OPENNESS, COMPETITION AND MULTILATERALISM

Successive cycles of multilateral trade negotiations carried out within the GATT have led to a strong reduction in tariff barriers to trade within the industrialised countries. The benefits which these countries can still anticipate from the suppression of essentially non-tariff barriers to trade are moderate. The spread of economic openness, however, is shifting the issue at stake in multilateralism. The increasingly international activity of companies is destabilising national laws. The repeated conflicts arising over the rules of competition provide a good example of this. Competition policy, which is complementary to trade policy, can no longer be defined only nationally. Despite this, no consensus exists for including basic rules in this area within the Millennium Round.

■ Measuring the Gains from Trade Liberalisation

The traditional approach to international trade is based on the principle of comparative advantage, and demonstrates that any country has an interest in dismantling its own barriers to trade. The gains from trade arise out of a better allocation of resources in an open economy. The conquest of new markets, favoured by a mercantilist approach to trade, is only important in as far as it fosters deeper specialisation. Nevertheless, international negotiations are subject to the principle of reciprocity: each party seeks to ensure equitable concessions from trade partners in exchange for its own measures favouring openness.

In over fifty years, successive cycles of trade negotiations have brought about a significant fall in the developed nations' customs duties. Running at more than 40% (on average) in 1951, tariffs are presently lower than 5%. However, non-tariff barriers of all sorts, especially anti-dumping measures, which limit access to markets raise the overall level of protection. In the European Union, these can be evaluated at about 14% of the total value of goods traded[1]. What can the Union expect to gain from the completion of liberalisation? The CEPII has carried out an assessment of the static gains from this process.

The method used is taken from the study of the United States, conducted by H.J. Wall[2]. The approach looks at the EU of twelve members for the years 1994 to 1996, and runs as follows. An equation is estimated which explains bilateral trade flows using a gravitational model including an indicator of obstacles to trade (Box 1)[3]. Subsequently, this equation is used to simulate what European Union imports would be if barriers to trade were suppressed. Lastly, the spread between imports under free-trade and imports under protectionism is used to deduce the welfare losses which result from protectionism, and the gains that are to be expected from attaining free-trade.

Moderate gains for Europe in goods trade ...

Under free-trade, the level of European imports would be 9.6% higher. This is equivalent to 0.74% of GDP, given the degree of openness of the EU[4]. In terms of welfare, this leads to improved efficiency: greater levels of imports improve the distribution of productive resources as well as consumer spending. Furthermore, welfare is increased thanks to the elimination of rents accruing to foreigners in markets that were previously protected by non-tariff barriers (see Box 2). To assess such overall gains in welfare on the basis of the results obtained concerning imports, it

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1. P. Messerlin in *Le cycle du millénaire*, Report by P. Jacquet, P. Messerlin and L. Tubania, French Council of Economic Analysis, n°20, La Documentation française, 1999.
2. H.J. Wall, "Using the Gravity Model to Estimate the Costs of Protection", *Review of the Federal Reserve Bank of St. Louis*, January-February 1999.
3. Since 1993, the Heritage Foundation has published a report on economic freedom in the world. The index of economic freedom includes, in part, trade policy, which we have used here, following H.J. Wall. The degree of restriction in a trade policy ranges from 1 (free trade) to 5 (important tariff and non-tariff barriers). The United States and the EU are both graded 2. To simulate free trade the index shifts from 2 to 1.
4. The degree of openness by the European Union stood at 7.7% in 1996, compared to 10.8% for the United States (source: CHELEM-CEPII).

BOX 1 - ESTIMATIONS OF THE GRAVITATIONAL MODELL

The equation estimated for the European Union (with 74 trading partners, between 1994 and 1996) is as follows:

$$\log(M_{i,j,t}) = 0.33\log(PIB_{i,t}) + 0.36\log(PIB_{j,t}) - 0.092\,protec_{i,t} + effets\,fixes_{i,j} + résidu_{i,j,t}$$
$$[5.46] \qquad\qquad [5.94] \qquad\qquad [-3.89]$$

M is the level of imports, **protec** is the Heritage Foundation indicator of protectionism, the *fixed effects* are pecific to each pair of partners, **i** and **j** indicate the importing and exporting country respectively (one of the two must be a member of the EU). The Student **t** statistics are given in the squared brackets. For the United States (85 partners, between 1994 and 1996), wall obtained the following result:

$$\log(M_{i,j,t}) = 0.42\log(PIB_{i,t}) + 0.45\log(PIB_{j,t}) - 0.154\,protec_{i,t} + effets\,fixes_{i,j} + résidu_{i,j,t}$$
$$[1.83] \qquad\qquad [1.94] \qquad\qquad [-4.01]$$

Notes: 1/ The fixed effects make it possible to cover a whole set of explanatory factors for belateral flows, including transport costs and special relationships which exists for historical, linguistic or cultural reasons.

2/The two estimations are not strictly compatible, as they are not estimated using the same database.

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is necessary to identify the supply and demand conditions as well as the level of rents. This information is taken from work carried out by G. Hufbauer and K. Elliot on the American economy[5]. Overall, the benefits achieved for Europe are equal to 0.65% of GDP.

This gain is less than that obtained by Wall in the United States (1.45%). The shift to free trade raises American imports more than European imports. This may be explained by persistence of a large number of tariff peaks in the United States, as well as the different sectoral composition of imports.

For the European Union and the United States, these results may seem limited. Furthermore, they are at the top of the range of existing estimates. Most assessments carried out for the OECD countries suggest that the costs of protectionism in traditional sectors of multilateral negotiation (industry and agriculture) are less than 1% of GDP.

... and for trade in services

What will be the effects of liberalisation in services, which account for nearly 70% of GDP and employment in the OECD countries, and which are the main area to be discussed in future trade negotiations? Statistical information in this area similar to that in goods is not available: it is particularly difficult to evaluate the scale of protectionism, as it is often found in forms that are hard to quantify, due to the specificity of trade in services[6]. However, given that trade in services is about four times less than goods trade[7], it is to be assumed that

protectionism is very high in this area so that liberalisation may produce gains equivalent to 1% of GDP. This would be the case if the estimates of B.Hoekman are accepted. According to these calculations, the tariff equivalent of protectionism in services for the EU runs to 10% in distribution, to fully 182% in transport and telecommunications and 27% in financial and professional services[8]. Given the relative weight of these activities, this amounts to an average rate of protection of services of about 50% (as opposed to 35% for the United States). In contrast, P. Messerlin considers that the protection of services in Europe is only slightly greater than for the rest of the economy[9]. In this case, the gains to be expected from liberalisation are far less.

If the static gains due to the completion of trade liberalisation within the OECD are relatively modest,

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BOX 2 - THE NET GAIN FROM TRADE LIBERALISATION

The standard breakdown, under partial equilibrium, of protectionist effects measured in terms of welfare is illustrated as follows, using the simple case of eliminating tariff barriers.

S and D are national supply and demand curves. In a protected economy, the good is imported at price $P^*(1+t)$, the international price, to which customs duties t are added *ad-valorem t*. At this price, the county consumes a quantity of Q^d_0 and produces Q^s_0, with the difference being imported. The abolition of protection leads to a national price of P^* generating a rise in consumption of Q^d_1 and a fall in production of Q^s_1. Thus imports rise to $Q^d_1 - Q^s_1$. Consumers benefit as they consume more at a lower price (their gain is equal to the area of A+B+C+D). Producers suffer a loss (A), while the State loses customs revenues (C). Yet, there is a net gain of B and D, where B is linked to greater productive efficiency, and D stems from a better distribution of resources by consumers.

In the case of non-tariff barriers being eliminated, the national economy benefits from the disappearance of rents accruing to foreign producers, who sell to the national market at a price above the world price*. The welfare gain is thus increased by the area C, which corresponds to such rents.
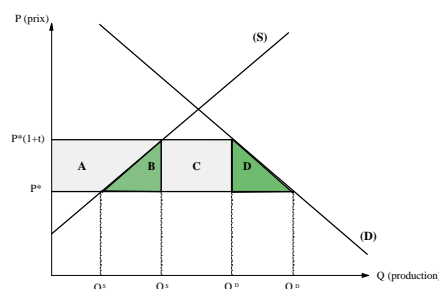
*See A. Bouët, *Le protectionisme*, Vuibert, 1998.

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5. G. Hufbauer and K. Elliot, *Measuring the Costs of Protection in the United States*, Institute of International Economics, 1994. It is assumed here that their results may be applied to Europe, as an initial approximation.

6. Only international trade in services is taken into account here, with other forms of trade like Foreign Direct Investment being left aside. For a more detailed description of the issues at stake in liberalisation in the service sector, see: B. Chane-Kune and N. Mulder, "L'ouverture internationale des services" in *L'économie mondiale 2000*, La Découverte, 1999.

7. Service imports by the United States, which is considered as one of the most open economies, stood at USD 152 billion in 1997, equivalent to about 1.95% of GDP. Exports were equal to about 3% of GDP. Sources: CEPII-CHELEM database and the WTO, *Annual Report*, Vol 2, 1998.

8. See B. Hoekman, "Tentative Steps: An Assessment of the Uruguay Round Agreement on Services", *CEPR Discussion Paper Series*, No 1150, 1995.

9. For the European Union, P. Messerlin (in CAE op. cit.) estimates the level of tariff and non-tariff protection to be about 15% (the value of imports), as opposed to 14% in industry and agriculture.

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greater openness may also be a potential source of dynamic gains, leading in other words to a durable, higher rate of growth. However, the scale of these effects remains controversial, given the critical review of the empirical literature which was put forward by F. Rodriguez and D.Rodrik[10]. As J.L. Guérin[11] has stressed, there is much empirical uncertainty surrounding this issue, given the varying ways in which openness is represented, the diversity of possible strategies and the conditions necessary for the realisation of such gains. In contrast, there is a wide-ranging consensus about the fact that openness must be accompanied by certain policies if its gains are to be achieved fully[12]. The relationship between trade openness and competition provides a good illustration of this.

■ The role of competition policies

It is generally expected that greater openness will encourage companies exposed to international trade to improve their economic efficiency. Yet, market structures may prevent this from happening. This occurs when non-competitive behaviour limits access to markets. The best known example of this is found in the practices of the Japanese distribution system. It is dominated by large Japanese industrial groups, which recently led to the conflict between Kodak and Fuji.

Furthermore, openness may favour the development of global oligopolies, especially in sectors with increasing returns to scale. Automobiles are a particularly clear case in point: in 1950 there were more than 70 large, independent producers, whereas today only about 10 remain, of which seven are truly global. Similarly, the merger between Boeing and McDonell-Douglas brought about a global duopoly. While such concentration may be beneficial in terms of generating economies of scale, it may also be unfavourable once companies can obtain rents which are greater than efficiency gains. In addition, as concentration takes place, it is possible to observe destructive competition leading to price wars and over-accumulation. This occurred in the semi-conductor industry, especially during the last crisis in the electronics industry during 1996-1998, when new factories in Japan and Korea never actually started up production.

National competition policies are meant to address these problems. While trade policies regulated the conditions of competition between countries, competition policies strive to protect economic agents –consumers and competing companies– from abusive practices by certain firms[13]. The United States has a long tradition in this area, and has pushed through a number of well-known cases leading to the break up of companies with dominant positions (Exxon at the beginning of the century and AT&T at the beginning of the 1980s). Another example is given by the legal action against the anti-competitive behaviour of Microsoft. These examples tend to prove that national policies are effective for combating such behaviour.

However, such policies do have limits. They tend to exist only in developed countries. They can basically only be applied within the country in question, but methods for intervening against overseas operations of national firms are very limited. Furthermore, these rules address primarily the internal consequences of anti-competitive behaviour and not the impact on partner countries. For example, in the case of the merger of Elf-Total-Petrofina, the French authorities where only concerned about concentration of distribution networks which could lead to market domination in certain French regions. In contrast, European competition policy sometimes includes concerns which go beyond the Single Market. In particular, the Commission successfully opposed the merger between De Haviland (a Canadian company) and Aerospatical-Alenia, on the grounds that the group would had a dominant position on the world market and not just on the European market[14].

Internationally, several bilateral agreements have been concluded, such as the one between Europe and the United States in 1991. It permits either party to undertake legal proceedings where companies are indulging in anti-competitive behaviour, and envisages legal cooperation when necessary. However, the Commission was not be able to prevent the merger of Boeing and McDonnell-Douglas; although it did manage to annul the exclusive supply agreements between the American group and certain airline companies.

As for the WTO, it can only sanction anti-competitive behaviour limiting market access when this leads to intervention by national authorities. Thus the WTO does not intervene in Mergers and Acquisitions. However, sectoral agreements with consequences for competition were concluded within the WTO framework in 1997. In basic telecommunications, the agreement includes a competition policy dimension, by recognising the right of access of all companies to public networks, at equitable prices. Various other discussions, along the lines of those relating to electronic trade, are also underway concerning professional services and the control of subsidies and methods of regulation.

These sectoral agreements beg the question: should the case-by-case approach be pursued, or would it be better to strive to define more general principles? A working group

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10. F. Rodriguez and D. Rodrik, "Trade Policy and Economic Growth: a Skeptic's Guide to the Cross-National Evidence", *NBER Working Paper* 7081, 1999
11. J.L. Guérin, "Quel cadre pour l'ouverture ?" *La lettre du CEPII*, No 181, July-August 1999.
12. Fontagné and J.L. Guérin, "L'ouverture, catalyseur de la croissance", *Economie internationale*, No 171, 1997.
13. J.M. Siroën, "Mondialisation, innovations institutionnelles et politiques de concurrence", *Cahiers du CERESA-CREDO*, University of Paris-Dauphine, 1999, No2.
14. Since December 1989, the Commission may control mergers leading the the creation of groups with a turnover greater than Ecu 5 billion in the world market, and more than Ecu 250 million in the European market.

TABLE - THE W T O AGENDA

INCORPORATED PROGRAMME: COMPULSORY ISSUES AT THE END OF THE URUGUAY ROUND	NEW ISSUES
Libéralisation of agriculture trade Libéralisation of services Technical obstacles to trade Re-examination of the accords on investments (TRIMs) Re-examination of thes accords on intellectual property rights (TRIPs) Procedures for examining trade policies.	Competition policy (working group set up in 1996) Transparency of public markets (working group st up in 1996) Trade and investment (working group st up in 1996)) Least Developed Countries Food security and sanitation Labour standards Regional accords and the WTO Facilitating trade Tariff peaks in industry.

Source: Further information is available on the WTO (www.wto.org).

was set up within the WTO in 1996 to examine the interactions between trade and competition policy. Nevertheless, this issue is not among the compulsory negotiations of the Millennium Round (see table). The European Commission would like to include this in the agenda, and that a multilateral framework of constraining rules be established. The United States does not favour this. It considers that its legislation is often sufficient and that the bilateral accords it has concluded, notably with the Europeans, are useful complements. Lastly, Japan, followed by the Asian countries, considers that an accord in this field should include regulations limiting recourse to anti-dumping policies, which are particularly arbitrary. The Americans and the Europeans disagree.

The industrialised countries are now sufficiently open for the gains from further liberalisation not to be of major amplitude. Even if the opening up of agriculture and services hold out the possibility of sach gains - but also conflicts among countries - the primary challenges lie elsewhere. In many areas, rules have to be set for the full gains of openness to be tapped, for all countries participating in trade. The rules relating to competition are particularly important from this point of view, but policies concerning foreign investments, intellectual property, social norms or the state of the least developed countries must also be examined. It will be a loss for everyone if the new trade cycle does not address these issues, which would in fact would mean leaving the strongest companies of the strongest countries free to do as they choose.

Michel Fouquin,
FOUQUIN@CEPII.FR
Guillaume Gaulier
GAULIER@CEPII.FR