships and agreements within industries and between government and industry. [redacted] 25X1 25X1

Judging from the size and scope of Tokyo's industrial policy, the impact on trade is probably large. In FY 1982 (April 1982–March 1983) Tokyo spent more than $5 billion for industrial development out of the general account, mainly for R&D. [redacted] 25X1 25X1

In addition to money, Tokyo has used "administrative guidance" to influence industrial development and thereby imports. The government intervened last year, for example, to lower electricity rates to help domestic aluminum smelters fend off foreign competition, which enjoys lower energy costs. MITI also forced oil refiners to lower the price of naphtha to help protect the petrochemical industry from imports. [redacted] 25X1

We believe Tokyo will continue to target growth industries for development and to protect some declining industries. Despite an austere FY 1983 budget, spending for industrial policy will increase substantially this year. In addition, Tokyo is debating a new depressed industries law that would expand MITI's power to protect problem sectors. [redacted] 25X1

From the US view, assessing the impact of industrial policy on access to the Japanese market is difficult because Tokyo continues to change tools. In part because of Finance Ministry concern over the fiscal deficit, Tokyo is making less use of special tax credits and depreciation. Tokyo has offered accelerated depreciation allowances, for example, to buyers of machine tools requiring high technology being manufactured for the first time in Japan. Public opposition has also forced MITI to curtail the use of cartels to restrict production and imports. [redacted] 25X1

As a substitute, MITI will probably try to make greater use of loans to help targeted industries. In FY 1983 government-backed loans will increase faster than general expenditures, according to official budget data. Academic studies indicate that government-backed loans to firms in a targeted industry help the firms acquire private loans because the banks believe Tokyo will help foster growth in the good times and protect the industry in bad times. [redacted] 25X1

Canada

Ottawa is responding to heavy pressure to protect domestic industry by strengthening a variety of nontariff barriers. Declining domestic demand, coupled with rising import penetration in the automobile, textile, and footwear industries, have caused major cutbacks in Canadian production and have led to restraints on imports of these goods. Canada's protectionist policies are unlikely to decrease no matter which of the two major parties is in office. [redacted]

Government Attitude Toward Protectionism

Canadian business and government leaders have long recognized the need for exports because the domestic market of 24 million people is too small to support large-scale production in many industries. At the same time, successive Canadian governments—while paying lipservice to an open international trading system—have maintained high import tariff walls. In response, foreign—largely US—firms moved inside the walls by investing in Canadian corporations or establishing subsidiaries. Now, foreign firms (74 percent of them US) control 46 percent of Canada's manufacturing sector. The highest degree of foreign ownership is in the electrical products, transportation, and chemical industries, more than three-fourths of which are foreign controlled. [redacted]

To bolster Canadian-owned business, Ottawa has developed a range of instruments to protect Canadian firms. The most extreme example, the National Energy Program, is explicitly aimed at boosting Canadian ownership in the petroleum sector to at least 50 percent. Introduced in 1980 the NEP replaced depletion allowances for oil and gas companies with discriminatory exploration grants.

Grant levels are determined by the degree of domestic ownership and control of the exploring company or consortium. Moreover, petroleum companies involved in large energy projects are strongly encouraged to use Canadian sources of supplies and services. [redacted] 25X1

Over the years nontariff barriers have played an increasingly important role in Canadian protectionism. In line with MTN agreements, Ottawa has cut tariffs significantly and further cuts will continue until 1987. [redacted] 25X1

Canadian agriculture has been a major beneficiary of nontariff protection. Imports of several agricultural commodities, such as fruits and sugar, are subject to quotas. In addition, Canadian farmers benefit from healthy subsidies which boost production and thus discourage imports. Artificially low grain shipping charges have held down the cost of western grain shipped to the eastern provinces. This effectively insulates the market from foreign competition and improves export competitiveness. [redacted] 25X1

25X1

Nontariff barriers also play a key role in the manufacturing industry. Traditional measures such as quotas and subsidies are used mainly to protect declining labor intensive industries from low-cost Third World competition. Less visible devices, such as taxes and crown corporations, typically give growth industries—particularly those employing high technology—an advantage in the domstic market.[1] [redacted] 25X1

Canadian providers of services also benefit from several protectionist measures. The tax system penalizes firms that patronize publications and broadcasters deemed to have insufficient Canadian ownership. For example, the cost of advertising in newspapers and magazines that have less than 75 percent Canadian ownership cannot be deducted from taxable income. In addition, Ottawa limits foreign participation 25X1

[1] Crown corporations are federally or provincially owned corporations. They often invest in growth industries to ensure Canadian participation. For example, the Canadian Development Corporation has invested heavily in the petrochemical industry to develop Canada's natural advantage in that sector. [redacted] 25X1

Canadian Trade Barriers

Tariffs. *Traditionally high; designed to protect small domestic manufacturers from foreign competition. Tariff protection remains significant for the textile, clothing, footwear, shipbuilding, and railcar industries.*

Quotas. *A 1971 law allows Ottawa to impose mandatory restrictions on imports of any manufactures that cause or threaten to cause serious injury to Canadian producers. Canadian quotas are largely directed toward textile and footwear products supplied by Third World manufacturers.*

Taxes. *A 1975 law terminated the tax deductions for expenditures by Canadians on advertising in Canada through the US media. The tax system also encourages Canadians to keep their savings in Canada.*

Government Procurement. *Ottawa and all the provinces have guidelines on government and crown corporation procurement. A price preference of 10 to 15 percent if often granted the domestic producer. Tenders often are not made public and only companies on government lists are allowed to bid. When enough Canadian companies are listed, foreign firms may be barred from bidding.*

Subsidies. *Both the Ministry of Industry, Trade, and Commerce and the Department of Regional Economic Expansion offer subsidies to private corporations to encourage domestic production. Common methods employed are loan guarantees and grants. Ottawa has financed a five-year $200 million aid program to restructure the textile and clothing industries.*

Crown Corporations. *Petro-Canada, the Canada Development Corporation, Air Canada, and Canadian Rail have invested in key industries thereby increasing Canadian ownership. These corporations often are used to promote development of high-growth industries, for example, petroleum, medical supplies, electric products, and chemicals.*

[redacted] 25X1

in the banking industry to 8 percent of the domestic market and mandates that data processing by banks be performed within the country. [redacted] 25X1

Ottawa also has several programs to promote exports—on which nearly one-fourth of the jobs in Canada depends. The Trudeau government has been particularly concerned with stimulating exports of manufactured goods to move away from Canada's traditional reliance on sales of natural resources. The Export Development Corporation (EDC), established in 1968, provides export financing to foreign buyers of Canadian capital goods, equipment and services. In 1981, the EDC provided $1.4 billion in export financing and an additional $2.2 billion in insurance and related guarantees. Last summer, legislation was proposed in Parliament that would double the EDC's authorized $810 million capital to boost its lending power. [redacted] 25X1

In the agricultural area the Canadian Wheat Board guarantees export credits at or below commercial rates to purchasers of Canadian grain. Subsidized credit sales by the CWB to the USSR, Poland, and East Germany boosted Canadian grain exports in 1981 and 1982. A bill to set up a government marketing corporation, Canagrex, to promote exports of nongrain agricultural products is now before Parliament. [redacted] 25X1

Recent Trends

Recent economic problems have encouraged the rise of import protection and export promotion policies. Since mid-1981 the Canadian economy has contracted more sharply than in any other postwar period; real

GNP plunged 5 percent last year. Since June 1981 the unemployment rate has risen from 7.4 percent to 12.8 percent. Despite a record trade surplus in 1982, the sharp rise in unemployment and severe import penetration in key industries have intensified calls for protection. [redacted]

Ottawa has taken direct action to curb imports in the automotive, textile and footwear areas. Despite a Voluntary Export Restraint (VER) agreement limiting Japanese sales of automobiles, Japan's share of Canada's automobile market rose from 15 percent in 1980 to 23 percent in 1981, prompting Ottawa to request negotiations for a second VER in 1982. When Tokyo balked at Ottawa's proposal to limit shipments to 146,000 vehicles, Canadian customs authorities began to examine individually all Japanese vehicles entering Vancouver, significantly slowing imports. Japan then agreed to further restraints. Nevertheless, because of slumping Canadian auto production, Japan's share of the automobile market increased even further in 1982. This has pressured Ottawa to tighten restraints; negotiations on a third VER are in progress. [redacted]

In August 1982, Ottawa reinstated a global quota on leather footwear similar to an existing quota on canvas footwear. In 1978-81 the original quota had contributed to cutting the import share of the leather footwear market from 64 to 52 percent. When the restrictions were suspended in late 1981, leather footwear imports surged 19 percent over the next nine months, dropping domestic production by 15 percent and causing layoffs in many Canadian shoe factories. Although the quota is aimed at low-cost Third World imports, both the United States and the European Community have been affected and have initiated requests for compensation. (C NF)

The situation in the textile industry is similar to that in footwear. Last July, the Canadian textile and apparel industries made a joint submission to Ottawa asking for rollbacks to 1980 levels in textile imports from Hong Kong, South Korea, Taiwan, and China. The request stemmed from the loss of over 27,000 jobs—15 percent of the industries' combined labor force—since May 1981. Negotiations have been inconclusive, and imports of clothing continue to increase. [redacted] 25X1

Continued Protectionist Pressure 25X1

The economic outlook remains bleak with only a weak recovery expected over the next two years. Unemployment will remain over 12 percent in 1983 and improve little in 1984. Canadian resource-based exports should pick up as the United States emerges from the recession, but the manufacturing industries—especially machinery, electrical products, and fabricated metals—will be slow to recover. [redacted] 25X1

Strong and militant labor unions in the automotive and steel industries will continue to press for additional protection. Canadian-US automotive trade presently enjoys duty-free status under the 1965 Auto Pact, 25X6 [redacted] A government-industry study on the status of the Canadian 25X1 automotive industry will be issued later this year and is likely to suggest that some new protectionist measures are necessary, particularly against Japan. [redacted] 25X1

Regional disparities, aggravated by the current downturn, play a key role in fomenting Canadian protectionism. Although the West's petroleum-based economy has slowed, the traditional manufacturing sector in Quebec and the fishing and lumber industries of the Atlantic provinces have been battered. Spokesmen for Quebec—a stronghold of Trudeau's Liberal Party—have a large impact on his decisions and are pressing for policies to boost economic growth in the east. The push for regional balance will continue as recovery develops faster in the more resource-oriented industries of western Canada. [redacted] 25X1

Party Attitudes. Canada's protectionist policies are unlikely to change greatly after the election to be held by early 1985, although differences do exist between

25X6

the parties. The Progressive Conservatives under Joe Clark or a new leader are not politically dependent on Quebec but probably cannot afford to ignore further protection of declining, labor-intensive industries. They have supported the Trudeau's government's moves to limit imports over the past two years. The Liberals are unlikely to alter their protectionist policies even if Trudeau retires.

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Protectionism could get a boost, however, if a minority Liberal government takes office, dependent on support from the New Democrats. The New Democrats are highly nationalistic and protectionist, particularly toward unionized heavy industries. Their influence would, at the least, make a minority Liberal government even more sensitive to the fortunes of such industries as automobiles and steel.

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Implications for the United States

Canadian protectionism has its heaviest impact on the United States because it is Canada's largest trading partner by far.

Canadian-US Trade

	1979	1980	1981
Canadian exports			
To the United States (*billion US $*)	38.0	41.2	46.2
As a percent of total exports	68	63	66
As a percent of total US imports	18	17	18
Canadian imports			
From the United States (*billion US $*)	38.8	41.5	45.3
As a percent of total imports	72	71	69
As a percent of total US exports	21	19	18

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25X6

Less Developed Countries [redacted] 25X1

Most LDCs continue to rely heavily on import barriers to protect local industries from foreign competition. Although the levels of protection remain high, they tend to rise and fall with the countries' foreign financial positions. Recently, many LDCs have raised barriers to deal with burgeoning debt problems. There are a few exceptions. The more dynamic exporters such as South Korea and Taiwan have steadily eased barriers since the late 1970s. [redacted]

Developed nations have accepted the LDC need for protection for both "infant industry" and financial reasons. In GATT negotiations, for example, LDCs benefit from all developed country trade liberalization on a most-favored-nation basis, but they are not obligated to extend reciprocal concessions. In practice, many LDCs have interpreted their exemption from selected GATT obligations as a license to maintain restrictive import regimes. Although arrangements between LDC debtors and the IMF for financing packages customarily include trade liberalization objectives, all parties recognize that a reduction in protectionism will be possible only in later stages of economic recovery [redacted]

Trade Policies of Selected LDCs

Argentina. Argentina's military government liberalized the country's traditionally protectionist import policies during the past several years, but strict import control measures imposed during the April 1982 Falklands conflict remain in effect. In April 1982 a licensing requirement was imposed on all imports, and in May nonessential imports, including most consumer goods, were banned. Before the Falklands conflict, only about 200 items—primarily machinery and equipment—required licenses. Banned items had been reduced from 700 in 1975 to a handful in early 1982. As is currently the case in other countries with severe payments problems, issuance of import licenses may depend on foreign exchange availability, administrative determination of need for the import, or the influence or pressure an importer can exert on government officials. [redacted] 25X1

Brazil. Brazil's import policies have become considerably more restrictive in the past year in response to its balance-of-payments problems. About 1,900 items—largely chemicals, pharmaceuticals, and machinery—were added to the list of banned imports, which consisted mostly of luxuries and nonessential goods. 25X1
The ban, however, does not apply to imports from other Latin American Integration Association members. Private firms are now being required to cut imports by 5 percent on top of the announced 10-percent cuts imposed in July 1982. State-owned firms have been forced to cut back as well. In addition, the Foreign Trade Department of the Bank of Brazil is supposed to be clamping down on import licenses. [redacted] 25X1

India. India began to liberalize its import policy slightly in the late 1970s when its foreign exchange position was comfortable. Licensing—the main vehicle for controlling imports—has been simplified. Raw materials and components may be imported relatively easily, and the government now tolerates limited 25X1
import competition for domestic manufacturers. Exporters receive special consideration in the granting of import licenses. Nevertheless, imports of most consumer products are still prohibited, and New Delhi views import substitution in petroleum, fertilizer, steel, and cement as a major aspect of its economic policy. Moreover, India now faces a huge foreign trade deficit, and higher tariff rates were announced last December and again this February. New Delhi may be tempted to tighten import controls when its annual import-export policy is announced in April, but it presumably would have to convince the IMF that such moves would not violate the conditions laid down for further disbursements of the Fund's $5.7 billion loan. [redacted] 25X1

Automotive Import Barriers:
An Illustration of LDC Protectionism

To stimulate industrialization and create employment, most advanced developing countries maintain extensive barriers to automobile and truck imports. Barriers include tariffs, quotas, and import licensing requirements, as well as harsh local content rules. These policies have forced US, Japanese, and West European manufacturers to establish manufacturing and assembly facilities or joint ventures in many LDCs in order to participate in local markets. Local content rules for selected LDCs are as follow:

Argentina	*96-percent local content rule—a virtual import ban—was being liberalized before the 1982 import clampdown, with some auto imports and exchanges of components between domestic and foreign plants allowed.*
Brazil	*Autos must be 99-percent Brazilian by value. Rules include partial or total bans on imports that compete with domestic components.*
Chile	*1973 local content rule of 70 percent has been phased down to 15 percent. Auto consumer tax and tariff had also been falling until this year.*
Colombia	*Stated goal is 25-percent local content, but parts imports are denied only when local product is competitive.*
Mexico	*50-percent local content required for cars, 65 percent for trucks, but recommended levels are 75 percent and 85 percent.*
Peru	*30-percent local content required.*
Venezuela	*55-percent local content required, rising to 59 percent in 1985. Producers can satisfy part of requirement by exporting.*
India	*Local sourcing required whenever possible.*
Indonesia	*Generally required to use local components whenever available. Japanese firms have exploited this by establishing affiliated parts makers.*
Philippines	*Tariff breaks on unassembled vehicles promote local labor content.*
South Korea	*Usually required to use local parts when available. The government pressures foreign firms to develop local sourcing.*
Thailand	*50-percent local content will be required later this year.*
Morocco	*14-percent local content is required for autos, 21 percent for trucks. May be increased.*

[redacted] 25X1

Mexico. Last September Mexico substantially raised import barriers in response to the mounting financial crisis. Licensing requirements were imposed on all imports, and only food and capital goods may be imported at the controlled exchange rate. The emergency measures reversed a program begun in 1977 to remove import licensing requirements from a large number of items and replace them with higher tariffs, thereby improving the predictability of import regulation. [redacted] 25X1 the de la Madrid government is beginning to take a more practical approach on import policy and is allowing exceptions to the import licensing rules where controls have hurt efficiency and hindered investment. However, [redacted] some operations are unable to import needed supplies because of limited foreign exchange availability. [redacted]

Nigeria. Before Nigeria's current financial difficulties, import restrictions were very limited. The few items that did not enter freely were controlled through licensing and import bans—such as those on goods coming from South Africa and Namibia. In April 1982, however, licensing requirements and import bans were broadened significantly, and import deposits from 25 to 250 percent of the value of the import were required. Additional restrictions announced in January added 150 general categories to the import licensing system, thereby including all remaining significant imports. Lagos also raised tariffs substantially—some to 175 percent—while reducing compulsory import deposits. [redacted]

Philippines. With Philippine accession to GATT in 1980, Manila instituted a four-year program of tariff and import license liberalization. A World Bank structural adjustment program begun in 1981 has also resulted in liberalization of trade and foreign exchange controls. Some items are no longer restricted, and 960 of 1,300 restricted goods are being liberalized over three years beginning in 1981. Average tariffs have been reduced from 42 percent in 1978 to 28 percent at present. Nevertheless, in response to its worsening payments position, Manila in January imposed a 3-percent surtax on all imports and required that duties and taxes be paid when opening letters of credit. Imports used in the production of exports are exempt. [redacted]

South Korea. South Korea is much less protectionist than most developing countries. In 1979 Seoul instituted a plan to liberalize 90 percent of South Korean import classifications by 1986. Tariffs were cut 11 to 25 percent in 1979 and are now around 5 to 10 percent for raw materials, 20 to 30 percent for capital goods, and 50 to 60 percent for finished goods. Uncompetitive domestic industries, producers of strategic items, and many agricultural producers will continue to be protected, but rules for machinery, electrical and metal products, petrochemicals, and products in which South Korea is internationally competitive have been or are scheduled to be liberalized. [redacted] 25X1 25X1 25X1

Taiwan. Taiwan has been steadily easing its import restraints over the past several years. In 1979 the government stated its intention to drop tariffs to levels maintained by developed countries, and the following year announced plans to drop average tariffs from 32 to 13 percent by 1983. Priority was given to cutting tariffs on raw materials and capital goods not produced in Taiwan. Although all imports require licenses, about 97 percent of all categories are licensed automatically and can be imported subject only to the availability of foreign exchange. The remaining items, primarily luxuries and consumer goods, are controlled to protect domestic industries; licenses for them are granted on a case-by-case basis. [redacted] 25X1 25X1

Venezuela. Venezuela's traditionally protectionist stance toughened substantially in January of this year. Two hundred agricultural and industrial products were banned for balance-of-payments and competitive reasons, and tariffs, already high on consumer goods, were increased. Import licenses were made mandatory on 565 new items, including foods, auto parts, and construction materials. Also in response to the payments crisis, the Venezuelan Government announced foreign exchange controls in February, with only imports of essential goods qualifying for foreign exchange at the preferential rate. Press reports quote a Colombian Andean Pact official as saying the actions could cut pact trade with Venezuela in half this year. In response, Venezuela has attacked other members' nontariff barriers that harm Venezuelan exports. [redacted] 25X1 25X1