
UNEQUAL TRADE

The Economics of Discriminatory
International Trade Policies

• *Richard Pomfret* •

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Basil Blackwell

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Preface

Discrimination has not been considered a major international trade policy issue since the flurry of interest over the EEC, EFTA and GSP during the 1950s and 1960s. The main theoretical contributions in this area were written between 1950 and 1965, and the classic assessments by Curzon and by Patterson of the place of nondiscrimination in the postwar international trading system were published in 1965 and 1966. The subsequent hiatus has been unfortunate: discriminatory trade policies have proliferated since the 1960s, and 1965-vintage 'customs union theory' was unable to explain the phenomenon. This book seeks to publicize both the extent and the serious consequences of discriminatory trade policies, and by reexamining the history, economic theory and empirical work on such policies to explain their proliferation despite an adverse impact on global well-being.

An important reason why discriminatory trade policies have received no recent integrated treatment lies in the tendency to view as distinct phenomena customs unions and free trade areas, tariff preferences for developing countries, voluntary export restraints, sectoral arrangements like the US-Canada Autopact, or other bilateral deals. My own research in this area over the last 20 years began in a similar disjointed manner as I worked first on the EEC's Mediterranean policy and then on Canadian trade policy and later on GSP. These origins are still apparent in the present book, although during the 1980s I have tried to familiarize myself with other GDAs – a pursuit in which I have been aided by successive generations of students in my trade policy seminar at the Johns Hopkins University's Bologna Center.

The ideas in this book have developed over many years, and have involved many debts. For the original stimulus, I am grateful to Herbert Giersch and Juergen Donges for entrusting to me in 1975–77 a research project on the EC-Israel free trade area, financed by the Volkswagen Stiftung and conducted at the Kiel Institut für Weltwirtschaft. My current employer, the Johns Hopkins University, has provided excellent intellectual and material circumstances for writing the present book. An Italian base offered a good

vantage-point for following European developments, while the opportunity to spend the 1983–84 academic year at the JHU School of Advanced International Studies in Washington, D.C. enabled me to observe the shift in US trade policy. A sabbatical leave spent at the JHU Baltimore campus in 1986–87 gave me the time and surroundings in which to write the final draft; I am grateful to Bruce Hamilton, Chairman of the Department of Political Economy, for providing me with office space and use of the department's facilities.

Too many people's ideas and comments have been incorporated into this book to acknowledge them all, but a few deserve special mention. My colleagues Isaiah Frank, Charles Pearson, James Riedel and Vera Zamagni have offered both specific and general advice. Detailed comments on earlier drafts of Part II were given to me by Pasquale Sgro, Ed Tower and Alan Winters. Chapters 6 and 7 are extended and updated from an article in the September 1986 issue of *Weltwirtschaftliches Archiv*, and I am grateful to the editor, Hubertus Müller-Groeling, for permission (granted with his invariable promptness and courteousness) to use this material.

The many drafts and revisions were cheerfully and efficiently typed by Joy Carper, Janice Delbert, Donna Hall (aka Althoff), Joy Pankoff and Libby Pratt. I am grateful to Sue Corbett for her early confidence in the book's publishability, and to Romesh Vaitilingam and Carol Busia as most cooperative editors. Last but not least, my thanks go to Rosemary Prentice for her patience in listening to monologues on trade policy matters and her unwillingness to accept any economist's argument (and especially mine) without question.

Abbreviations

The subject matter of this book seems especially prone to abbreviations and acronyms. Many are mentioned in only one section and are defined as they occur, but a few conventions about recurring abbreviations should be clarified. I use GDA (geographically discriminatory arrangement) as a generic term synonymous with discriminatory trade policy. PTA (preferential trading arrangement) refers to a GDA where trade barriers are lowered for imports from certain nations, and a FTA (free trade area) is the specific case of a PTA in which tariffs on trade among the participants are eliminated. The EEC has imperceptibly metamorphosed into the EC as the European Community has increasingly sought to present itself as more than just an economic arrangement; I use both terms without much distinction, although EEC is preferred in earlier contexts when it was normal usage. Likewise Comecon and CMEA are used interchangeably.

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1

Introduction

Discriminatory trade policies are not a new phenomenon. When rulers first intervened in trade flows they saw no necessary reason to treat all trading partners equally and some discriminatory elements have always been present in the international trading system. Yet in the twentieth century there have been consistent efforts to purge these elements. The various international conferences of the interwar period echoed with calls for more equal trading conditions, which finally took effect in the 1947 General Agreement on Tariffs and Trade (GATT) – the legal framework for the postwar international trading system – whose cornerstone is the principle of nondiscrimination. Despite these intentions the world has in recent decades seen a gradual retreat from the principle, to the extent that by the 1980s a majority of world trade was being conducted under discriminatory regimes and the GATT system is now seriously threatened.

Why has this happened? The central theme of this book is that, despite the negative GATT stance which has firm roots in economic theory, there are incentives for individual groups of countries to introduce discriminatory trading arrangements. Thus, without strong multilateral commitment to maintaining a system based upon nondiscrimination, such a system will gradually be undermined. Moreover infringements of the nondiscrimination principle tend to breed further infringements, creating a momentum for increasing systemic breakdown. These patterns are illustrated by the recent history of the world economy discussed in Part I, while the theoretical underpinnings for divergences between global and national interests in nondiscrimination are examined in Part II. Finally in Part III theory and practice are combined to produce an explanation of the existence of discriminatory trading arrangements. The concluding chapter summarizes the findings and considers future prospects.

In this introductory chapter, I will define terms, then justify the earlier statement that the majority of today's international trade is taking place under discriminatory arrangements, and finally set out the global costs of

such arrangements. Discriminatory trade policies involve deliberate use of government policy to create different trading conditions for residents of various foreign nations. I will not be concerned with discrimination initiated by private agents (e.g., citizens' boycotts, international cartels and other price discrimination by firms). Nor will I deal with trade policies which incidentally harm some countries more than others, as any product-specific import duty, for example, invariably does.¹

There are a variety of terms used to describe the phenomena being dealt with in this book, most of them value-laden. Discrimination is intended as the most neutral term to describe different treatment for trade with different trading partners. Usually the different treatment is towards imports, but not exclusively so, e.g. the US grain embargo following the Soviet invasion of Afghanistan or Arab restrictions on oil shipments to the Netherlands and the USA after the 1973 Arab-Israeli war. A distinction is often made between negative and positive discrimination, with the yardstick being most-favored nation treatment. Negative discrimination may be in the form of sanctions (as in the above examples of export restrictions), but also applies to almost any quantitative restriction on imports. Positive discrimination may simply involve having a separate tariff schedule for, say, developing countries, but it can also apply to attempts at economic integration.² Analytically there is no distinction between 'sanctions' and 'preferences' and indeed, as soon as either are introduced most-favored nation treatment itself becomes discriminatory in one direction or the other.

Economic integration does, however, pose a demarcation problem, and is also responsible for more terminology which will recur in this book. One approach is to form a free trade area, in which each country grants free access to its partners' exports but maintains its own commercial policy towards non-members. A customs union goes a step further in establishing

¹Similar definitions are adopted by Patterson (1966, pp. 20 – 1) and Hieronymi (1973, p. 7). Patterson emphasizes the distinction between discrimination among nations and discrimination among commodities, and Hieronymi emphasizes the difference between public policy and private agents' independent decisions. Riedel (1987) argues that discrimination among commodities is the most serious discrimination in US tariff policy.

²Semantic confusion may arise, however, because the economic integration literature frequently distinguishes between negative integration (i.e., removing barriers to integration like internal tariffs) and positive integration (i.e., creating union-wide markets and institutions by positive actions). This usage was popularized by Tinbergen (1954, p. 122), who believed that 'negative integration' may be sufficient to raise living standards but it 'will be a slow process which may be accelerated by positive action' of which the two elements are tax harmonization and industrial policy. More recent analysts of the EC (eg. Pelkmans, 1984) have much longer lists of 'positive integration' policies.

a common trade policy towards non-members, while a common market enables free movement of factors of production (labor, capital) across members' borders. Finally a full economic union involves a common market plus common economic policies. These are not necessarily sequential steps and the taxonomy does not precisely fit actual arrangements (e.g. in the US, which is in most senses an economic union, state governments can have economic policies running counter to federal policies and purchasing arrangements which form barriers to free inter-state trade, whereas the European Community is an incomplete common market which has some common economic policies). It is, however, a useful taxonomy in highlighting the continuum from simple preferences to full economic union and pointing to the arbitrary element in focusing on trade among *nations* in the present context. The difference between Alberta's discriminatory treatment of Manitoban exports and French treatment of Italian exports is one of degree rather than of kind. The European Community has supra-national aspirations but in this book it will be treated as an arrangement among independent nations (along with other free trade areas, customs unions and common markets),³ whereas federal nations such as Australia, Canada or the USA will be treated as single trading units.

The number of discriminatory trading arrangements is large (see chapter 5) but clearly they vary in relative importance. Many customs unions have been formed (and unformed) among developing countries in recent years, yet their impact on world trade is dwarfed by that of the European Common Market. Voluntary export quotas on South Korean and Taiwan footwear exports to the US between 1978 and 1981 were important for the industries concerned, but were far less significant in terms of the trade involved than, say, the Autopact with Canada or the 1981 voluntary export quotas on Japanese autos. To give an idea of the relative importance of the major discriminatory measures I will now compare the value of trade conducted under these arrangements to total trade. This is of course a rough approximation and there are obvious biases involved insofar as negative discrimination reduces trade while positive discrimination stimulates trade, so the trade under the latter measures is overstated relative to a nondiscriminatory world and, in the extreme case, discriminatory prohibitions will suppress trade. Nevertheless the orders of magnitude are striking.

Cline (1982) has estimated non-MFN imports to comprise about one-tenth of total American imports in 1980 (the MFA (3.8 per cent), the Autopact (3.0 per cent), GSP (2.9 per cent) and Comecon (0.3 per cent) were the categories covered). He went on to note that:

³In chapter 5, pp. 74–9, I will argue that the EC may be en route to a single federal entity, although when it crosses the hazy boundary will be a matter of dispute.

For the European Community the fraction is considerably higher, although less so if EC members are treated as a single bloc and only their trade with outsiders is considered – leaving their free trade arrangements with the European Free Trade Association (EFTA), textile-apparel arrangements, GSP, Lomé Convention preferences (for African, Caribbean and Pacific developing economies), and Eastern bloc trade as their main exceptions to unconditional MFN.

and that Japan adheres almost totally to the MFN principle. Thus, ‘unconditional MFN still governs the bulk of trade today’ and ‘departures from unconditional MFN . . . have not become dominant for trade policies’ (Cline, 1982, p. 19).

Cline’s conclusion is too much based on American and Japanese practice and hence too optimistic about the significance of departures from MFN treatment. The European Community’s position is crucial because of its members’ quantitatively dominant role in world trade (34 per cent of global imports, and 20 per cent even if intra-Community trade is excluded; table 1.1). Yet the listing of the EC’s exceptions to unconditional MFN treatment clearly suggests a much weaker commitment to non-discrimination. Indeed, the quotation above raises the question of exactly which countries are *not* on

TABLE 1.1 *World Imports by Importing Country, 1985*

<i>Importing Countries</i>	<i>Value of Imports (\$ billion)</i>	<i>Share of Total Specified Imports (%)</i>
European Community (12)	664	34
– intra-EC trade	353	
USA	362	19
Japan	131	7
Canada	81	4
Australia – New Zealand	30	2
EFTA	110	6
Comecon	75	4
Europe n.e.s.	26	1
Middle East	105	5
Africa	60	3
W. Hemisphere LDCs	81	4
Asia n.e.s.	200	10
Total World Imports	1947	

Note The source includes Portugal and Spain in the EC, although the data is for 1985. Categories are as in the source apart from Hungary and Romania which are included in the USSR etc. group to form a Comecon category; the remaining n.e.s. (not elsewhere stated) European group consists mainly of Yugoslavia and Turkey. The column total is greater than the sum of individual entries because of unspecified trade.

Source: IMF *Direction of Trade Statistics*, Yearbook, 1986.

TABLE 1.2 *European Community (12) Imports by Country of Origin, 1985*

Exporting Country	EC Imports (\$ billion)	Percentage share
Intra-EC Trade	353	(53)
EFTA	63	(9)
Mediterranean Countries ^a	25	(4)
Lomé Signatories	23	(3)
GSP Beneficiaries ^b	44	(7)
Comecon	27	(4)
OPEC ^c	37	(6)
MFN ^d	93	(14)
Total EC Imports ^e	664	

Note (a) excluding Albania and Libya, which do not have preferential agreements with the EC; (b) excluding countries listed under other headings; (c) except Algeria; (d) US (53), Japan (23), Canada (6), South Africa (6), Australia (4), and New Zealand (1); Taiwan is not listed in the data source used; (e) the entries cover all EC imports but do not sum exactly to the total because of rounding.

Source: as table 1.1

the exceptions list. The answer is Australia, Canada, Japan, New Zealand, South Africa, Taiwan and the United States. In effect, since most of the exceptions involve preferential treatment, the MFN tariff facing these seven countries is least-favored nation treatment apart from the MFA (and other voluntarily restrained) goods and relative to Comecon members.

Table 1.2 breaks down EC members' imports by country of origin. Half of the total consists of intra-EC trade, and about half of the remainder comes from countries to whose exports the EC grants preferential access. Not all exports from the EFTA, Mediterranean, Lomé and GSP countries receive preferential access,⁴ but the only items systematically excluded are EC-produced agricultural goods and under the Common Agricultural Policy imports of these products have dwindled in importance. Tariff preferences are, of course, non-existent on duty-free imports and I have listed the OPEC members as a separate category because, although many of these receive preferential treatment on manufactured exports to the EC,

⁴Nor do their preferred exports receive equal treatment by the EC; in particular, preference margins are smaller for GSP, which is also subject to ceilings beyond which MFN tariffs apply. The Mediterranean agreements were more important before Greece, Portugal and Spain became EC members; reallocating their approximately \$19 billion worth of exports to the EC (9) from intra-EC trade to the Mediterranean category in table 1.2 would reduce the former to 50 per cent and increase the latter to 7 per cent.

their total exports are dominated by petroleum products.⁵ This proportion of duty-free trade plus imports from countries granted MFN treatment by the EC accounts for less than one fifth of total EC imports, leaving over 80 per cent of EC imports on non-MFN terms.⁶ Thus, for the EC at least, departures from unconditional MFN treatment have become dominant for trade policies.

TABLE 1.3 *Percentage of Total Imports entering on other than MFN Basis, Major Trading Nations, 1985.*

	Total Imports (\$ billion)	Non-MFN (\$ billion)	Percentage (Non-MFN ÷ Total)
European Community ^a	664	535	81%
United States ^b	362	36	10%
Japan ^c	131	8	6%
EFTA ^d	110	92	88%
Canada ^b	81	8	10%
Australia ^e	24	3	13%
New Zealand ^f	6	1	17%
Total	1378	683	50%

Note: (a) from table 1.2; (b) Cline's percentage, (c) GSP \$6 billion plus Comecon \$2 billion; (d) intra-EFTA \$18 billion, EC \$64 billion, Comecon \$8 billion, GSP \$2 billion; (e) NZ \$1 billion plus GSP \$2 billion, (f) Australia \$1 billion.

Source: as table 1.1; GSP figures for EFTA, Japan, Australia and NZ are from Laird and Sapir (1987, table 1).

⁵The OPEC/GSP dichotomy probably understates the share of EC imports from developing countries which enters on MFN terms. Laird and Sapir (1987, table 1) quote UNCTAD data showing about 60 per cent of EC imports from GSP beneficiaries as not MFN dutiable, and only just over 10 per cent (or less than \$9 billion in 1984) as GSP preferential. On the other hand, the EC imposes a range of discriminatory non-tariff barriers (notably under the MFA, but also on other products) on imports from developing countries so that the share of these imports not receiving MFN treatment is much larger than that of GSP preferential imports alone.

⁶This type of exercise can only provide approximate magnitudes. In addition to agricultural products there are other exceptions to preferential treatment which would have to be covered on a product-by-product basis. At the same time, the seven countries ostensibly granted MFN treatment do in fact receive preferential treatment on MFA goods, as well as suffering discrimination against almost all of their dutiable exports to the EC (and Japan is particularly discriminated against by the imposition of 'voluntary' export restraints on her exports of autos, electronic goods and other products). These caveats aside, however, table 1.2 clearly illustrates that the EC's explicitly preferential arrangements cover a large part of her total imports.