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PRIME MINISTER

TRADE POLICY: SECRETARY OF STATE'S MEMORANDUM OF 21 OCTOBER

I am not clear what the Secretary of State intends to be the substantive conclusion of the E discussion. But I agree with some of the conclusions of the Secretary of State's memorandum. In particular the GATT Ministerial meeting is unlikely to make any substantial progress towards further trade liberalisation, and if it manages to arrest the drift towards world protectionism, that is probably rather more than we can expect. This is a pessimistic conclusion, but I do not think any other is warranted.

#### Objectives of Policy

The objective of our free trade policy should be to get foreigners to reduce their trade barriers. The alternative tactics to achieve this objective are:-

- (a) Reduce our trade barriers (the bilateral or multilateral trade disarmament of GATT, Kennedy and Tokyo rounds).
- (b) Increase our trade barriers ("retaliation" of the 1930s vintage).
- (c) Use other means of persuasion (eg Aid negotiations).

#### Methods and their Relative Efficiency

The best method is (a) - barrier reductions. The Secretary of State does not mention this because he may argue that we have got to nearly the end of feasible reductions. But this is clearly not the case. Apart from the obvious examples of Japanese cars (a "voluntary" arrangement), there are many less obvious examples, such as the absolute ban of CEGB's import of coal from USA or South Africa. (This latter arrangement enhances the power of the NUM, keeps coal prices high and raises all derivative prices such as steel, motor cars, etc). There are many such barriers, the reduction of which would serve our interests. Since we are a small part of world trade, unilateral reduction is normally our best policy.

/The worst method

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The worst method is (b) - increasing the barriers - yet this is the one seemingly favoured by the Secretary of State. All the evidence of history shows that "retaliation" has led to higher, not lower, tariff barriers. [Carried out à l'outrance between two large trading blocs, W.M. Gorman showed it would lead to around a 70% reduction of trade!] Retaliation would create protected industries and trade unions (such as the NUM) with their political lobbies and captive politicians. This policy is inconsistent with all that you stand for. However, if you do decide that retaliation is the right course, then it is best to ensure that it is very limited indeed and restricted in time (a sunset clause).

A good method - (c) - may be to use other means of persuasion. Consider for example India. Aid presents us with a considerable weapon which we can deploy to open up a market. India receives 40% of IDA funds. As a condition of our contribution to IDA, we might well propose that India substantially reduce her quota restrictions. Alternatively, we may suggest to India that our bilateral aid programme will be adjusted according to progress they make in eliminating their import quotas. In the case of South Africa we may offer to reduce the present restrictions on the import of coal for our power stations. (This, incidentally, would reduce the National Union of Mineworkers' stranglehold on electricity generation and, albeit after the next strike, would be good in its own right.)

*Don't want  
unh. Aid  
not big  
enough.*

Some NIC's are being increasingly encouraged to follow the successful path of Chile in reducing all tariffs in 1975-76 to a uniform 10%. We need to encourage this process and we ought to evolve a policy for doing so.

With Taiwan and Korea there are many difficult problems associated with their security. We have little leverage. The main influence must be the policy of the United States. One could encourage the United States' Government to think in terms of using its capacity to supply military aid and hardware for the purpose of trade liberalisation.

Another possibility is, of course, using official credit policy to induce tariff reductions. This would probably require some OECD initiative.

Export Subsidies

The Secretary of State's memorandum deals almost entirely with import restrictions imposed by foreigners. Yet there is the vexed question of alleged export subsidies, such as in the case of French turkeys, United States textiles, and above all steel. In principle these are much less objectionable than import quotas and tariffs. The subsidy is usually explicit, it has to be financed, and is obviously harmful to the exporting country. Furthermore, if, for example, the United States subsidised energy well below world market price and thus exported energy-intensive goods below market cost, then in the long run this must benefit us. In the short run there will be adjustment costs and many political reasons to prevent such short-run disruption, to which we must respond. But, in the long run, if they are giving us something for nothing, why not take it?

Imports Advisory Board

The Secretary of State's suggestion for an Imports Advisory Board is potentially a valuable one. It is of the utmost importance, however, to ensure that it really is independent, has technical expertise, and is composed of people who fundamentally believe in freedom of trade. They must be quite independent of industry pressure.

Technical knowledge is extremely important in this field. The list of tariffs in the Annex to the Secretary of State's paper is misleading. First, they are nominal not effective rates of protection. Secondly, there are often parallel excise duties which tend to nullify the tariff. It is, in fact, quite difficult to determine precisely the degree of protection. So we need to be quite clear what we are talking about before we get involved in the detailed decisions.

Unemployment and Trade Barriers

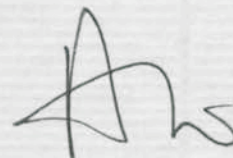
The Secretary of State's memorandum does not mention the main rationalisation for retaliatory measures. This is because it is thought that it will preserve jobs. In the unlikely absence of further retaliation by the foreigner, and in the very short run, this may well be true. But, like the effect of an inflationary expansion of demand, positive effects in protecting employment will

soon be gone and there will be every reason to believe the long-run effect will be negative. Unemployment is caused primarily by wages being above their market clearing levels. A protective tariff will discourage any moderation of wages (as one can see in, for example, the behaviour of the mineworkers over these last five or six years). In the protected field, and probably also in the unprotected areas, prices will be higher. This is unlikely to encourage wage moderation for workers in the non-protected industries. Essentially they will be paying a tax to support the high wages of the workers in the protected industries. We also must add to these effects the well-known loss of efficiency that is always associated with increases in protection. In sum, therefore, retaliatory tariffs are considerably worse than general monetary expansion as a means of promoting a temporary surge in employment; the tariff is focused and discriminatory, and is likely to give rise to further retaliation. And in the long run it will reduce employment by keeping wages up and slowing down the adjustment process.

Conclusion

I suggest that it would be best if E Committee agreed that the basic strategic objective was to reduce the trade barriers of our trading partners and not to protect against imports. All the measures suggested by the Secretary of State should be judged solely in terms of this criterion. I hope E will take a rather jaundiced view of the efficiency of "retaliatory" measures; the evidence certainly points to such a conclusion.

Secondly, I suggest that we use a wider set of instruments in a more imaginative way in order to achieve the objective. For example in seeking reductions in the Spanish tariff we might offer our enthusiastic support for Spain's entry into EEC. We need to play all our hand and not merely the trade cards.



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