Private and Confidential

Presentation of Trade Policy

1. Introduction

Britain depends upon the open trading system. She is more heavily dependent on overseas trade than most other major industrialised nations. Some six million jobs depend on our exports of goods and services.

The open trading system, at a time of virtual stagnation in world trade, is under increasing pressure. This reflects:

(a) rising unemployment in all OECD countries;

(b) the rapid emergence of the newly industrialising countries, providing high quality goods at low prices;

(c) the possible departure of the Labour Party from the post-war consensus on the need to maintain a liberal trading regime;

(d) the apparently unmanageable pace of chance now required of certain British industries;

(e) the increasing number of countries threatening to resort to protectionist measures;

(f) the political and financial problems of trade with the Eastern bloc.

Our trade policy is likely to be judged by:

(a) its impact on output and employment;

(b) the extent to which it is seen to be either ideological or naive, or pragmatic;

(c) the degree to which the demands of certain industries are seen to be desirable or sensible;

(d) the extent to which the EEC is seen to be helpful or not;

(e) the manner in which it affects consumers and other industries as users of imported goods or as victims of retaliation;

(f) the vigour and effectiveness of Government action against other countries' unfair trading practices and in pursuing Britain's interests through international channels;

(g) its relationship to the Government's general economic and industrial policies.

This paper has three sections. The first examines current public perceptions, in so far as they are known; the second outlines the Government's trading policy and how it might be presented; the third offers comments on some current fallacies and misunderstandings about our trading policy.

2. Public Perceptions

The relative complexity of the arguments in favour of open trade and the Common Market puts the open trader at some disadvantage in political debate. With concrete industrial examples to allude to, the protectionist can always appeal to patriotism, pragmatism, practicalities and even compassion. These sentiments can, of course, also be invoked by the open trader, but he will not always be able to match the simple appeal of the protectionist promise to "save jobs".

Though poll data on trade is not extensive, some results indicate that the protectionist has a ready market for his views:

(a) Foreign imports are seen as one of the main causes of Britain's economic difficulties; few consider increased imports a result of our own economic failures; nearly one in two people favour import controls;[1]

(b) The Common Market is generally judged to have been economically harmful; there is little appreciation of the increased export and employment opportunities it has offered;[2]

(c) Awareness of the importance of European markets is very limited; there is little realisation of how many jobs would be put at risk by withdrawal;[3]

(d) The Common Market is held to be responsible for increased prices generally and increased food prices in particular; there is a concomitant belief that food would be cheaper outside the Community;[4]

(e) The Common Market is held to have denied us trade with the Commonwealth and the rest of the world;[5]

(f) Foreign governments are widely believed to be more adept at protecting their own industries.

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1. Gallup poll, Daily Telegraph, 21st July 1980.
2. MORI polls, various 1977-82; Survey Research Associates, March 1979.
3. ORAC, July 1980 and March 1982; ORC February 1979.
4. MORI polls, various, 1977-82; ORC February 1979; ORAC March 1982.
5. ORAC, February 1979 and March 1982.

3. Presentation

(a) Open and fair trade is more important to the United Kingdom than most other major industrialised countries;

(b) Open and fair trade has clear, practical benefits for the United Kingdom;

(c) As our largest export market the European Community is vital to British jobs and investment;

(d) Competitiveness is the most important element in the United Kingdom's overall trading success;

(e) The vigorous promotion of exports and inward investment by the Government has increased employment in the United Kingdom;

(f) The Government is willing to protect certain vulnerable industries from sudden surges of imports, in order to allow some traditional industries time to adapt and restructure;

(g) The Government rejects the widespread use of import controls as ultimately counter-productive;

(h) Government and EEC action against unfair trading practices abroad, such as those in France, has been very effective;

(i) British exports of services are at record levels, and our national trading surplus is second only to that of the U.S.A.

3.1. General Trade Philosophy

First, an open trading system is clearly in Britain's interest. Britain's exports are equivalent to about 30 per cent of GDP, which is a higher proportion than virtually any other major industrialised country. Our interest clearly lies in dismantling barriers rather than encouraging them by erecting our own. That is why the Government is pressing, through international channels, for the liberalisation of trade in services too.

Second, the Government does not blindly pursue a liberal trading policy for all industries in all circumstances. It is pragmatic and sensible - and permissible under Article XIX or the GATT - to protect industries that face serious damage from a surge of low-cost imports. It can give an industry time to re-equip and adapt to new market conditions.

Third, trade must be fair as well as free. That is why the Government has pressed and is pressing - in the GATT and through the European Community - for the opening up of certain markets abroad, notably Japan.

3.2 The Benefits of Open Trade

The broad economic case against protection is:

(a) Open trade allows countries to specialise in those activities at which they are most productive;

(b) This leads to higher output, lower prices and a higher standard of living;

(c) Increased competition from imports stimulates efficiency, productivity and innovation in British industries;

(d) By providing secure export markets open trade encourages companies to invest in new plant and products;

(e) Free access to the European market encourages foreign companies to invest in Britain;

(f) British manufacturers gain from free access to competitive, well-designed industrial components and supplies.

The city states of Hong Kong and Singapore, as open trading economies, clearly demonstrate these benefits.

3.3 <u>The Disadvantages of Protection</u>

Import controls

(a) allow management to abandon the struggle to contain labour costs, improve their products and invest in new technology, so allowing industries to become mediocre and uncompetitive, leading to higher prices;

(b) tend to protect jobs only temporarily; protection in the coal industry has not shielded it from world recession;

(c) deny consumers a wider choice of imported and domestic goods;

(d) can provoke retaliation, so only protecting jobs in some domestic industries at the expense of other export industries;

(e) can temporarily aid one industry but penalise another; for example, other industries can be denied access to the technology they need to remain competitive;

(f) depress import demand and so drive up the exchange rate at the expense of export industries.

Governments reacted to the depression of the 1930s with tariffs and quotas. World trade plummeted. By contrast, the dismantling of those barriers to open trade after the war, under the GATT system, meant that by 1980 exports of manufactures[6] by the main industrial countries had grown tenfold since 1950.

4. Departures from the Open Trading System

The most effective solution for industries threatened by low-cost imports is to improve their competitiveness or change their product.

Some protection has nevertheless to be provided for industries threatened by sharp surges of imports. Various forms of protection, consistent with our obligations under the GATT and the Treaty of Rome, operate in the clothing and textiles, consumer electronics, footwear, steel and motor car industries.

Some of these are voluntary restraint agreements (VRAs). These are preferable to import controls, since they are more flexible and less likely to provoke retaliation, or demands for compensation.

Anti-dumping procedures, which are appropriate in certain circumstances, are pursued with the utmost vigour. These are consistent with the policy of free but fair trade.

Protected British industries are listed below.

4.1 Textiles and Clothing

Production and employment in the textile industry have been seriously damaged by low-cost imports. In 1980 imports of

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6. In volume terms.

textiles and clothing totalled £1,545 million, £1,258 million more than in 1970. 150,000 jobs were shed in 1980-81, and a further 17,000 in the first half of 1982, though not all these job losses are attributable to low-cost imports. Despite this, textiles and clothing are still a major employer, accounting for about a tenth of manufacturing employment. The industry is also still a major exporter - in 1980 the UK exported textiles to the value of £1,363 million, £945 million more than in 1970. Given its importance and vulnerability the Government has granted the industry a good deal of protection. Low-cost imports now account for only 12 per cent of the UK market and over nine-tenths of these are subject to actual or potential restraint under the Multi-Fibre Arrangement and related agreements. All are being renewed for the 1983-86 period, giving the industry more protection than any other in the UK.

4.2 Footwear

About half of all low-cost footwear imports are covered by measures of restraint, initiated by the Government or secured by the British Manufacturers' Federation (BFMF) with Government support.

4.3 Motor Cars

Regular discussions take place between the Society of Motor Manufacturers and Traders (SMMT) and the Japanese Automobile Manufacturers' Association (JAMA). The Japanese have voluntarily restrained their share of the UK car market to between 10 and 11 per cent in 1980 and 1981. It is expected to stay at that level in 1982.

4.4 Consumer Electronics

The Radio Industries Council (RIC) regularly meets its counterparts from Japan and a number of other Far Eastern industrialising countries, to discuss the UK market in consumer electronics. Various inter-industry arrangements covering imports from Singapore, South Korea, Thailand and Taiwan operate.

4.5 Steel

Since 1977 employment in the British Steel Corporation (BSC) has fallen from 208,000 to 90,000. Since 1979 BSC's manned capacity has fallen from 21 million tonnes to 14.4 million tonnes. Private sector installed capacity has fallen from 5 million tonnes to 4.4 million tonnes in the same period.

The social cost is high. Therefore the Government has secured, through anti-dumping action in the EEC, voluntary restraint arrangements (VRAs) on steel imports with 14 non-EEC countries. These cover about 70 per cent of UK steel imports from non-EEC countries. The VRA countries have agreed to certain restraints on volume and price in return for exemption from anti-dumping action. Where VRAs do not operate the provisions of the basic import price scheme apply.

Import penetration of the UK steel market is the lowest of all the EEC steel producers.

4.6 State Aids to Exports

Another departure from the open trading system is the increasing willingness of Governments to subsidise exports, especially of capital goods. This normally takes the form of "soft" finance for major projects in third countries. The devices used are various - aid programmes, mixed credits, government guarantees - but all distort the world market for major project business.

The Government have and will continue to argue against and resist such practices by supporting efforts within international organisations, such as the OECD, to monitor and discourage them. The Government is prepared, however, to use instruments such as the Aid and Trade Provision and ECGD's rapid matching facility to assist British companies to meet the competition on equal terms.

5. Trade Barriers Abroad

Open trade is good for all countries and the GATT system has stood up well to current pressures. In fact the present world tariff structure is largely the result of successive rounds of multilateral trade negotiations aimed at reducing tariffs. The last was the Tokyo Round concluded in 1979, as a result of which tariffs are being reduced on a reciprocal basis between 1980 and 1988.

However, the GATT system has been placed under considerable strain during the current recession. Protectionist pressure has surfaced in all countries.

In its own interest, the United Kingdom is a relatively open market. Over four fifths (83 per cent) of visible imports in 1980 were admitted duty free; agricultural levies and various import restraints covered only 7 per cent of total imports or 11 per cent if only non-EEC imports are considered.

Some other markets are just as open. Among the Newly Industrialise Countries (NICs) Hong Kong and Singapore have completely open markets. NICs as a whole took 12 per cent of UK exports in 1980; the USA took 12.3 per cent of our exports in 1981; and the EEC countries now take over 40 per cent of our exports. This trade is extremely valuable to Britain. In 1980 the UK had a current account surplus of £2.9 billion; in 1981 it reached a record £6 billion and in 1982 it was probably £4 billion. The forecast for 1983 is for a £1 billion surplus. This is a substantial improvement on the £0.9 billion deficit of 1979. In 1981 the UK had a £4.9 billion surplus in manufactured goods with oil-exporting countries and a £2.3 billion surplus with other developing countries. However, in some markets British exporters are facing problems of access and high tariffs. These are listed below.

5.1 <u>Japan</u>

Japanese exports to Britain have doubled, in real terms, in the last four years. This has led to a serious and growing imbalance of trade - £1.13 billion in 1980: £1.58 billion in 1981 and £1.97 billion in 1982. This year the Japanese will probably sell us £2½ billion worth of goods; we will sell only £660 million to them.

Japan has scarcely opened up her market at all. In 1980, for example, British industry sold £1,896 million worth of aero-space products worldwide, but only £30 million worth to Japan. £132 million worth of vehicle components were sold to the USA and £218 million worth to Germany, but only £6 million worth to Japan.

Pressure via the EEC and the USA has resulted in two recent packages which have begun the process of opening up of the Japanese market, but more fundamental changes are required.

5.2 Spain

Trading relations with Spain are governed by the Spain/EEC Agreement, signed in 1970, before Britain joined the Community. Spain has consistently failed to observe it properly, notably by maintaining a discriminatory fiscal system and by administer-ing quotas in an opaque way.

Spain's high tariff barriers against Community exports are legal under the Agreement but now unwarranted. Spanish industrial development since then - especially in areas like steel, ships and textiles, where Community countries have cut capacity - has made the Agreement increasingly one-sided. The British tariff on cars from Spain, for example, is 4.2 per cent; the Spanish tariff on cars from Britain is 36.7 per cent.

The problem will disappear in the longer term since Spain wishes to join the Community. Meanwhile Britain has asked the European Commission to report urgently on interim remedial action to bring about a fairer balance of trading opportunity.

5.3 France

Britain has made clear to France that she is not prepared to see her export trade damaged by some of the methods chosen by the French to "recapture the home market".

These methods were prompted by the prospect that Socialist economic policy would result in a FFr 100 billion trade deficit in 1982. They include excessive customs formalities for videos and discriminatory loans by nationalised banks.

These measures have been unanimously condemned by France's Community partners, and the European Commission is actively pursuing possible breaches of Community law.

5.4 The USA

When President Reagan announced the embargo on the export of technology for the Siberian gas pipeline, the Government took immediate action to protect British companies. Subsequent diplomatic moves, in conjunction with our EEC partners, secured the removal of the embargo.

More recently, the US steel industry's initiation of countervailing and anti-dumping complaints against European steel imports used US trade law procedures to protect a recession-hit industry from imports. US official procedures for dealing with these cases, and the interpretation placed upon the concepts of subsidy and injury by the US authorities, caused very serious concern in Europe. Indeed, they were arguably inconsistent with US international obligations.

Though the British Government played a full role in the negotiations which led to the subsequent steel agreement, without the added influence of the EEC it would have been far less acceptable.

The Agreement established restrictions on access to the US market for a range of carbon steel products. A ceiling of 5.9 per cent market share in steel pipes and tubes for the US was also agreed. There remain outstanding countervailing and safeguard actions involving UK and other EEC exports to the USA of special steels.

5.5 Australia

Australia protects her industry with very high tariffs and quotas. The UK case against them is more difficult, because they are compatible with the GATT; we have a healthy trade surplus with Australia; and Australian objections to the protectionist Common Agricultural Policy are arguably very understandable.

5.6 Competition for Overseâs Projects

One of the Government's declared objectives is to help UK exporters secure a greater share of major overseas project business. Several steps have been taken to support UK companies and contractors. These include the creation of the Projects and Export Policy Division at the Department of Trade, which co-ordinates the assistance given to consultants and contractors pursuing large overseas projects. This has enabled increasing and more effective use to be made of financial support mechanisms such as the Overseas Projects Fund, the Aid and Trade Provision and ECGD facilities.

With this Government help British industry has achieved some notable successes over the past two years. Contracts won include a £550 million power station in Hong Kong by GEC; a £330 million Mexican steel mill by Davy-Loewy; a £250 million power station in India by NEI; a £200 million hydro-electric scheme in Indonesia by Balfour Beatty; a £250 million university in Oman by Cementation; a £195 million metro project in South Korea; a £170m trans-pacific cable project by STC and a £100 million order in Zimbabwe for boilers by Babcock Power. In addition, contracts worth some £200 million of project business have been secured under a Memorandum of Understanding with Brazil signed by the Government in October 1981. Contracts worth a further £200 million are under negotiation.

Altogether successes reported on projects in excess of £50 million have, since the first quarter of 1981, been worth almost £3 billion, of which more than £2 billion is UK content.

6. Misunderstandings and Fallacies

6.1 Import Controls Would Save Jobs

Only in the very short term. They would do nothing to eradicate the root cause of Britain's unemployment: a lack of competitiveness caused by low productivity and relatively high wage and price inflation. They would prop up declining industries at the expense of growth industries; reduce the incentives for management and labour to contain their costs; and raise prices and lower consumption. In the longer term, that would destroy jobs, not protect them. We cannot raise quality and keep tight control over costs by opting out of the world market.

6.2 Temporary Import Controls Can Mitigate the Unpleasant Side-Effects of Industrial Change

This is true in certain instances (e.g. textiles) but it is implausible to argue that hospitalisation behind import controls can always give an industry time to recuperate. Only competition stimulates the innovation, efficiency and productivity needed to survive. And temporary controls have a habit of becoming permanent.

6.3 Import Controls Will Help the Balance of Payments

This assertion rests upon the fallacious assumption that a country's standard of living is enhanced by an increase in exports and diminished by an increase in imports. In fact the purpose of exporting is to gain the foreign exchange to import what cannot be produced at home but is necessary to improve the standard of living. A country which exported its entire national production but imported nothing, for example, would be literally destitute. It is therefore natural that the UK will have trade deficits with some countries and trade surpluses with others. In general, the UK has deficits on trade in manufactured goods with developed countries and surpluses with developing countries.

6.4 Britain is Naive to Stick to GATT/EEC Trading Rules When Others Do Not

Free trade is good for all countries and the UK market is relatively open. However, the Government is pressing - in GATT and via EEC - for liberalisation of those markets where British exporters are at a disadvantage. Within the EEC remedies are available for breaches of the competition rules. These breaches frequently take the form of unnotified state aids. Such aids can be difficult to pinpoint. But the Commission has successfully prevented other Member States adopting a considerable number of state aids, once they have been notified, as being incompatible with the Treaty of Rome. Such aids have included, for example, differential relief for Italian employers' contributions to sickness insurance schemes, subsidy for soft drinks manufacture in Belgium, and for petrochemicals in the Netherlands.

6.5 The Government Gives Less Help to British Exporters than Our Competitors Give to Theirs

This is not true. Quite apart from the extensive facilities provided by the Export Credits Guarantee Department and spin-off benefits to exporters from the Government's overseas aid programme, the Government spends about £80 million a year to assist UK exporters - that is £1 for every £1,000 of exports of goods and services. This is spent on the official export services provided by the Department of Trade, together with the Commercial departments in UK Embassies and High Commissions and Consulates overseas, which are administered by the British Overseas Trade Board. They include a wide range of market advice and specific services designed to help exporters however big or small.

6.6 Membership of the EEC has had an Adverse Effect on the Economy and Employment

Withdrawal, not membership, puts jobs at risk. The Community market now takes 43 per cent of British exports. Withdrawal would put 2½ million jobs at risk, and deny us many more as investment from America, Japan and other non-EEC countries went elsewhere in the Community. Tariff-free access to the Community market of 270 million people is a powerful attraction to foreign investors. Britain now accounts for about half of the Japanese investment in the Community, and over a third of all US investment in the Community is in Britain. We would not have these jobs at all if we had been outside the Community.

The EEC also offers valuable negotiating strength - as it has demonstrated over the Multi-Fibre Arrangement, footwear restraint, steel cutbacks and exports to Japan.

6.7 <u>Withdrawal from the EEC Would Allow Britain to Revert to her Commonwealth and Other Traditional Markets</u>

Wrong. With British entry into the EEC Commonwealth countries have diversified their trade and now account for less than 15 per cent of Britain's trade. Our current competitive position makes further inroads in North America unlikely; Latin America operates tough import controls; and the Eastern bloc absorbs only 3 per cent of British exports. The EEC accounts for over two fifths of Britain's trade; the Community would not negotiate a favourable trading arrangement if Britain withdrew.

6.8 <u>Food is Cheaper Outside the EEC</u>

Of the 283 per cent rise in food prices since accession, only 8-10 per cent is attributable to CAP. Our old suppliers of foodstuffs - such as Australia and New Zealand - have found other markets. Moreover, the world market in food is very small. In fact so little food is traded on the open market it is hard to judge what constitutes a competitive price. This is because the bulk of world trade in food takes places on fixed contracts. Britain, for example, has a contract with the African and Caribbean producers (ACP countries) of sugar to buy a certain amount of sugar at a fixed price. Similar contracts exist for other foodstuffs. Thus if Britain withdrew from the EEC and sought to buy on the world market, for example, all the butter she needed beyond her domestic production, she would take half the world market's supplies. That would have a catastrophic effect on the price of butter.

6.9 <u>The Decline of Manufacturing Means the Loss of Export Markets</u>

Historically, Britain has been a net importer of food and raw materials and a net exporter of manufactured goods. Manufacturing is still very important: it provides 6 million jobs and a quarter of total output is exported. However, it is merely nostalgic to imagine that Britain should continue to manufacture and market particular products just because she always has. Vigorous efforts are made instead to promote new products and services to replace the old. Our trade in services, for example, has grown drmatically. In the last decade all the main service sectors, except shipping, grew in real terms. Civil aviation (£2.4 billion in 1981) more than doubled; travel (£3 billion) rose by half; miscellaneous services (£5.2 billion) rose by two fifths. UK earnings from financial and consultancy services are greater than ony other country in the world. Exports of services in 1981 totalled £17 billion - an increase of a fifth (in volume terms) on 1971. Between 1980 and 1981 Britain's invisible export earnings increased from £24 billion to over £26 billion.

6.10 <u>Eastern Europe Floods the British Market with Shoddy Goods</u>

Much of the trade with the Eastern bloc is in raw materials.

Many of their goods are uncompetitive in quality and so do not sell well, e.g. they have only 2 per cent of the British car market. Restraints on textile, footwear, pottery and steel imports operate; anti-dumping action has been taken in many cases.

6.11 Trade with the Eastern Bloc Shores up Communism

The USSR buys over £400 million a year of British goods and Eastern Europe a similar amount - which is about 2 per cent of British exports. Britain supplies about 1½ per cent of Soviet imports. This is an important market for some British businesses. The COCOM system is used to frustrate the Soviets acquiring strategically important technology. Credit and loans to the Eastern bloc are carefully vetted.

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