

# TRADE PROTECTION

in the  
European  
Community

Ludger Schuknecht

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**TRADE PROTECTION  
IN THE  
EUROPEAN COMMUNITY**

**To my parents**

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## Chapter 1

### INTRODUCTION

Imaginary Petition of the Candle-Makers to the French Chamber of Deputies:

...We are suffering from the intolerable competition of a foreign rival, placed, it would seem, in a condition so far superior to ours for the production of light that he absolutely inundates our national market with a price fabulously reduced. The moment he shows himself our trade leaves us - all consumers apply to him; and a branch of native industry, having countless ramifications, is all at once rendered completely stagnant. This rival, who is no other than the sun, wages war to the knife against us... Bastiat (1922)

#### 1.1 The EC Trade Policy Rhetoric

Economists have traditionally argued that free trade maximizes a country's national income. The EC claims that its trading system is based on this principle. The few qualifications in the trade literature, however, serve the EC rhetoric to justify its external trade protection. The exporters, according to the EC rhetoric, use unfair trade practices to prevent the emergence of EC industries or to drive existing industries out of the market. A new "war of industries" is being fought, as the French Prime Minister Cresson suggests.

The EC's antidumping policies, for instance, are supposed to secure a "level playing field" as Commissioner de Clerq (1988) suggests "...the Community has a vital interest in maintaining a liberal system of international trade. But liberal trade is only possible, in practice, if industries can be sure that they are adequately safeguarded against unfair trade practises. This is why antidumping has become an important feature of the Community's trade policy ..."

Occasionally, the EC appeals to the social consciousness instead of referring to commercial fairness when justifying its trade

protection. Adjusting to world markets imposes intolerable social costs on society through the loss of employment and know-how or through dependence on foreign imports. According to the EC logic, protection is beneficial because it gives companies a breathing space in which to adjust - even if it is not altogether efficient.

The EC also promotes a certain image of trade protection and its characteristics. It claims that a sophisticated system of technical rules governs the application of trade policy instruments and secures the implementation of commercial and social fairness in a comparably liberal and transparent manner. Commenting again on antidumping, de Clercq argues that "...the Community's policy... is incontestably by far the most liberal... [and] among the most transparent."

Within the EC, on the other hand, the beneficial effects of free trade are heralded. Efficiency gains from liberalization will lead to economic growth, rising employment, and more personal economic freedom. The goal of a Single European Market enshrined in the EC's founding document, the Treaty of Rome, is within sight. A community-wide competition policy and the European Court of Justice ensure that this freedom is not abused and various funds facilitate the adjustment to the Single European Market. But the advantages of the Common Market for its members are generated internally and should mainly be felt by its founders. As the President of the EC Commission Jacques Delors points out in the introduction to the Cecchini-Report (1988), "...the goal is a unified and strong Europe."

To summarize, the EC rhetoric implies that internal free trade is beneficial. External competition, on the other hand, can be unfair and unsocial because there is no international law or agency to monitor it. The EC therefore has to deal with such practices itself. In doing so it claims to apply only fair standards in a more liberal and transparent manner than its major trading partners.

## **1.2 An Alternative View of EC Trade Policy Making**

This study is in strong disaccord with the EC rhetoric: the concept of social or commercial fairness is meaningless for the evaluation of trade practices, because "...what constitutes unfair, 'unreasonable', unacceptable trade can be invented in unending improvisations..." (Bhagwati, 1991). Fair trade is a handy concept which allows intrtransparent and highly protectionist non-tariff barriers and which, at the same time, appeals to the public sense of what is 'right' and to

what some economists claim are new justifications for protection (Bhagwati, 1991: 14). The EC's trade protection which is administered by the EC Commission is in fact highly *politicized*. The rhetoric of fair trade or socially-oriented trade policy is just an excuse or a marketing device for the Commission and the import competing branches. It covers up the fact that relief from import competition is granted especially to *well-organized and politically influential producers*, such as the textile, steel, vehicles, or consumer electronics industries amongst others.

The EC import volume in 1989 was over one trillion ECU or 1.2 trillion U.S. Dollars, 450 billion ECU of these from non-member countries. Non-tariff barriers are currently the most important and dynamic trade policy instruments: in 1983, over 20% of EC imports were covered by non-tariff barriers with an increasing tendency (Noguès, Olechowski and Winters, 1986). If this share had remained stable till 1989, which is a rather conservative estimate, this would have meant 100 billion Dollars worth of imports covered by non-tariff barriers. On the other hand, average tariffs have been reduced in various negotiation rounds under the General Agreement on Tariffs and Trade (GATT).

The welfare effects of protection are significant. The costs of the agreement with Japan for video cassette recorders, for instance, amounted to approximately 1/2 billion U.S. Dollars for the whole EC for the year 1983 (Kalantzopoulos, 1985). The voluntary export restraint on Japanese car imports cost British consumers alone approximately 250 million ECU in the same year, not to mention other member countries (Greenaway and Hindley, 1985). Heitger (1987) estimates that protectionism depresses the growth rate of the world economy by almost 2% each year.

Important non-tariff barriers are quantitative restrictions in textiles, footwear, iron and steel, automobiles etc. Most of these are *voluntary export restraints* and national measures enforced by *Article 115*, Treaty of Rome. The GATT (1991) registered 51 voluntary export restraints in 1990. The EC's Official Journal reports over 2200 Article 115 measures in the 1980 to 1990 period. In the eighties, *antidumping* has emerged as another potent trade policy instrument. 75% of the over 900 antidumping claims resulted in either voluntary price increases by the exporter or duties on their products.

The protectionist margins for producers are significant. Tariff equivalents for affirmative antidumping decisions amounted to 23% contrasting with a mere 5% average tariff on manufacturing products

(Messerlin, 1989). Estimated tariff equivalents for selected voluntary export restraints range between 3% and 50% (Kostecki, 1987).

All of these instruments are discriminatory in that they apply only to imports from selected countries. The decision-making process is not transparent; it is cumbersome or goes through unofficial channels, and the results are poorly published or not at all. The claim that the EC's trade policy is less protectionist and more transparent than that of other countries does not rectify this fact.

Paradoxically, proliferating external protection coincides with internal liberalization. Why should special interests refrain from seeking trade protection at the EC level when they have successfully prevented widespread external liberalization through the GATT? The key to explaining these conflicting phenomena lies in the different levels of trade policy making. Special interests obtain *external* trade protection because the *given institutional framework* accommodates such pressure. Internal trade liberalization, on the other hand, became feasible when the EC *changed the rules* for internal trade policy making.

In a nutshell, *the study intends to explain the emergence of both external protection and internal liberalization*. The bulk of this study deals with the first phenomenon - protection within accommodating institutions. A lesson, however, can be drawn from the EC's Common Market Project. Ultimately, the rules determine the nature of the trade game. The change in the legal/institutional framework of the EC lent credibility to the liberalization programme.

The study's approach is strictly economic. EC trade policy is not analyzed for its consistency with GATT or its own legal standards. Nor does the study follow the naive assumption that politicians only serve the people's well-being. Instead it applies a public choice approach to trade policy making. This theory asserts that individuals pursue their self-interest in politics as they do in the market place. The political actors, i.e. bureaucrats, politicians, interest groups, and voters, and their degree of organization and representation determine trade policy making within the EC's institutional constraints. A thorough analysis of the EC decision-making process and supportive empirical evidence is set against the EC's rhetoric. A considerable amount of historical and legal background information, data on trade, trade protection or welfare costs and further literature are also provided.

**Protectionism as a Political Response to Pressure Groups**

The first objective of the study is to show that special interests in the EC have better chances of protectionist decisions being made in their favour when they can claim injury by imports and when this claim is supported in the political sphere. This is due to the EC's institutional structure. Although EC protection is *de jure* administered protection, politicians have the final word in most decisions.

The EC Commission investigates the requests for protection and drafts the decisions. It also administers the implementation of trade policies. The proceedings, however, are not based on some rigorously applied standard of commercial or social fairness but the rules leave significant regulatory discretion. The Commission, however, has to gain approval for most decisions by the forum of the EC member governments, the Council of Ministers. This makes the administration accountable to the politicians and in turn facilitates politicized decisions. The politicians put pressure on the administration to satisfy their clientele, i.e. domestic producer groups. This bias is reinforced by the lack of transparency in the procedures and the underrepresentation of important interests such as consumers.

The study begins with a theoretical chapter. Economic theory teaches us that free trade maximizes world welfare and, as a rule, is also the best trade regime for single countries. Internally, however, special interests have an incentive to seek trade protection. This can result in a protectionist Prisoners' Dilemma rooted at the national level, where every interest group is protected from trade competition. This view is contrasted with the less relevant view of protection as an international Prisoners' Dilemma where countries pursue protection to secure the gains from economies of scale or international market power. The theoretical argument for the use of rules as a remedy, binding politicians at the national and/or international level is also presented in this chapter.

Chapters 3 and 4 describe the EC trade policy. First, the decision-making process, its main actors and its national and international constraints are discussed. This constitutes the system of checks and balances which underlies the trade policy choices analyzed in the following chapters. Subsequently, a summary of the EC trade policy instruments is provided. The array of instruments makes up a network of protection which can benefit the most varied interests.

Chapters 5 to 8 are the core chapters of this study. They analyze in detail those EC trade policy instruments which have been responsible for most protectionism during the 1980s. The application of national protection under Article 115 (Chapter 5), voluntary export



restraints (Chapter 6), and antidumping (Chapters 7 and 8). The institutional framework for the application of these instruments differs significantly, affecting the scope and suitability for protectionist interests. Due to the vastness of the topic only these issues are discussed in detail.

Article 115 mainly enforces national protectionist barriers. Political scrutiny is exerted at the national level. In final decisions, however, it gives EC bureaucrats some discretion to pursue their own interests. This issue is particularly important when the question arises where national protectionist pressure will shift to when the Single European Market is realized.

Voluntary export restraints are the EC's most politicised instrument because their negotiation is usually not constrained by administrative rules. They are often negotiated under the supervision of top politicians and bureaucrats. Very little is published about them. They protect the most important industries such as cars, steel or textiles. The secretive character of the negotiation process dissipates resistance to voluntary export restraints because there is hardly any information available and no official forum to address.

Antidumping measures have significantly increased in importance over the past 15 years. They can be applied very flexibly because antidumping decisions can be easily tailored to the political winds. Claims against developing countries are motivated by shifting comparative advantage and claims against industrialized countries aim to reduce intra-industry competition. Cases against the former members of the Council of Mutual Economic Assistance in transition from socialism to capitalism deserve particular attention. Chapter 8 analyses in detail the export of "soft" goods to the EC and the implications for these economies' adjustment to Western markets.

### **Internal Liberalization through Institutional Changes**

The study, however, does more than just explain EC protectionism during the eighties. Internally, the EC intends to liberalize trade completely before the end of 1992. This goal could not be achieved with the given trade policy rules. Liberalization only became feasible and credible when the EC changed its institutional framework. *Endogenizing the choice of institutions* adds an important dimension to the analysis of EC trade policy making.

Chapter 9 analyses how the Single European Market can be implemented despite protectionist special interests. The first part argues that the interests of all actors (special interests, bureaucrats and politicians) in internal protection have decreased over the past