

## An ABC of Trading Blocs

*Gary Banks, Projects Director at the Canberra-based Centre for International Economics, reviews Unequal Trade: The Economics of Discriminatory International Trade Practices by Richard Pomfret (Basil Blackwell, Oxford, 1988).*

Richard Pomfret has composed an interesting and informative book by bringing together issues that have hitherto been dealt with either separately in journal articles or as single chapters in books. The unifying theme is discrimination in international trade, something that should be of particular interest to Australian and New Zealand readers. 'When elephants make love, the mice get trampled' is the way our situation in the international trade scene is sometimes described. The analogy is apt, if incomplete. As we are painfully aware, mice can get hurt when elephants fight too. And if the elephants actually set out to trample the mice, things become worse still.

Discrimination in trade can take a number of forms, all of which are discussed in the book. For present purposes, they can be loosely categorised into three types: (i) 'regional trading arrangements' (such as the EC and the Australia-New Zealand Closer Economic Relations Agreement); (ii) unilateral tariff preferences (such as Australia's schemes for developing countries); and (iii) ad hoc discrimination against particular foreign suppliers of particular products (such as the export restraint deals that have been imposed on Japan and other low-cost exporters of 'sensitive' products).

The book takes a survey approach. It dwells most on (i) and least on (iii). It is organised in three parts: Part I provides historical and institutional background (half the book); Part II theoretical and empirical analysis; and Part III deals with 'political economy' issues. The treatment provides breadth rather than depth; it is accessible to a 'lay' readership, except for some of the analysis in Part II, and is very readable.

As the author notes, this area of economics is particularly prone to jargon and acronyms. Readers will save time by reading the glossary of abbreviations at the beginning of the book where, like me, they may learn for the first time that GDA stands for 'geographically discriminatory arrangement', a generic term used by the author to cover all forms of trade discrimination.

The author's message in the historical and institutional survey is that discriminatory trade policies contributed to the economic crisis

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of the 1930s and the political crisis that followed. In this period, discriminatory arrangements took the particularly virulent form of bilateral clearing and balancing arrangements (which are still common among Eastern Bloc countries), as well as regional agreements that raised barriers to outsiders, rather than reducing them to insiders. But the effects of the discriminatory element in all this cannot be disentangled from the international financial breakdown (the inconvertibility of currencies) and the rise in trade restrictions generally in that period.

The author briefly describes how this inter-war experience led to the design of a multilateral trading system centred on the General Agreement on Tariffs and Trade (the GATT) in which the non-discrimination rule was given a central role. He criticises the architects of GATT for allowing regional trading arrangements to be an exception, a provision (Article 24) he finds to be 'bad law and bad economics'. At this point the reader may feel that he would have benefited from having seen Part II, on the economics of GDAs, first.

The survey of theoretical and empirical work in that part of the book does not provide the hard evidence to condemn regional trading arrangements that the author obviously feels should be there. While he claims that there has been a lack of attention to this issue by economists in recent years, the list of those who have made a significant contribution in the past reads like a 'Who's Who' of the profession: including Jacob Viner, James Meade, Harry Johnson, Robert Mundell, Max Corden, and other eminent economists.

The upshot of all the theoretical ink that has been spilled on this issue can be summarised in three inconclusive propositions: (a) a country can be better off or worse off from participating in a preferential trading arrangement, depending on its size, the nature of its trade and that of its trading partners, its (relative) protection levels, the scope for economies of scale and other factors; (b) preferential

tariff reductions may or may not bring larger gains to a country than could be obtained through non-discriminatory reductions; and (c) whether global welfare is enhanced by preferential trade arrangements is similarly dependent on the circumstances of the case at hand.

A fourth, and the only conclusive, result is that global welfare will always be increased more through non-discriminatory than discriminatory reductions in protection.

The real test of a regional trading arrangement's economic status thus becomes an empirical question. A chapter is devoted to surveying the work that has been done. The EC provides an interesting case study and various approaches are reviewed. The conclusions that emerge are that EC members have indeed benefited, though largely at the expense of non-members (such as Australia). The author briefly describes the merits and deficiencies of analytical techniques traditionally used and the recent application of more sophisticated economy-wide modelling to capture the price effects of preferential arrangements. As in many areas of economic policy, the 'first round' effects of changes in trade policy can be quite different to the final outcome on the economy as a whole. (This is demonstrated in the context of agricultural trade policies in Centre for International Economics, 1988.)

An analytical problem that has not been overcome, and possibly cannot be, is the proper evaluation of the so-called 'dynamic' effects of liberalisation. This is not just a question of being able to lower costs of existing production through longer production runs (economies of scale), but also the increased specialisation within existing industries that is made possible by expanded markets, and the impact of increased competition on productive efficiency and 'inventiveness' within the firm. These sources of gain have strong theoretical support but remain empirically imponderable.

Professor Pomfret berates his

fellow academics for failing to sound any alarms about GDAs and thus contributing to the 'retreat from a non-discriminatory trading system' (p.186), with discriminatory arrangements now accounting for over one-half of world trade. Here, as in other parts of the book, the lumping of all discriminatory trade policies into the one hat creates difficulties. There has been no shortage of alarm bells about category (iii) above (see for example Tumlin, 1985). If economists have not presented the same 'solid or vociferous front' against discriminatory liberalisation that they have shown for protectionism, the author's own review of the theory and empirics tells us why this might be so: increasing protection is unambiguously bad for national as well as global welfare (except for a few quibbles); regional liberalisation is not.

The last part of the book, on why GDAs exist and what practical threat they pose, is also made difficult by an attempt to generalise, when what is of most interest are the differences among particular forms of discrimination. Professor Pomfret sees GDAs as both very harmful to the world economy and not a major threat in practice, because of various forces acting to limit their spread. But this double-barrelled conclusion is hard to reconcile with what we know about the particular manifestations of GDAs (and what we learn from earlier parts of the book). For category (i) — regional trade arrangements — it is hard to generalise about their economic effects; for category (ii) — preference schemes for developing countries — the costs to donor countries are not great; while for (iii) — bilateral trade restraint deals — there are good reasons to believe that they will not stabilise, if only because of their great convenience and effectiveness as protective instruments.

At the very end of the book, Pomfret does seem to assign most importance to ad hoc bilateral discrimination and asks (but does not answer) the question: 'what can be done to reverse the growing use of discriminatory trade policies?'

## Damages Unlimited

When posed in this context, the answer is clearly the same as the answer to the question 'what can be done to reverse protectionism?' When protection levels are reduced, trade discrimination in all its forms recedes as an economic issue. For example, if Japan were a free (or even fair) trader in agriculture, Australia could afford to be relaxed about any special deals it may make with the US. As it is, the

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scope for such deals to divert trade from Australia in agriculture, and the potential damage to our trade and national income, are very great.

It has become apparent that there is only so much that the GATT can do to control protectionism and its discriminatory manifestations. As Pomfret notes at one point, 'the real requirement for long-term observance of international trade laws is their acceptance by the nations being regulated.' (p.184) The question of how to bring national policy practice into conformity with internationally agreed principles — and more important, how to bring national policy into line with national interest — has puzzled the economics profession since Adam (Smith) was a boy. A relatively new branch of economics called 'public choice' theory has made a valuable contribution in recent times, by helping to explain how pressure groups exert their influence on policy outcomes.

In the area of trade policy, there is increasing recognition that the key to reform lies in an informed community and in institu-

tional arrangements (organisations, procedures) that feed information about the economy-wide costs of protection into the decision-making process. Australia's own Industries Assistance Commission has been upheld as a model for what other countries might do in this regard (see Long et al., 1989, and Rattigan et al. [forthcoming]). (Think how much easier it would be to get foreigners to open their markets if they had a domestic organisation showing how beneficial that would be for them.)

The increase in regional trading arrangements over the past few years, combined with the apparent failure of the GATT to contain protectionism, has led to concern in Australia about being 'left on the shelf'. For those interested in knowing whether Australia should join (or help form) a trading bloc, this book provides no answers. But then there is no simple answer. All we know is that life can be very difficult for a small country in a world of every country (or bloc) for itself. We have a vested interest, therefore, in fighting for a non-discriminatory multilateral trading system. Given the high costs to Australia of losing it, we also need to be doing our homework on the other options available to us.

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*Alan Moran, Director of the Business Regulation Review Unit, reviews Liability: the Legal Revolution and its Consequences by Peter W. Huber (Basic Books, New York, 1988).*

There is in America a tax that no legislator has ever enacted, no electorate ever sought, no candidate ever pressed the flesh for. Huber calls it a tort tax.

This tax accounts for 95 per cent of the cost of Americans' childhood vaccines, 30 per cent of the cost of ladders and a third of the price of a small airplane. It is incredibly expensive to collect. Only 40 per cent of the transfer payments ends up with the injured party: the remainder disappears into the pockets of lawyers and other middlemen. Overshadowing these direct costs are the indirect costs entailed in attempts to avoid the tax. Such efforts have sharply curtailed many previously acceptable activities and denied society many innovative goods. Litigation with its extensions of product liability has brought the demise of amateur sports like lacrosse and hockey, has closed down amusement parks, led cities to forbid the use of snow sleds, and sharply reduced the availability of child care.

A diplomat friend, an experienced horsewoman, complains that American riding schools will no longer permit their clients to ride at more than a trot. Indeed, the Australian government's Industry Council report on light aircraft points out that litigation has been the main factor in the decline in US sales of light aircraft from 18 000 in 1978 to just 613 in 1987: a reduction that has not only destroyed a leading world industry but has also brought about less safety. This is inevitable when new safer machines do not replace tired old