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ISSUES AND OBJECTIVES OF U.S. FOREIGN TRADE POLICY

A COMPENDIUM OF STATEMENTS

SUBMITTED TO THE

SUBCOMMITTEE ON FOREIGN ECONOMIC POLICY

OF THE

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CONGRESS OF THE UNITED STATES

SEPTEMBER 1967

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LETTERS OF TRANSMITTAL

SEPTEMBER 22, 1967.

TO THE MEMBERS OF THE JOINT ECONOMIC COMMITTEE: Transmitted herewith for the use of the members of the Joint Economic Committee is a compendium of statements prepared for the Subcommitee on Foreign Economic Policy on "Issues and Objectives of U.S. Foreign Trade Policy." The 12 statements included in the compendium were presented by distinguished international economists from the universities, from professional associations, and from the business world in response to a request from Representative Hale Boggs, chairman of the subcommittee. The contributors were invited to give their assessment of certain important aspects of U.S. foreign trade policy and to indicate how they thought policy should be directed in the light of the recently completed Kennedy Round of trade negotiations.

These statements do not necessarily reflect the views of the committee or any of its members.

WILLIAM PROXMIRE,
Chairman, Joint Economic Commitee.

SEPTEMBER 21, 1967.

Hon. WILLIAM PROXMIRE,
Chairman, Joint Economic Committee,
U.S. Congress, Washington, D.C.

DEAR MR. CHAIRMAN: Transmitted herewith is a compendium of statements on "Issues and Objectives of U.S. Foreign Trade Policy." The contributors, who are distinguished international economists in academic life, in research institutes, and in professional and business circles, were invited to write on subjects which were of particular concern to the subcommittee as it approached its brief initial set of hearings. It was the intention of the subcommittee both to provide itself with expert opinion and to achieve a wider range of opinion than the hearings alone would be able to provide. Some of the papers are extensions of or extracts from the current professional work of the authors. In view of the comparatively short time available for the preparation of this compendium, the subcommittee did not aim at a complete survey.

The professional experts who contributed to this compendium have been most generous in giving their time and energy to meet the subcommittee's request. The subcommittee, therefore, wishes to express its gratitude and appreciation to them and to their organizations.

The staff of the Joint Economic Committe undertook responsibility for coordinating the papers in the compendium in accordance with plans developed by the subcommittee. Miss Carol Kern was the editorial assistant in preparing the manuscript for publication.

As is evident from the diversity of subject matter and viewpoint, the opinions expressed in these papers are those of the individual contributors. They do not necessarily represent the positions of the Joint Economic Committee or of individual members or of the committee staff.

HALE BOGGS,
Chairman, Subcommittee on Foreign Economic Policy.

PREFACE

In planning a short set of hearings for July 1967 on the subject of the future of U.S. foreign trade policy, the Subcommittee on Foreign Economic Policy took account of several special factors that appeared likely to affect the usefulness of the hearings.

First, there had been a gap in the public discussion of where the national interest of the United States lay, in regard to the next steps in trade policy. Congressional commentary during the last 6 months of the Kennedy Round negotiation had been for the most part reserved and particular. As the terminal date of the Kennedy Round, the last day of June 1967, approached, the tension and uncertainty of the negotiations engaged public attention.

Secondly, the subcommittee was quite aware of the shift in the relative importance of different subjects of trade policy, for example, the growing significance of nontariff barriers; the undefined problem, for national trade policy, of the development of multinational corporations; the acute difficulty of beginning negotiations on agricultural commodities; the possibility that the special situation of the trade of less developed countries would receive less than due attention, and many similar issues.

Thirdly, it was not expected that either the subcommittee or any external observer would be able to supply a prompt and complete evaluation of the outcome of the negotiations. Yet, in order to give substance and balance to its deliberations it was necessary to have up-to-date and expert commentary on the status of U.S. trade policy.

For these reasons, in the main, the subcommittee sketched out some of the issues and objectives of trade policy and considered some of the recent expert writing on these subjects. Members of the staff inquired whether the authors were willing to contribute their most recent work for the information of the subcommittee or were able to adapt its scope to meet the subcommittee's intentions.

Happily the authors concerned, and in some cases the organizations or businesses with which they were associated, gave the most ample and generous support to these requests, and the subcommittee gratefully recognizes their valuable contributions.

The subcommittee accepted in every case the authors' own approved statement. Apart from earlier editorial reductions of the scope of the papers, the staff contribution was that of coordination. The subcommittee therefore stresses that the views presented are those of the authors and not those of the subcommittee or any of its members.

At the hearing of July 19, 1967, on "The Future of U.S. Foreign Trade Policy" before the Subcommittee on Foreign Economic Policy, the papers presented by Mr. William Diebold, Jr., of the Council on Foreign Relations, Prof. Robert E. Baldwin of the University of Wisconsin, Dr. John Pincus of the RAND Corp., and Prof. Lawrence W. Witt of Michigan State University were the basis of their testimony before the subcommittee.

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Section I

THE BASIS OF NEGOTIATION

FUTURE NEGOTIATING ISSUES AND POLICIES IN FOREIGN TRADE

BY WILLIAM DIEBOLD, JR.*

The Trade Expansion Act made major innovations in U.S. foreign trade policy. The Kennedy Round introduced some unprecedented features into international negotiations. Neither worked quite as it was expected to but both achieved important successes. Neither can be adopted unchanged as a model for dealing with the next set of problems we face.

Analyzing what has just been done can help us to decide what new steps ought to be taken. For that we need to call on the experience of those who went through the negotiations and also statistical work comparing tariff cuts, or the lack of them, to patterns of world trade. Lacking both these sources, this paper is an outsider's attempt to say something about the decisions that will confront the United States in the next 5 to 10 years based on a look at the unfinished business of the Kennedy Round.

Though I have not had a chance to read the fine print, I think that what was done and not done in the Kennedy Round can be fairly safely summarized in a few propositions.

On a wide range of manufactured goods tariffs have been cut to lower levels than at any time since the early 1930's, but significant tariff protection remains on a number of important products.

Nontariff barriers, not new in international trade negotiations, have had their importance highlighted by the Kennedy Round, both for the future and as a means of making final some of its conditional arrangements.

In agriculture, the Kennedy Round made a number of useful tariff cuts and made some progress in linking transatlantic grain trade with world food problems. No dent was made in the barriers put up by the European Economic Community's common agricultural policy, but the discussions may have given an impetus to a new kind of international negotiation about agriculture.

While a number of the things done in the Kennedy Round will be of benefit to the less-developed countries, they were relatively silent partners; their main trade problems have yet to be dealt with.

East-West trade, too, will be affected only in a modest degree by the Kennedy Round.

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*Mr. Diebold is senior research fellow at the Council on Foreign Relations, Inc., New York. The council is a private nonprofit organization. It takes no stand on questions of national policy. The views expressed in this statement are the author's only. Most of the points made in this paper will be dealt with more fully in a book on U.S. foreign economic policy that Mr. Diebold is preparing for the council.

If this summary is reasonably accurate, it gives us the outlines and some of the dimensions of the issues we need to consider in looking at future U.S. trade policy.

In what follows I have assumed that the United States will continue to press for the removal of barriers to international trade, whether they are imposed by itself or by others. The case for such a policy is, in my opinion, clear—but I do not argue it here. If the assumption were to be regarded as false, readers could dispense with the pages that follow except to the extent that they might be thought helpful as a partial list of the kinds of barriers to American exports that might well increase in the absence of an effective effort to lower them and as some indication of the forms in which American consumers might have to make the payments exacted from them by restrictions on imports.

This paper emphasizes broad issues and general directions. It says little about timing, tactics, or the specifics of legislation. It leaves out a number of questions of trade policy, including the important matter of adjustment assistance, one of the most notable instances of the TEA's not working out as expected. Even with these limits the paper covers so wide a range of issues that it is full of unqualified and perhaps even dogmatic statements. Part of the excuse for that is that the aim of the paper is to raise questions; not answer them. It does not prescribe what U.S. trade policy should be in the years ahead, but tries to state some of the issues about which decisions will have to be made in shaping that policy.

The Remaining Tariffs

Much of the impact of the Kennedy Round will be on that large segment of world trade made up of the exchange of manufactured goods among industrialized countries. From now on we can think of the remaining tariffs on this trade as falling into three categories:

(1) those that were reduced by the full 50 percent or something approaching it, or that are quite low even if the cuts were smaller;

(2) those that were reduced by little or nothing because deeper cuts were regarded as economically or politically unacceptable to major trading countries;

(3) those that a country would have been willing to reduce but withdrew from the bargaining because other countries were not willing to make adequate concessions.

There are no hard and fast lines between these categories, but it is clear that they present rather different kinds of problems for the future. There is little to say about the third except that it provides an area of maneuver in future tariff bargaining. The second includes the hard cases—whether for a number of countries or just one or two key ones—which will probably require special efforts and very likely more than tariff bargaining if they are to be dealt with at all. More will be said about these later.

As to the first category, two questions suggest themselves: How restrictive are these duties? If they could be cut as much as they have already been cut, should one expect to be able to reduce them still more in the not too distant future, say when the Kennedy Round reductions are fully in effect?

Merely because a duty is below 10 percent it cannot be called unimportant or unprotective. A 9-percent aluminum duty that the European Community refused to touch was one of the sore points of the Kennedy Round. Businessmen and consumers are not indifferent as to whether a tax is 3 or 8 percent. Valuable recent work distinguishing "effective" from "nominal" tariff rates has emphasized an old but often forgotten point that if raw materials and other inputs are tariff free, the protection offered the manufacturing process may be much higher than the apparent duty rate on the finished product. Nevertheless, when a large number of duties get down to what by the standards of the last 50 years are fairly low levels, many of them begin to look rather dispensable. Certainly the idea that they spell the life or death of great industries looks less plausible than ever. It is no accident, after all, that in the TEA Congress gave the President the power to remove duties of less than 5 percent. It would seem modest enough, then, to suggest that one aim of future trade policy would be for the United States and other industrialized countries to eliminate "nuisance tariffs." The question would be only where the line should be drawn—at 5 percent or above.

To pursue this aim the power the President now has could be extended. But broader approaches ought to be considered. After all, the lesson of the trade policy the United States has followed since 1934 is that tariffs can be very substantially reduced without great damage to domestic interests and with probable benefit to the national economy. This conclusion is certainly supported by the European experience in the Common Market and EFTA. The Kennedy Round has shown the willingness of a number of governments to take another big dose of the same tonic. Would it not be realistic to think of one more step that would eliminate (or at least drastically reduce) most of the tariffs remaining on trade in manufactured goods among industrialized countries? Of course there would be exceptions, including probably the hard cases of category 2 above which have to be approached in a different manner. But much more would be included than the "nuisance tariffs," those of 5 percent or less. Many of the duties that will be 10 or 12 percent after the Kennedy Round cuts are fully in effect were several times as high 15 or 30 years ago. Sometimes the last quarter of a tariff may seem more valuable to those it protects than the first three-quarters, but it is hard to dismiss the impression that if such cuts could be made in 20 or 30 years, the remnants could be disposed of in another 10. The argument would not be that the remaining duties were meaningless or negligible but that in the light of what has already been done, and on the basis of giving and gaining that is the core of tariff policy, a general agreement to eliminate over a period of time a large number of tariffs on trade in manufactured goods among the industrialized countries would be a desirable and not unimaginable goal.

Another Kennedy Round with linear cuts would be one way of going at this possibility (though I doubt that there would be much enthusiasm for that idea now). Perhaps a more clear-cut approach would be to think of a formula under which countries would move more or less automatically toward the agreed-on goal. While a number of formulas could be devised—and the possibilities multiplied by combining them in various ways—the alternatives that follow give a reasonable idea of the main lines of approach.

(1) Duties could be reduced according to a uniform schedule that would bring all of them to zero in a short time.

(2) Some duties might be reduced faster than others, perhaps because they were higher to start with, or more slowly because some countries needed longer to adjust to free trade than others, but all would be completely removed by a scheduled time (presumably but not necessarily the same time).

(3) A country's obligation might be to reduce the average of its tariffs (or the average in each of several categories of tariffs) by a certain amount each year. This formula would permit each country some flexibility—going slow on some duties if it went faster on others—while assuring the same results in the end.

(4) If the elimination of tariffs were unacceptable the same formulas could be used to proceed to a more modest goal.

One possible goal which might be pursued with or without a formula is tariff "harmonization." This loose term means to some people that different countries should apply the same tariff rate to the same products (or depart from the pattern only for special reasons). The European Community's proposals for dealing with *écrêtment* and tariff discrepancies in the Kennedy Round were in a sense versions of this form of harmonization. Another way of using the word is to describe a goal in which most tariffs on trade in manufactured goods among industrial nations—with the inevitable exceptions—would fall into an agreed-on range—say 8 to 10 percent. As in the third of the formulas outlined above, flexibility could be introduced by applying the rule to averages. The economic advantages of harmonizing tariffs are less obvious than of reducing them, but there is a kind of elementary equity about the idea which might make tariff reduction more acceptable than some other kind of arrangement.

Formulas have the advantage of seeming to simplify matters, but that will not be enough to persuade governments to submit their hardest cases to them. The future will, therefore, include some of the same kind of tariff bargaining as the past. Perhaps, though, the chances of success can be increased by some new approaches. Eric Wyndham White, Director-General of GATT, has suggested that in some major industries "characterized by modern equipment, high technology and large-scale production, and by the international character of their operations and markets" negotiations might lead to free trade "within a defined period." [1] To some degree industry by industry negotiations were begun in the Kennedy Round, partly it would seem to deal with some of the "hard cases." The idea of advancing from exceptions lists to possible free trade is an attractive one. Chemicals and steel are industries in which a number of leading countries have both protected and exporting sectors; in aluminum there are only a few big producers and a very international market. One advantage of this approach is that other trade barriers could be looked at along with tariffs. Another is that the relative importance or unimportance of trade barriers would be made much clearer than is usual when a negotiation is only about trade barriers and everything else that affects the industry is regarded as falling outside the discussion. The result, Wyndham White believes, could be a series of agreements moving toward free trade industry by industry.

[1] Speech to the Deutsche Gesellschaft für Auswärtige Politik, Oct. 27, 1966.

The approach prompts questions about the government-business relationships needed for this kind of negotiation. Another set of doubts may focus on the tacit or explicit understandings that might be encouraged between private businessmen in several countries. It is also important, as Representative Thomas Curtis pointed out in his testimony to this subcommittee on July 12, 1967, to avoid accepting past shares in the market as a fixed pattern for future trade. Nevertheless, the idea has enough merit in it to deserve serious exploration and perhaps some experimentation.

Industry by industry negotiation may not lead to separate industry agreements. While in some complex industries it may be possible to balance the advantages and concessions of a number of countries, in others the discrepancy will be too great or one of the parties will want to bargain its acceptance of an industry arrangement for another country's acceptance of a different industry agreement. The experience is common enough in normal tariff negotiations; it is said to have taken a Common Market concession on paper to get the Scandinavians to reduce automobile duties in the Kennedy Round. This is not a fatal weakness of the industry-by-industry approach but a warning that its adoption may not go quite as far as its name suggests to divide trade negotiations into a series of discrete transactions. By the same token an agreement on nuisance tariffs and another on reduction by formula might well be linked with one another, and industry agreements to them.

In analyzing trade problems of the post-Kennedy Round period we tend to distinguish among them and naturally look for solutions suited to the problems, not universal solvents. This suggests a certain breaking up of the pattern of negotiations and the analysis of nontariff barriers points strongly in the same direction, as we shall see. Perhaps we should get in the habit of thinking about trade negotiations as a continuing process proceeding at different paces on different matters, rather than as a process with periodic climacterics such as the main rounds of tariff negotiations under GATT have been. But it may be a mistake to think that things can be broken apart in this way, given the discrepancy between the aims of one country and another and the natural tendency of bargainers to use all the counters at their command. It does not follow that an all-in new Kennedy Round is the only alternative but it seems likely that separate pieces of negotiation will not be truly independent of one another.

NONTARIFF BARRIERS

Some of the first American businessmen to complain about the results of the Kennedy Round charged that not enough had been done to reduce Europe's nontariff barriers on American exports. That is a healthy emphasis that can lead to more good than the more familiar complaint of the past that American industry could not survive without tariff protection.

Nontariff barriers are nothing new. Getting rid of quotas was one of the great aims of American trade policy in the first postwar decade. As the dollar shortage gave way to general convertibility, quotas were largely peeled away and tariffs once again resumed their importance. Now major reductions in tariffs are making other nontariff barriers more prominent. Maintaining an attack on them should be a major feature of the next phase of American foreign trade policy. It will not be a simple matter. The wide variety of nontariff barriers is the beginning of the difficulties—but only the beginning.

The Kennedy Round has made people familiar with American Selling Price and European taxes on automobiles which discriminate against large cars. Buy American rules in this country and comparable government procurement practices in Europe are well known to businessmen. Marking and labelling regulations, laws about trademarks and patents, packing regulations, rules about health and safety are all examples of things that can be barriers to trade. Some of these nontariff devices, like ASP, work by enhancing the effect of tariffs or making it difficult and costly for goods to pass through customs. Trade by government agencies can be conducted so as to bar as well as to promote transactions, and to protect domestic production or discriminate between one foreign supplier and another. Any number of taxes and other kinds of charges may in one way or another impede trade, including perhaps some which for generations economists said were neutral in their impact.

It is not only variety but motive that makes the analysis of nontariff barriers difficult. Some are used overtly to restrain imports. Others are used only covertly, under the guise of performing some other function, once perhaps their real purpose. In still other cases, the impediment to trade results from the legitimate pursuit of some honest public purpose.[2] Gray areas abound and the categories overlap. Where barriers are overt, the questions are about the will and means to negotiate. In the second category, more demonstration is necessary though the negotiating problem is similar. In the third case, however—the barriers that are incidental to something else—matters are more complicated. One has first to find the cases, then judge how much damage is really being done to foreign trade, and where. Then comes a process of finding ways to reduce the damage to trade without seriously interfering with the pursuit of the legitimate aims of the policy. That being done, there comes a weighing of the inescapable damage to trade against what is needed to pursue the purpose for which the regulations were imposed, a choice in which domestic and foreign interests may well conflict.

Taxes may be found in any of these categories. Those that are plainly subterfuges for tariffs will of course not pass muster under GATT or any other sensible international agreement about trade barriers. But as tariffs fall, many kinds of once-innocent taxes begin to look suspicious, especially for the discrimination they may hide. In recent years, long-established principles about the effect of "indirect" taxes on international trade have been called into question. Economists are questioning the facts and theories on which the rules about taxes in GATT and in other agreements are based. Their doubts coincide to a considerable degree with the businessman's commonsensical and untutored reaction that if his goods have to pay a tax on entry into a country while his competitor's goods are exempted from the same tax when they are exported, he is at a disadvantage. After years of work, the six countries of the European Community have decided to

[2] I notice that officials of the U.S. Government have recently been in Paris discussing the new automobile safety regulations with their European counterparts who, in turn, have to enforce national safety and other regulations which are incompatible with one another.

harmonize at least the systems of their turnover taxes—and an aligning of the rates will probably follow. In England and the United States questions are being asked as to whether it would not be helpful to the international competitive positions of those countries if part of the corporation income taxes were turned into this kind of transaction tax which would be forgiven on exports and levied on imports. The border tax issue may well be the most important of the nontariff barriers to be fought over in the next few years. (And if it is not, it will be important to be sure why.) The issues are not simple; in some countries domestic considerations will outweigh foreign trade aspects. And if certain taxes are altered to improve the Nation's foreign trade position, what questions may not eventually be raised about the rest of the tax burden?

The pursuit of nontariff barriers leads far and into many corners. It does not stop with government action. Private business practices can be serious trade barriers. Of course what governments do or do not do to regulate businessmen is part of the problem. The laws vary greatly from country to country and enforcement is another question again; it may be legal to treat the foreigner as you may not treat your compatriot. Several postwar efforts to get international agreement on the regulation of restrictive private business practices have come to nothing. The process continues in a low key and no very important breakthroughs have been heralded, but if we are to look more intensively at nontariff barriers these old subjects will have to rise in importance on the international agenda.

As my examples may have suggested, the long-run problems of nontariff barriers concern not only their range and variety but the uncertainty of what is a barrier and who is hurt by it. In the short run, though, while these questions are being studied, governmental action can focus on discernible barriers. Here the question is: How to deal with them?

Sometimes existing rules apply. That is the case with quotas on manufactured goods applied by industrialized countries in balance-of-payments difficulties. To the extent that such controls are not removed when the difficulties are over, the remedy is to press harder. Agriculture is something else again, to be discussed later, while the heavy incidence of controls on coal and oil suggests that the emergence of energy policy as a focus of governmental attention in Europe, North America and Japan may put yet another set of trade barriers in a special category.

The commonly heard statement that the remaining quotas on trade in manufactured products are of minor importance needs three qualifications. First, it does not apply to cotton textiles. Second, many European countries still apply quotas to a wide range of imports from low wage countries. Third, the rather good formal record of North American and European countries conceals a reliance on commitments by Japan (and to a degree other countries) to limit exports of certain products. It is hard to believe that a general attack on nontariff barriers—which are apparently quite important in limiting imports into Japan—could carry much conviction if it did not take account of voluntary export quotas like these.

When the question is not one of enforcement but of making new rules, the heterogeneity of nontariff barriers poses problems. Some could be flatly banned but for most it would be a matter of making rules about their use and abuse. General rules covering a range of practices could be devised or codes of behavior drawn up. But would not a code that was general enough to apply to all nontariff barriers be so general as to be meaningless? We shall, then, probably end up with a number of different agreements of rather different sorts. An agreement to prevent the misuse of antidumping procedures has come out of the Kennedy Round. There has been talk of a code covering government purchasing. Europeans believe it would help matters if the United States accepted the Brussels customs nomenclature and the practices common in other countries.

Something more is probably needed, some kind of consultation procedure. This would help to reveal which things are important and to whom. It would explore the possibility of adjustments that would make it unnecessary to go through the elaborate process of devising and negotiating an international code capable of regulating very different national situations. While bilateral adjustments may prove expedient, the most sensible approach to the most prevalent barriers would be to provide a place in one of the multilateral agencies to which countries could go with their complaints at the same time that they raised the issue with the offender. Out of the accumulation of case material might come a more objective study and appraisal than would otherwise be possible and some guidance as to relevant and enforceable rules. An agreement setting up this kind of procedure might also incorporate some broad principles about nontariff barriers, but whether much would be gained by this step is hard to judge until we find whether major trading nations are ready to go beyond the broadest statements of principle.

The heterogeneity of nontariff barriers makes for separate treatment. This will undoubtedly sometimes be the best way, as in the case of the antidumping code. But the separation of issues may make it impossible to agree on some of them. Countries are not equally interested in the removal of each type of barrier. For example, if negotiations had been over road taxes alone, what could the United States have offered the Europeans to persuade them to end their discriminatory practices? Formally or not, therefore, it may be necessary to link specific nontariff barriers of quite disparate types. For the same reason, it seems unlikely that arrangements on nontariff barriers can be totally separated from tariff bargaining.

How we negotiate about nontariff barriers is related to where we do it. GATT and OECD both have claims. There seems no reason to choose one as the exclusive arena. Purely pragmatically one might pursue an issue in one place at one time, in another at another time, and sometimes in both. So far as logic goes, nontariff barriers related to tariffs are certainly best discussed in GATT; some of those linked to invisible transactions and primarily of interest to industralized countries might well be brought into the discussions of the OECD's code of liberalization. In between are a large number of issues that might reasonably be looked at in either place as opportunity offers.

The examples of nontariff barriers already cited show how far afield from traditional trade negotiations we are likely to move in the next decade. All kinds of issues usually thought of as "domestic" may become the subject matter of international negotiations—either because the United States asks it of others or they do of us. This may not happen quickly but in the long run it seems inevitable. This will in many ways be awkward. But little will be gained by trying to shy away from it. Indeed, if the United States wants to take a new initiative in international trade, as it has several times in the last generation, this might be the best to pick. In our present state of knowledge it is impossible to say whose trade is hardest hit by the sum total of nontariff barriers, but there is at least an even chance that the United States has more to gain in this field than others and there can be no doubt that the world economy would benefit from the same degree of progress in removing nontariff barriers in the next 30 years as has been achieved in reducing tariffs and removing quotas in the last 30—thanks largely to American initiatives.

If we are to do this, though, another problem arises, different from the others and also difficult: How can the United States most effectively negotiate about nontariff barriers? The formula delegating powers to the President that has been used successfully in the Trade Agreements Act for over 30 years does not fit. It is not easy to see a clearly analogous definition of the power and its limits considering the variety of the issues and the extent to which domestic legislation is involved in them. But can there be effective negotiations if each agreement depends on positive congressional action?

Agriculture

The new issues in trade policy discussed so far arise largely because of the progress made in the last 20 years in lowering tariffs and eliminating quotas on manufactured goods. The same cannot be said of trade in farm products; there the same old problems persist and trade barriers have probably been increased more than removed. For a long time many people have felt hopeless about the possibility of liberalizing agricultural trade. The Kennedy Round has not brought a fundamental change but it has pointed to some possibilities.

Although the negotiators failed to work out a long-run agreement assuring outsiders of continuing access to the European Community's market for products covered by the common agricultural policy, they were on the right track. No doubt it was reasonable of the United States to turn down as insufficient the Community's offer limiting the degree of self-sufficiency that it would strive for in grains. However, the fact that this was the kind of issue discussed is a hopeful one, for it has become increasingly clear that, over a large segment of agricultural trade, negotiations can have a major effect only if basic policies are discussed. Negotiations confined to trade barriers will almost surely run into the same blocks as in the past. It is from domestic policies that the trade barriers are to a great degree derived. We are not used to discussing internationally such traditionally domestic matters as farm production goals, prices, land use, and surpluses. That course is difficult for any democratic country and it may be that the United States or others may not in the end be willing to go through with it. But there is a strong case for trying since the alternative seems to be to perpetuate an impasse of the sort we have known in the last 20 years.

This hard choice does not confront us for every farm product. There are quite a few on which conventional tariff reductions (or sometimes quota enlargements) are meaningful and satisfactory. We ought to try to keep as many products in that category as possible.

The grains agreement that has come out of the Kennedy Round demonstrates one more dimension of future agricultural trade negotiations among industrialized nations: they will be directly affected by the world food situation. Probably that will more often than not make agreement easier (because it will tend to increase demand and raise prices), but it will also extend the range of issues from trade barriers and domestic policies to aid, export subsidies and prices and the status of commercial shipments to poor countries.

Less Developed Countries

Instead of trying to deal comprehensively with what is now coming to be called North-South trade, I shall make only a few general remarks, trying to give a perspective.

"Trade not aid" has always had a healthy sound to Americans. More trade would certainly be good for the less developed countries; they earn far more foreign exchange from exports than they get in aid. But there are probably not many underdeveloped countries for which the alternatives are mutually exclusive. In most places adequate development will probaby require both aid and increased opportunities to trade; often, the basic question will be what proportions should be maintained between these two things. And that in turn will depend to an important degree on how much the United States and other industrialized countries will do to open their domestic markets further to competing goods.

There is no doubt that many less developed countries could gain substantially if barriers to their sales of agricultural products and minerals were reduced. The protection the Uinted States and Western European countries give their domestic producers often hits the less developed countries. What is more the tariff structures of the industrial countries discourage the growth of processing industries in the less developed countries. This results from having duties which are relatively low on raw materials and mount as the degree of processing increases. Canada has complained of this aspect of the American tariff for years and for the less developed countries the effect can be serious. The processing of local raw materials is apt to be one of the sounder bases for industrialization, so the elimination of barriers that discourage it would seem to have an added attraction, in addition to improving the export position of the less developed countries.

It is unfortunate, in my opinion, that so much of the recent discussion about exports of manufactured goods from the less developed countries has been about giving them tariff preferences so that they would be subject to lower duties than products coming from rich countries. The real issue is freer access to the markets of the developed countries. Whether preferences would be a good way of getting that access, or enhancing it, is a subsequent question. I fear that working on plans for future preferences has kept governments in less developed countries from pressing Europe and North America as hard as they might to remove present barriers. To a degree the arguments over preferences have served as an excuse for some industrialized countries to sit tight with their existing limited preferences while the pressure grows on the United States to do something to compensate Latin

America for being left out of the British and European preferential arrangements. There is certainly a case for lowering barriers to imports from Latin America, but what good would it do the United States to do that at the expense of Asian or African countries? One of the hard problems of the near future will be to decide how far the United States should go in acting alone if it cannot work out satisfactory arrangements with the Common Market, Britain and perhaps Japan about preferences.

If, for whatever reasons, the United States goes along with the idea of granting preferences to the manufactured goods of the less developed countries, it should try to insure that they satisfy three criteria.

They should not discriminate among LDC's; they should be limited in time (by reducing the general rate, not raising the preferential one) ; and they should not be allowed to hold up the removal of duties on imports from advanced countries. There is a good case for giving the full Kennedy Round concessions to the LDC's right away, but it is doubtful how much they could benefit from such a step.

The real question is access, not whether access comes in a preferential form. Unless the governments of developed countries are willing to confront that fact and accept the idea of taking more competing imports, it will do little good to talk about preferences. Some who advocate preferences do so because they fear that Europe and North America will not alter their agricultural protectionism and therefore should give the LDC's at least something that they want. If that advice is followed—more for diplomatic than economic reasons, it would seem—the question will be how generous an offer will be made and how many exceptions the United States or other advanced countries will insist on making. How much economic advantage will the LDC's get from a preferential system in which the goods they can most successfully export in quantity are limited by quotas?

Unfortunately, there are good grounds for fearing that any system of enlarged preferences likely to be put forward in the next few years will be limited in scope, ringed around with qualifications, and riddled with exceptions. The rather attractive idea of avoiding rigid rules and permitting each industrialized country to be somewhat restrictive where its own domestic sensitivities are greatest is only too likely, in my opinion, not only to fail to encourage generosity on other products but to lead to the less developed countries' being given what they can least use and being denied freer access to markets in which they could really make progress. How much diplomatic or political advantage will the United States, or the other developed countries, get from such a development?

Inevitably the Long-term Cotton Textile Arrangement comes to mind. It is a document that looks two ways, professing to provide an orderly expansion of markets for the exports of less developed countries while permitting importing countries to make or keep arrangements that in themselves are restrictive. The results may be ambigious: because of shifts in trade among the 64 categories established in the agreement it is hard to judge the full meaning of figures showing sizeable increases in imports. Who has benefitted, at whose expense and in what degree is hard to tell. But this kind of reality cannot be left out of account when general declarations are made about the importance of helping the less developed countries expand their exports.

While cotton textiles are by far the most important manufactured goods exported by the less developed countries, there are others and, if development is to proceed, the list will have to grow. In spite of the rich man's label that has been put on the Kennedy Round, it includes a large number of tariff concessions from which less developed countries can benefit, provided they produce and export these products cheaply enough and market them effectively. If they can take advantage of this access that has been given them, and even more if the access can be improved by future trade barrier reductions, they can make important gains. By accepting increased import competition from the less developed countries, in agriculture, mining, processing, and manufacturing, the rich countries open new possibilities for the effective use of aid and investment as levers of development.

East-West Trade

As I see it, there are four main questions to be considered.

First, should we relax export controls on sales to the Eastern countries? These are matters which are to a considerable degree within the discretion of the President but it is understandable that he should want an indication of congressional support for expanding trade before using what was originally restrictive legislation in this way. So far as practical effects go, there appear to be relatively few cases in which the American restrictions present major difficulties for the U.S.S.R. or East European countries, except perhaps in the short run for certain strategic items or advanced technologies. Another question that then arises is how far we should go in granting credit.

The second question is whether the President should be given power to grant most-favored-nation treatment to the Communist countries if he feels he has carried on satisfactory negotiations with them. Here the considerations are quite different in dealing with the U.S.S.R. and with the smaller East European countries. For the latter, it is a question whether we can improve their freedom of choice in the world by giving them easier access to this market. For the former, it is primarily a question of whether we would like to add trade to the list of issues on which Moscow and Washington can effectively negotiate as part of their continuing dialog. The potential economic gains to the United States from such steps are, in my opinion, quite secondary to these broader considerations. It seems foolish to impose rigidities on ourselves without gaining any obvious economic and political advantages.

The third question is what to ask for in return for most-favored-nation treatment. Under systems of state trading, a reciprocal promise of equal treatment has little value. The reforms being introduced in most of the Communist countries may make that pledge somewhat more meaningful in the future and we should certainly insist on having it just in case that turns out to be true. A range of things affecting trade can suitably be incorporated in agreements with the Communist countries to reciprocate for the American grant of most-favored-nation. No one of them is guaranteed to work. Few have the simplicity of rules about tariffs and quotas that we are used to. We must, therefore, have an experimental approach in what we do. That is one reason that it will be wise to make agreements that are subject to review or renegotiation after a few years.

The fourth decision concerns bringing the Communist countries into GATT. Here we face the same kind of problem we do in bilateral relations. GATT rules have little to say about the conduct of state trading countries and, consequently, offer less assurance to other signatories of the agreement. Special arrangements, such as those that have been worked out with Poland, have a certain value, though again they set up trading arrangements that are not wholly satisfactory. There is value, though, in bringing the Communist countries into GATT on some basis as a way of providing for the discussion of common problems. The thing to understand is that their membership does not solve these problems but only opens up opportunities to work effectively on them and to experiment as long as both sides are willing. Safeguards against risk of serious loss should not be too hard to devise.

Some Other Dimensions

In this sketch of some of the main elements on the agenda of U.S. foreign trade policy in the post-Kennedy-Round period I have made the tacit assumption that the way to remove trade barriers in the future is the way it has been done in the past, by bargaining with other countries. We remove our barriers, they remove theirs. We are, after all, not talking about something the United States can do all by itself, nor have we very good means of persuading other countries to remove barriers except by offering them something. It is true that this view runs full in the face of much economic logic which shows that since it is the American economy that suffers from putting impediments in the way of its imports, unilateral action to remove them would be a good turn to ourselves. Nevertheless, the advantage of bargaining as a way of dealing with the rest of the world (which is not likely to respond simply to high-minded example) is to me compelling.

A word of caution is in order about how we think of reciprocity. The balancing of statistics showing how much trade is affected by what each country has done has never been entirely satisfactory. The real national interest lies in the consequences of trade barrier reduction, not in its anterior circumstances. As an increasing number of domestic activities are drawn into the trade negotiations in the manner described above, it will become increasingly meaningless to try to find a common measure for judging the exact value of what each country has done. A broader view of what constitutes satisfactory performance seems needed. That conclusion is suggested, too, by the widespread acceptance of the idea that it is impossible to ask less developed countries for reciprocal reduction of trade barriers. It does not follow that nothing should be asked of them, since their ability to take advantage of trade concessions made to them will depend to an important degree on their own policies. This broadening of the approach to trade may also lead us to conclude that sometimes unilateral action may be the best course even if, under the old vocabulary, the United States seemed to be giving something away.

Great as the postwar expansion of international trade has been, the increase in American direct investment abroad has been greater. An important part of the total is made up of investment in manufacturing industry in Canada, Britain, Western Europe, and, to a degree, Japan, our major trade partners. How should we think about the very substantial sales by American-owned manufacturing companies abroad which in 1965 were double our exports of manufactured goods? Are they additions to our exports, displacements of them, or a partial replacement of them, or a partial replacement of exports that would have been wholly lost to foreign suppliers if there had not been American-owned companies abroad? Subsidiaries, either by their own purchases from the United States or by the stimuli that they give to American sales abroad through their dealings with foreign buyers, influence American exports. How do the amounts compare to the drain on the U.S. balance of payments represented by the movement of capital abroad? Clearly, the scope of what we have to think about when we speak of "the foreign trade of the United States" has broadened even beyond the range suggested by the discussion of nontariff barriers.

The growth of overseas investment is stimulating interest in the development of truly multinational corporations. For them international trade is an intracorporate transaction. What do tariffs and other trade barriers mean to them? Are changes in these barriers likely to have important effects on the corporation's behavior? We know very little of these matters, but it seems to me certain that the more they are examined, the greater the increase in the number of issues that will have to be taken into account when we talk about trade policy. The same is almost certain to be true of the investigation into the way technological change and innovation affect international trade. The consequence will be a further widening of the range of government policies that will have to be thought of as affecting foreign trade.

Quite a different kind of alteration of established attitudes toward traditional trade barriers results from the growth of economic regionalism as an important factor in world trade. The common external tariff of the European Community is not just an economic instrument; it is also part of the institutional cement that holds the group together. How long this will be true is hard to say, but it is in the American interest, and I believe in the interest of true integration in Europe too, to press the view that other ties than commercial discrimination must become strong enough to justify the great effort that has been made to change the historical face of that continent. Meanwhile, though, there is not only a political but a functional difference between the common tariff and national tariffs. What is behind the common tariff is not a single economic and political entity so the process of deciding what the Community's tariff should be is complicated both procedurally and substantively by national differences.

As regionalism grows in the rest of the world, the question is more frequently asked whether the United States should not be finding partners with whom to form some kind of common market or other preferential trading area. Politically there are all sorts of difficulties about this approach, most of them going back to the simple fact that while such a grouping removes barriers to trade among the members it sharpens the distinction between members and nonmembers. Whom would the United States like to exclude? Economically, too, it is hard to put together a grouping that promises the United States substantially greater advantages than might be obtained from a global reduction of trade barriers on a nondiscriminatory basis.

A possible exception to the generally negative conclusion to which these two arguments point is the idea of some closer association between the United States and Canada. The two economies are already extraordinarily intertwined and a surprising amount of their trade is free of barriers. The idea of completely eliminating tariffs between them is an old one on which Canadians have blown hot and cold and in the end always rejected. Now there are again stirrings on this subject north of the border but what will come of them is not clear. Since both the greatest gains and the greatest disturbances of any major step toward trade integration between the two countries would be Canadian, I suggest that the proper posture for Americans is to wait and see and be prepared to talk about ways and means and goals if the Canadians should make up their minds that closer trade integration with the United States is something they want.

The growth of regionalism and foreign preferential groupings has made some Americans wonder if the United States should abandon the principle of equal treatment which has been a basic element of our trade policy. Exceptions, waivers, and violations of the most-favored-nation clause have been cited to strengthen the case. Perhaps the greatest stimulus of all to such thinking was the fear that the Kennedy Round would be spoiled by the refusal of one major partner to agree to terms acceptable to all the others. Although that hazard has been passed, it remains true that the most-favored-nation principle can sometimes slow progress in liberalization to the speed acceptable to a single major trading nation. Nevertheless, in spite of all these considerations it would be unwise to deprecate or depreciate the principle of equal treatment, much less to jettison it. What substitute is there for it in the rational ordering of world trade? Economists can show that some mixture of discriminatory arrangements can maximize welfare in certain circumstances, but can they turn their analysis into effective policies? Discrimination may benefit any given number of countries at one time or another, but to give nations freedom to discriminate is unlikely to produce the greatest benefit for all. Since a guiding principle is necessary to shape a world trading system it is hard to see what rule can apply generally except that of equality.

Even massive departures from a rule need not destroy it if they have an orderly basis. One proof of GATT's worth was its flexibility in permitting European discrimination against American goods when dollars were short and pressing them to restore equality when their currencies became convertible. The less-developed countries are now being permitted many departures from the rules that are being applied to other countries, and with good reason, but it is equally sensible to work out a way for them to come back to normal standards as their situations improve. One of the aims of liberalizing East-West trade is to bring at least some of these countries into an easier relation with others in the world trading system. Replacing the bilateralism now prevalent in East-West exchanges with some kind of miltilateralism would benefit Eastern and Western countries alike. As an organizing principle for world trade equal treatment remains of fundamental importance. In its practical effects it is an important—if imperfect—safeguard against discrimination directed against the United States.

Unless this country is clear about equal treatment and vigorous in furthering it, the erosion of recent years is likely to grow, to the detriment of the United States and the decrease in the chances for making the world trading system more rational.

Breaking down problems as I have done in the foregoing sketch may suggest that the United States should have not one trade policy but at least three—for industrial countries, less-developed countries, and Communist countries—or perhaps even four if we count agriculture separately. In a sense this is correct but it is also misleading. The policies differ because they cope with different problems and exploit different ranges of possibility. The aims they serve, while not identical, must, in a high degree, overlap. Serving the interests of one country, these separate policies cannot make sense if they conflict with one another persistently or to an important degree—though some inconsistency is natural in a pluralistic society. The separation that is needed to pursue some ends effectively has to be accompanied by a common view of the whole, as to both ends and means.

Another factor that might make for fragmentation is the parceling out of trade tasks among a number of international agencies, notably GATT, OECD, UNCTAD, and, in a more limited way, ECE and the agencies for hemispheric cooperation in which U.S. relations with Latin American common markets and free trade areas are discussed. All this is in addition to direct negotiations with other governments and the European Economic Community, and in such bilateral bodies as the joint meetings of Cabinet members we have with Canada and Japan. No doubt there is some confusion, some overlap, some duplication; to an outsider it does not yet seem to have reached an alarming level, but that is the sort of thing on which the testimony of those closer to the events is more valuable. There is certainly a potential problem for the future. It is complicated by the fact that the criterion cannot be just neatness and order; we must ask, too, where action will be most effective and how American policy can best be furthered. The answer may differ at different times and vary according to issues. What is more it may not always be apparent and there may be need for probing or experimentation that will entail duplication and some waste.

Unfortunately, the ramification of trade policy described earlier in this paper is going to make the choice of forums more difficult, just as it will make the process of negotiation more complicated. The drawing into trade negotiations of many matters not formerly thought of as being part of trade policy is bound to have that effect. To the extent that any given issue can be separately pursued, one forum or another—including some not generally thought of as the loci of trade negotiations—may appear suitable, but such partial solutions will still leave the problem of the interrelatedness of all issues for bargaining purposes which has been mentioned several times above. It is probably not wise to try to lay down a rigid formula to cover all cases, but unless one has some principles in mind and some rough guidelines for practice there is a risk, not only of confusion, but of a failure of policy. This is true because the long-run aims of American trade policy must include the building and maintenance of a world trading economy and that goal is affected not only by the competence of organizations but by the rules that surround them.

The three organizations most involved—GATT, the OECD, and UNCTAD—have sufficiently distinctive characteristics to suggest a rough division of labor, though the difficult problems may lie in the refinements. UNCTAD, the newest of the three, is an invaluable prod forcing the United States and other developed countries to give more attention to the problems of the less-developed countries than they would otherwise. For this reason we should welcome UNCTAD and help to make its examination of problems penetrating as well as vigorous. It does not follow that the action which governments take in response to UNCTAD discussions need always be taken in UNCTAD. No doubt there will be some matters on which special UNCTAD-sponsored agreements will be in order, but UNCTAD's essential function is to insure that the needs of development are never absent from the consideration of trade policies. It can do that no matter what form an agreement finally takes, or even if key countries take national action without formal agreement. In dealing with trade barriers it seems likely that some of UNCTAD's most important results might manifest themselves in the removal of quotas and the reduction of duties through GATT procedures, since it is not wise to treat the trade of the less-developed countries as if it were separate from the body of world trade as a whole.

The OECD, the middle-aged member of this trio, has already been the scene of a number of trade discussions and has under its aegis a code of liberalization of invisible transactions that has a certain relation to some kinds of nontariff barriers. On the face of it, OECD is preeminently suited to deal with questions that are of primary interest to the industrialized countries; but it is not always crystal clear which those questions are, especially as the economies of the most developed of the less-developed countries become more complex. It can, of course, be made possible for a few nonmember countries with special interest to take part in OECD deliberations. Another function frequently recommended for OECD is as an "antechamber to GATT" (or UNCTAD), a place where the industrialized countries try to achieve some degree of harmonization among their own policies before engaging in negotiations with others. Up to a point this, too, seems plausible, but there are two caveats. First, the industrialized countries have not shown themselves very proficient at coordinating their trade policies, whether on preferences for less-developed countries or East-West trade—but that is not the organization's fault. Second, if they were to be successful in finding common fronts, delicate questions would arise about how far they could wisely go in reaching understandings before negotiating with outsiders. If, for example, a cotton textile agreement had been drafted in OECD and then submitted to nonmembers it is unlikely that some of the exporting countries would have accepted terms that they finally agreed to in the arrangement negotiated under the sponsorship of GATT. Of course, the agreement might not have been the same.

GATT, once thought of as a temporary agreement and technically not an organization at all, not only has shown great survival value but has something both UNCTAD and OECD lack, a comprehensive body of rules about international trade. And that is crucial—far more important than organizational strengths or weaknesses. No doubt the rules have weaknesses, and changes will be needed to deal with some of the trade problems of the next decade. No doubt procedures and organizational arrangements can be improved. But one need only consider the achievement of the Kennedy Round to realize not only the importance of GATT but the extraordinary labor (and risks of failure) that would be involved in trying to build a new code of trade policy on a different foundation. The separation of issues will no doubt sometimes make it sensible to deal with certain kinds of problems outside GATT, though the need to match concessions on otherwise unrelated matters in order to strike bargains may tend to pull issues toward GATT. It would probably not be wise to try to find a place for every trade issue in a revised GATT structure, but a good general guide might be the maxim suggested by my colleague, Helena Stalson: Do it in GATT unless it can clearly be done better somewhere else. And in making that judgment the prime consideration is not just whether it is easier to get agreement in one place rather than another, but what the effect of the agreement is likely to be on the structure of world trade. In facing the issues outlined in this paper, the United States will find that its interest in coherence and order in the system of world trade will usually be best served by strengthening the position of GATT and the principle of equal treatment it embodies.

TOWARD THE SEVENTH ROUND OF GATT TRADE NEGOTIATIONS

BY PROFESSOR ROBERT E. BALDWIN*

It is well to begin a discussion of future trade legislation by recalling that the official name of the recently concluded Kennedy Round is the sixth round of GATT trade negotiations. In other words, unique though these negotiations have been in several respects, they represent but one of a series of trade liberalization efforts that originated 20 years ago. Indeed one must go back a third of a century to the Trade Agreements Act of 1934 in order to put the Kennedy Round in proper perspective. At that time, as a result of the Tariff Acts of 1921 and 1922 and then the Smoot-Hawley Act of 1930, tariffs were at their highest levels in the Nation's history. However, since the first Trade Agreements Act, the United States has become the leader in a significant worldwide reduction in duty levels. Although simple averages are notoriously poor indicators of the restrictive effects of tariffs, a rough notion of the extent of these liberalization efforts can be obtained by pointing out that the average (weighted by trade volume) duty level in 1934 was 48 percent whereas it will be around 8 percent after the Kennedy Round reductions.

The purpose of this paper is to review briefly the history of the negotiations that have brought about this liberalization and then to focus upon certain problems these negotiations have failed to solve adequately. It will be argued that further significant progress in reducing protectionist levels is dependent upon a more successful handling of these problems.

AN OUTLINE OF PREVIOUS NEGOTIATIONS

The Period 1934–1945. The period between 1934 and 1967 can be divided conveniently into three subperiods as far as the history of U.S. commercial policy is concerned. The first extends from 1934 to 1945; the second from 1946 to 1961; and the third from 1962 to the present. In 1934 the President was given the power to undertake trade negotiations with other countries for the purpose of securing reciprocal tariff reductions that, on our part, could go as far as cutting then existing duties in half. Prior to the original Trade Agreements Act, efforts to secure reciprocal tariff reductions had not met with much success. The executive branch had sought to conclude formal treaties with various countries on several occasions but only three ever were ratified by both parties—the last being with Cuba in 1902. Obtaining the necessary two-thirds majority vote of the U.S. Senate in most cases proved to be an impossible task, since it was necessary to specify

* University of Wisconsin.

the particular items proposed for duty reduction in each case. This difficulty was avoided under the 1934 legislation by giving the President considerable power to undertake reciprocal reductions covering a broad range of items. Since 1930 the Congress has not passed a tariff act, but instead granted the President the authority on successive occasions to continue to reduce (and to raise) the general level of duties.

The trade agreements concluded between 1934 and 1945 were bilateral in nature. Thirty-one agreements were negotiated between these years. The technique employed was that the two parties concentrated upon reducing duties on those items for which each tended to be the principal supplier for the other. The mutual tariff reductions agreed upon were then generalized to all traders with both parties. This approach had both advantages and disadvantages. The main drawback was that, by extending the duty cuts to all countries, nonparticipants were able to increase their exports to the two countries without also opening up their economies to greater imports. In view of the existence of widespread unemployment in most countries during this period coupled with the notion of reciprocal concessions contained in the legislation, efforts to avoid this "free ride" aspect of bilateral negotiations were made by confining the cuts between two countries to a small number of items in which each was the other's main supplier. Items for which there was no single overwhelming supplier or countries who were not major suppliers of any item tended to be neglected. Even between two countries, where the principal-supplier trade was highly unbalanced, it was impossible to reduce one party's tariffs the same percentage as the other's and still achieve an acceptable balance of concessions for each. On the other hand, the bilateral technique with its concentration upon principal supplier items permitted a movement toward freer trade without requiring the consent of all major trading nations. Clearly during the thirties it would have been impossible to proceed on any other than the step-by-step basis actually adopted.

The Period 1945–1961. At the end of World War II there was a widespread desire to deal on a cooperative, multilateral basis with economic problems that had important international repercussions. Consequently, the opportunity arose for undertaking tariff negotiations not on a country-by-country basis over time but on a multilateral basis at a given time. The arrangement in which this opportunity was seized and made workable was the General Agreement on Tariffs and Trade. In 1947, 22 nations completed a multilateral tariff cutting exercise that resulted in concessions on nearly two-thirds of total world trade. The United States negotiated under the additional 50 percent cutting power that Congress had granted the President in 1945.

Besides establishing an organization through which periodic multilateral tariff negotiations designed to reduce duty levels could be undertaken, the GATT set forth a code of commercial policy. The most-favored-nations principle is the cornerstone of the GATT. The first article of the Agreement specifies in detail that each nation shall grant nondiscriminatory treatment to the products of all other contracting nations with regard to import and export duties and subsidiary charges, rules, and formalities in connection with importation and exportation, and internal taxes and other internal regulations. A second basic principle is the general prohibition of quantitative restrictions as a protective device. Except under special circumstances, only customs duties can be used for this purpose.

The United States participated in two additional rounds of tariff negotiations within the GATT framework under the 50 percent cutting authority granted in 1945. One was held at Annecy, France, in 1949 at which 10 more countries became contracting parties to the General Agreement and another at Torquay, England, in 1950–51. In 1955 the Congress again gave the President additional tariff cutting authority but considerably less than it gave in 1934 and 1945. The new authority permitted him to reduce duties by an additional 15 percent over a 3-year period. With these powers the United States participated in the fourth round of GATT negotiations in 1956. This session at Geneva dealt with the accession of Japan to the GATT.

The negotiating session prior to the recent Kennedy round was the so-called Dillon round (named after the then Secretary of the Treasury) in 1960–61. This was the first negotiation held after the formation of the European Economic Community. The objective of the United States was to obtain a reduction in the common external tariff of the EEC in order to offset at least partially the trade diversion caused by reducing duties within the EEC toward zero. Consequently, in 1958 Congress gave the President the authority to reduce duties by another 20 percent.

The five rounds of negotiations under the GATT between 1947 and 1960–61 represent an outstandingly successful example of productive international cooperation. Not only were tariffs among the industrial nations reduced significantly but the highly restrictive structure of quantitative controls erected for balance-of-payments purposes at the end of the war were gradually dismantled.

The Period 1962–1967. After the disappointing Dillon round, however, a view began to develop to the effect that the traditional technique of bargaining was inadequate for achieving further significant liberalization of world trade. The technique employed within the GATT was item-by-item bargaining in an essentially bilateral series of simultaneous negotiations. It was argued that this negotiating method tended to limit both the scope and depth of tariff reductions. Domestic pressures within each country were, it was claimed, more successful in excluding many items on the basis of particular reasons than would be the case if an across-the-board tariff-cutting approach were used. In addition, it was noted that, when one country excluded important items in a particular industry, other participants tended to exclude for bargaining purposes their important import items in the same industry. The outcome tended to be a negotiation confined to items in which no severe import competition problem existed in any country and therefore in which no one was particularly interested. Participants also adopted the restrictive bargaining attitude of giving up as little as possible in return for as much as possible.

Given these apparent drawbacks of the item-by-item approach coupled with the growing diversionary effects of the EEC on outside trade as internal duties were decreased, the Kennedy administration sought the power to undertake a sweeping negotiation, especially with the EEC, that would bring about a significant cut in duty levels among the industrial nations. The outcome of these efforts was the Trade Expansion Act of 1962 followed by the Kennedy, or sixth, round of GATT negotiations. The essential authority granted under the Trade Expansion Act was the power to reduce duties by 50 percent over a 5-year period. A unique feature was the authority to cut duties to zero on items for which the EEC and the United States accounted for at least 80 percent of world trade. The act also contained language permitting the President to negotiate on nontariff barriers.

The history of the 4 years of negotiations in the Kennedy Round is too well known to require more than a few sentences. In terms of what the United States hoped to accomplish, the results cannot be regarded as other than disappointing. The average cut is more like one-third than one-half. Since Britain was not admitted to the Common Market the 80-percent provision pertaining to United States-EEC trade became irrelevant. No significant progress was made in beginning to dismantle the complex set of controls that protect important sectors of agriculture in most industrial countries. The nontariff-barrier field also received little attention. However, despite the length of the negotiations and the wide gap between expectations and accomplishment, the Kennedy Round will be regarded in the future as a considerable success. For, compared with previous GATT tariff-cutting exercises, this round stands out as the one involving the deepest average tariff reduction.

Problems for Future Negotiations

The last two rounds of GATT negotiations have, however, made it increasingly clear that certain key problems must be dealt with more adequately if further liberalization efforts are to be successful. In a real sense, these problems have arisen because of the very success of previous liberalization efforts. These efforts have eliminated the protection that was largely superfluous and increasingly cut into those areas where significant resource reallocation effects are produced by the reductions. We must deal with the hard core of protection from now on, if further expansion of world trade is to be encouraged. In doing so, several difficult problems must be met. Three of the more important ones are as follows: (1) Achieving a better balance between consumer and producer interests in economically vulnerable industries; (2) Mitigating the restrictive effects of nontariff barriers; (3) Making the negotiating process more effective in achieving its goal of trade liberalization.

(1) *Achieving a better balance between consumer and producer interests in economically vulnerable industries*

This is the key domestic problem in any tariff-cutting exercise. Yet it is one that has not been adequately handled since the first Trade Agreements Act of 1934. The issue can be simply stated. Since the time of Adam Smith, economists have been able to show that—setting aside infant-industry and term-of-trade effects—it is possible for a country to raise its real income level under free trade compared to a system of tariff protection. However, although the gain to consumers in the form of lower prices is more than enough to compensate the producers of protected products from any loss they suffer, in practice such compensation is not made. In industries where workers and employers can readily find alternative employment the adverse effects of tariff cuts are minor. But in industries where employment and profits are already declining because of increased imports or competition from some other domestic or foreign industries; where the workers are older, less skilled, and less educated than most workers; and where the areas in which the industries are located are depressed generally, then the costs of greater import competition can be high for a small group. It is true that even under these conditions there is usually a net gain in the sense that the gainers from lower prices could conceivably compensate those losing their employment. However, in the actual situation where compensation is not made, it is understandable for members of both the legislative and executive branches of the Government to give greater weight to the large loss suffered by a few people than the more than offsetting gain distributed very thinly over many people. Obviously the typical legislator knows that he is likely to lose votes on balance if he sacrifices the losses of the few for the greater, but thinly spread, gain to the many. But instead of this representing a regrettable fact of politics—as some seem to suggest—I suspect it reflects the actual value judgments of the people in general. In other words, the general public does regard a larger gain spread over many people as inferior to a smaller total loss that falls on a relatively few. However, they would prefer even more a situation where those who were severely hurt economically were given the resources needed for their successful adjustment and where there still remained a consumer gain.

In the past this problem has been handled mainly by refraining from cutting duties on those industries that might suffer a severe loss or by refraining from cutting to the level where such losses would be incurred. President Roosevelt and Secretary of State Cordell Hull pledged themselves not to cut in industries where substantial injury would be caused. In postwar trade legislation the notions of the peril point, that is, the duty level below which substantial injury would be caused, and of the escape clause, that is, a modification of a previously granted tariff concession due to injury-causing increased imports, were introduced to handle the problem. Finally, in the 1962 act provisions for adjustment assistance in the form of extended unemployment payments, retraining and relocation allowances, low-interest-rate loans, technical advisory services, and so forth, were introduced in order to meet the problems connected with a 50-percent, across-the-board cut.

This trade adjustment assistance portion of the Trade Expansion Act represents a major innovation in dealing with the balance problem between consumer and producer interests. However, the provision is phrased in such narrow terms that in practice it seems unlikely to be an important source of adjustment assistance. The assistance provided is also on a meager scale. What is needed to deal with the tariff-cutting problem as well as—even more importantly—with the broad problem of adjusting to technological progress within the domestic economy is a general adjustment assistance act. Otherwise, we shall soon arrive at that level of tariffs where substantial potential overall gains remain but where, because of the hardships imposed upon some in obtaining these gains, they are not tapped.

(2) *Mitigating the restrictive effects of nontariff barriers*

Besides having to deal with the hard core of tariff protection, we are increasingly becoming aware of the restrictive nature of nontariff obstacles to trade. Nontariff barriers that were superfluous in their restrictive impact when duty levels were high have become effective deterrents to increase trade as these duties have declined. An added reason why these barriers are likely to become more significant is the probably tendency for countries to introduce new nontariff devices and to enforce old ones more vigorously in order to offset the internal adjustment burdens of tariff restrictions under the Kennedy Round.

An elaboration of the many nontariff barriers that are important in world trade today would require a lengthy paper in itself. The typical classification divides them into the following groups: (1) Quantitative controls and State trading; (2) government procurement policy; (3) customs valuation and practices; (4) antidumping legislation and practices; (5) border tax adjustments. Actually this list covers only a portion of the laws, rules, practices (public and private) distorting trade in a manner that discriminates between domestic and foreign producers. All of the above measures distort trade in a direct and obvious manner. But businessmen have become increasingly concerned with trade distortions brought about indirectly by laws, practices, taxes, and subsidies aimed at domestic activities. These include: (6) Domestic subsidies, for example, maritime and other transportation subsidies, agricultural subsidies, research and development subsidies, and special tax benefits; (7) domestic taxes and regulations; and (8) monopolistic practices in private product and factor markets.

Although it is easy to recognize the trade-restricting effects of nontariff barriers, it is a much harder task to suggest how best to reduce these effects on a worldwide basis. The Kennedy Round has not produced much progress along these lines. The tariff-reducing aspects of the negotiations were so difficult and time consuming that it was not possible to launch a major effort to reduce nontariff barriers. However, enough was learned to realize that these are much more difficult to deal with than duties. A major reason for this is because import protection or export promotion is not the main purpose of many of these trade-distorting measures. For example, in parts of agriculture, the coal industry, and the textiles field, nontariff barriers are often only an incidental part of a set of measures designed to ease the adjustment of sectors that are depressed for reasons quite unreleated to import competition. In other cases, the trade distortions are byproducts of measures designed to meet goals that may conflict with economic efficiency in a narrowly defined sense. The various nontariff measures designed to promote national defense fit this category. Similarly, policies whose objectives are to redistribute income, for example, minimum wage legislation, or to increase national prestige, for example, the space program, fall into this grouping.

Clearly, one cannot expect nations to abandon these goals simply for a more rational distribution of world resources devoted to foreign trade. There may be opportunities to modify some of these goals over a long-run period of time, but short-run policy usually must take them as "given." The best that can be done under these circumstances is to try to eliminate needless conflicts among policy measures. For example, the approach followed by most countries in meeting the agricultural problem needlessly sacrifices the benefits of economic efficiency. Temporary income-support payments coupled with measures to attract excess resources out of agriculture are much preferable on efficiency grounds and yet also can prevent undue distributive hardships. The same points apply in such industries as coal and textiles. Maintenance of adequate defense capacity in certain industries also can often be achieved in a manner that does not sacrifice the gains from international trade.

The changes required to obtain these trade benefits are primarily modifications in domestic policies. Easing trade restrictions will only be a byproduct of these domestic changes. This means, of course, that negotiations with the purpose of modifying simultaneously both internal and external policies are necessary. As the Kennedy Round discussions of the world agricultural problem have indicated, successful negotiations of this type are, however, most difficult to achieve. Thus, we face a formidable task in any further efforts to expand significantly the benefits of trade. Some of the most serious distortions in world trade are the indirect consequence of domestic policies, yet these are the kinds of measures that are the most difficult to modify. Only if there is a general desire among the major trading nations at the highest political level to modify these policies will such negotiations succeed. Furthermore, it may be that the main push of any efforts to change these domestic measures must be directed initially more at harmonization than at significant liberalization. Suggestions to standardize and harmonize various trade restricting measures on a sector approach have met with some success in the present negotiations and may be a useful approach for future negotiations. Then, as harmonization is achieved, it may be easier to reduce the trade-restrictive impact of domestic policies.

(3) *Making the negotiating process more effective*

(a) *The level of economic analysis supporting the negotiators.* Despite some important progress made in the Kennedy Round, the level of economic analysis involved in trade negotiations must be regarded as inadequate. Billions of dollars of sales and thousands of jobs are affected by any extensive tariff cutting operations yet our negotiators have only the roughest of ideas as to the effects of these cuts on import levels, employment, profits, and so forth.

On paper the steps outlined in the Trade Expansion Act for securing this information look impressive. The President is directed to furnish the Tariff Commission with a list of items that may be considered for duty reduction and the Commission must within 6 months "advise the President with respect to each article of its judgment as to the probable economic effects of modifications of duties or other import restrictions on industries producing like or directly competitive articles." In preparing its advice the Commission is directed to take into account numerous economic factors affecting each article. Furthermore, the Tariff Commission must hold public hearings as part of the process of arriving at its advice. The President also seeks information and advice directly from the various departments of the Government and even holds public hearings of his own on items that might be affected by duty cuts.

For the Tariff Commission to hold public hearings and prepare a detailed, sophisticated analysis in 6 months of the probable economic effects of duty reductions on each of some 4,000 items, in addition to carrying out its other duties, is an impossible assignment. The same holds true with respect to the advice from most other departments. Neither the Tariff Commission nor the various departments possesses a staff that is adequate in size for the job outlined in the Trade Expansion Act. But the problem is more than one of size. Except for a few dedicated people in the Tariff Commission and the various other departments, the personnel is simply not trained to undertake the kind of economic analysis needed for the job. The people involved are highly competent in carrying out their regular work, but they generally are not well-suited for carrying out the economic analysis outlined in the act.

The public hearings held both by the Tariff Commission and under the President's direction also are not very useful in ascertaining the economic consequences of tariff reductions. Very few of the presentations give the kind of economic facts needed to obtain more than a casual impression of what a duty reduction will do.

The result is that the vital decisions concerning the impact of duty cuts on domestic producers as well as what we might gain in terms of greater exports are only imperfectly understood. The final decision as to the list of offers seems to be reached by a complicated haggling process in which economic and political pressures are the dominant determining factors. Obviously these are highly relevant factors for reaching final decisions. But when they operate in an environment of comparative economic ignorance as to the relationships on which these economic and political pressures supposedly are based then the outcome cannot be other than highly imperfect.

Fortunately, in the Kennedy Round a small group of exceptionally hard-working and dedicated individuals from various parts of the Government has helped pull together information from a variety of sources and provide reasonably satisfactory economic backstopping operations for the U.S. negotiators. But much more is needed. If we are to obtain the benefits from expanding trade yet avoid unreasonably severe adjustment burdens to particular sectors, we must greatly improve our economic-support efforts.

One way this can be done is for Congress to provide a small amount of funds annually for the purpose of undertaking economic studies designed to determine the ability of workers and employers in various industries to adjust to increased import competition. In addition, studies should be made as to our export potential in various fields. These studies could be undertaken by economists both within and, in particular, outside of the Government. The essential point, however, is that they be done by individuals who can combine a sound analytical background with modern techniques of statistical and economic analysis. They can provide the answer as to what would be required in terms of adjustment assistance in order to obtain the benefits of trade without undue hardships to particular groups.

The Kennedy Round also offers a unique opportunity to obtain by direct observation data concerning the economic effects of U.S. tariff cuts on U.S. industry as well as of foreign tariff cuts on U.S. exports. But, to take advantage of this opportunity and obtain the greatest possible knowledge from this experience, a carefully formulated economic study must be developed and put into operation soon. Too often we simply predict what will happen without ever improving our subsequent predictions by checking out carefully what actually did occur. Here is a unique opportunity for such a check.

(b) *The reciprocity problem.*—As John Evans has pointed out so well in his book for the Council on Foreign Relations, "U.S. Trade Policy—New Legislation for the Next Round," Harper & Row, 1967, the notion of reciprocity as interpreted in the actual negotiations has hampered the move toward trade liberalization. In these negotiations each party tends to regard any tariff cut by himself as bad and any cut by other parties as good. Consequently, unless each party is convinced that its exports will increase as much as its imports, it pulls back some of its offers to achieve this objective. This in turn sets off a chain of further withdrawals producing the end result that the country with the smallest offer tends to set the standard cut. The principal supplier technique helps to avoid this in part but the general tendency is clear.

Countries with initially low average duties are put in an especially difficult position. They may be prepared to cut completely to zero, but they know that higher duty countries will consider reciprocity to be achieved before they themselves reach a zero level. Thus, the former countries could be left with zero duties of their own and no bargaining power to use in order to obtain further tariff reductions from other countries.

It probably must be taken as a given constraint of any tariff-cutting exercise that the cuts should not result in any significant increase in a country's balance-of-trade deficit. Moreover, given the unwillingness to use other policies for balance-of-payments adjustment purposes, this means that the direct and indirect effects of the multilateral tariff cuts by themselves must not cause a significant export-import imbalance. However, this general constraint still leaves considerable latitude to the negotiators. Moreover, studies made thus far seem to indicate that as far as the United States is concerned rather significant changes in U.S. versus foreign offers produce only a small net effect on the U.S. balance of trade. The feedback effects are very strong. Yet negotiators easily become caught up in the give-and-take spirit of bargaining sessions and tend to forget the larger purpose of the whole exercise. The result is that some of the benefits to all countries from trade-expansion tend to be sacrificed.

(c) *Tariff-cutting techniques.* The interesting aspect of this problem is that the negotiators are not under any legislative directive to adopt this narrow view of reciprocity but have tended to establish it themselves. This perhaps means that the nature of the negotiations should be changed. Indeed this was one of the initial objectives of the Kennedy Round. Instead of item-by-item bargaining, an across-the-board cutting procedure was to be followed. Implicit in this was the notion that approximately equal percentage cuts (weighted by trade volumes) would achieve reciprocity. We have learned in the Kennedy Round, however, that such a simple technique cannot stand up to the economic and political realities of any negotation.

In the future we should try to follow simple tariff-cutting techniques that minimize the negativeness of item-by-item bargaining, but we must also be highly flexible with regard to alternative techniques. The objective is to reduce duties without causing undue hardships domestically. With a vigorous adjustment assistance program coupled with the notion of achieving a general balance of concessions, we can best implement this goal by using a variety of techniques. This might involve some general percentage formula for most items, sector-by-sector negotiations in certain areas, and item-by-item in others. This is the procedure eventually followed in the Kennedy Round. Had it been followed from the beginning, the negotiations might long ago have been completed. In short, we need a balance between simple tariff-cutting procedures and direct negotiations in sensitive areas. In the Kennedy Round we initially were too rigid on a particular simple tariff-cutting formula; namely, the linear-cut concept. A greater willingness to consider sympathetically other types of cutting formulas might have accelerated the negotiations and deepened the average cut. Yet, all items cannot be covered by simple rules. Negotiations on particular sectors still will be needed. However, if one starts out by trying to negotiate all cuts on an item-by-item basis, this, too, will lessen the average tariff reduction.

CONCLUSIONS

A number of highly competent observers interpret our recent tariff-cutting experience as requiring radical changes in our approach to worldwide trade liberalization. Some of them suggest the formation of free trade blocs between the United States and various other industrial nations. Others propose the abandonment of the most-favored-nations principle in our tariff-cutting policies. While these various proposals have points in their favor, the merits of proceeding along the same general lines as in the last six GATT negotiations to me seem greater, especially if the goal is the economic one of lowering artificial impediments to world trade.

There is still much to be done in reducing the trade-inhibiting effects of nontariff barriers. This will be a very difficult task but there is some evidence to suggest that at least the major industrial countries are willing to proceed toward a harmonization and reduction of some of these barriers. With an effective adjustment assistance program together with an adequate background of economic analysis, a less rigid view of the reciprocity concept, and a more flexible negotiating approach there is also still much that can be accomplished in the tariff field. We will be hampered by the unwillingness of some countries to reduce their barriers as far as we are prepared to do. But what can be accomplished by a flexible approach to tariff cutting seems significantly preferable to the longrun economic and political risk involved in regionalization and tariff discrimination. Thus, it is not too early to begin to plan for a seventh round of GATT negotiations aimed primarily at the nontariff barrier problem and at expanding trade between developed and less-developed countries, but also designed to achieve further moderate cuts in duties among industrial countries.

THE BORDER TAX ISSUE DEFINED

BY HELEN B. JUNZ*

With the disappearance in the postwar period of a large number of quantitative restrictions on international trade and the progressive dismantling of tariff barriers, nonquantitative and nontariff barriers to international trade have become relatively more important. Major among these barriers are differences in the relative ease and cost with which imported goods enter countries and a main element in these differences is the tax treatment accorded to goods crossing international borders.

Under present international rules, countries are permitted to levy charges on imports and allow rebates on exports up to the amount of indirect taxes levied on like products consumed or produced domestically.[1] The question at issue is whether or not this system of so-called border tax adjustments for differences in national systems of indirect taxation has a trade-diverting effect. This paper attempts to set out the rationale behind the current practice of border tax adjustments and to assess it against the body of discussion that has arisen since its inception. The conclusion is that the current system of border tax adjustments, under less-than-perfect market conditions, which is characteristic of the world we live in, tends to give a competitive advantage to countries which employ them vis-a-vis those that do not.

THE BORDER TAX SYSTEM

Under the rules laid down in the original GATT and in the 1955 revision, border tax adjustments may be made only for indirect taxes, such as excise, turnover, and value-added taxes. Thus, countries having such taxes normally will levy an import charge—or import equalization tax—designed to impose the same amount of indirect tax on the imported product as is embodied in the price of the like home-produced product. Conversely, exporters receive a rebate—or tax exemption—equal to the amount of indirect tax embodied in the price of an exported good. The intent of the adjustment system is to free world market prices completely from indirect taxation so that prices of imported goods reflect only indirect taxes levied in the country of consumption.

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* Economist, Europe and British Commonwealth Section, Division of International Finance, Board of Governors of the Federal Reserve System. This paper reflects the personal opinion of the author and must not be interpreted as representing the opinion of the Board of Governors.

[1] See appendix I (this paper) for the relevant provisions as laid down in the General Agreement on Tariffs and Trade (GATT) and the treaty establishing the European Economic Community.

Direct taxes, on the other hand, are specifically excluded from the border tax system and any border adjustment for such taxes would be viewed as an export subsidy or an import charge contravening GATT.[2] The logic behind this different treatment of the various taxes lies in the premise that taxes borne by the factors of production should reside in the country of origin and that taxes borne by the ultimate consumer should reside in the country of destination. Therefore, the entire border adjustment system is based upon the assumption that direct taxes are always fully shifted backward to the factors of production and that indirect taxes are always fully shifted forward into the final price of a good.

Examination of Economic Logic of Border Tax System

Under the above assumption of tax shifting, imported goods, without tax equalization charges, would be at a price advantage vis-a-vis home-produced goods to the extent that the exporting country had a lesser rate of indirect taxation. Conversely, without tax rebates a country with a relatively high rate of indirect taxation would be at a competitive disadvantage in world markets relative to countries with a lower rate of indirect taxation.

Second, without border adjustments goods moving in international trade would be taxed doubly: once in the country of origin and once in the country of destination, both tax levies being paid by the consumer in the country of destination. Thus, the foreign consumer would make a contribution to the exchequer of the country of origin. Furthermore, world market prices would be raised by the amount of the tax and the volume of trade would be likely to shrink.

Thus, if the assumption of full reflection in final prices of indirect taxes and zero reflection in prices of direct taxes holds true, the current system of border tax adjustments indeed serves to neutralize the trade effects of different national tax systems. However, the current system is open to two basic and related questions:

1. Is the current practice of classifying certain taxes as "direct" and others as "indirect" a correct reflection of actual conditions?

and

2. Given such classification, are shifting assumptions correct?

Distinction Between Direct and Indirect Taxes

Indirect taxes are generally defined as taxes on consumption, while direct taxes are defined as those levied on income. However the distinction on the basis of these definitions has become more and more cloudy over time. The only area where there seems to be clear agreement is with regard to personal income taxes, which are classified as "direct"

[2] The distinction between "direct" and "indirect" taxes is, in fact, not made explicit in the GATT regulations, but flows from interpretation of and amendments to the relevant provisions.

and retail sales taxes, which are classified as "indirect" taxes; beyond this the classification becomes a morass.[3]

Thus, it could be argued that the distinction made in international practice between direct and indirect taxes may essentially be arbitrary and seems to be based more on prevailing practice than on theoretical reasoning. For example, it is not at all clear whether employer contributions to social security fall into the indirect or the direct tax category, although GATT practice specifically places them with direct taxes. Conversely, value added taxes, according to GATT classification, are considered to be indirect taxes. However, value added taxes fall on both costs and profits of the producer (value added being defined as the difference between the value of a firm's purchases and sales) and to the extent that they fall on profits are not always clearly distinguishable from a profits tax in their effect. Nevertheless, corporate profits taxes are classified as "direct" and value added taxes as "indirect" taxes.

The Question of Tax Shifting

Given the murkiness of the borderline between "direct" and "indirect" taxes, it is not surprising that the premise of full forward shifting into price of direct and full backward shifting to the factors of production of indirect taxes has given rise to even greater uncertainties. The shifting argument is based upon Marshallian price theory which holds that, under pure competition, profits taxes will not affect prices because prices are determined by marginal producers and marginal producers have no net profits. Modern theory of shifting and incidence of taxation has moved a long way from so clear cut a statement. For example, statistical studies can be found which support either the full backward shifting or the full forward shifting theory for some direct taxes.[4] Basically most experts today would argue that shifting of either type of tax can and does occur in both directions and that the degree of shifting will vary with different circumstances, such as variations in demand and supply elasticities, in degree of market control and in government policies. The current border tax adjustment system, however, is solely predicated upon a general full shifting assumption and, therefore, cannot be conditional upon the structure of market forces or upon certain government actions, such as a permissive monetary or fiscal policy.

[3] Richard A. Musgrave and P. B. Richman, "The Allocation Aspects of Direct vs. Indirect Taxation," Brookings conference on the role of direct and indirect taxes in the Federal revenue system.

[4] Full forward shifting into price of corporate profit taxes is suggested by Marian Krzyzaniak and R. A. Musgrave, "The Incidence of the Corporation Income Tax," Johns Hopkins Press, 1963; full backward shifting by Challis Hall, "The Incidence of the Corporation Income Tax," American Economic Review, May 1963.

TABLE 1.—*Balance of trade effects of general taxes assuming fixed exchange rates and unchanged real demand for domestic output* [1]

	Balance of trade effect	
	With border adjustment	Without border adjustment
I. Raise indirect taxes:		
a. Product prices rise	NEUTRAL	Unfavorable.
b. Factor prices fall	Favorable	Neutral.
II. Raise social welfare charges:		
a. Product prices rise	Neutral	Unfavorable.
b. Factor prices fall	Favorable	NEUTRAL.
III. Raise corporate profits taxes:		
a. Product prices rise	Neutral	Unfavorable.
b. Profits fall	Favorable	NEUTRAL.

	Balance of trade effect		
	Indirect tax with border adjustment, others without	All taxes with border adjustment	No border adjustment
IV. Substitute indirect tax for social welfare charges:			
a. Under Ia and IIa	Favorable	Neutral	Neutral.
b. Under Ia and IIb	NEUTRAL	Unfavorable	Unfavorable.
c. Under Ib and IIb	Favorable	Neutral	Neutral.
V. Substitute indirect tax for corporate profit tax:			
a. Under Ia and IIIa	Favorable	Neutral	Neutral.
b. Under Ia and IIIb	NEUTRAL	Unfavorable	Unfavorable.
c. Under Ib and IIIb	Favorable	Neutral	Neutral.

[1] This table is adapted from an unpublished submission by Richard N. Cooper and Richard A. Musgrave to the Symposium of Experts on Border Tax Adjustments held by the OECD in Paris, September 1964. Effects in capital letters reflect GATT reasoning.

Insofar as the actual extent of forward, or backward, shifting of relevant taxes cannot be determined clearly, the extent of tax neutrality brought about in international trade by the current border tax adjustment system is also unclear. Table 1 sets out a number of examples of possible effects on trade balances of various tax changes under different shifting assumptions. Thus an increase in indirect taxes, with full border adjustments, would not affect the balance of trade only if product prices rose to the full extent of the tax (case Ia), which is the case assumed by the GATT convention; if, on the other hand, factor prices were to fall, the trade effect would be clearly favorable. Thus substitution of, for example, an indirect tax, which is not fully reflected in product prices, but which is rebated in full, for a corporate profits tax, which was not reflected in prices and which was not rebatable, would have a favorable trade effect (case Va); the trade effect would be doubly favorable if the corporate profits tax was partially reflected in prices (case Vb).

Since there is a substantial body of theoretical and empirical evidence which tends to contradict the view that certain taxes are always fully shifted into price, while others are always fully absorbed by the factors of production, it is most likely that the true state of affairs encompasses all and several combinations of the possibilities shown in table 1. Consequently, in modern economies the instances of trade neutrality consistent with GATT assumptions constitute only a special rather than the general case.

Practical Issues

If the current system of border adjustments neutralizes tax effects on international trade in special cases only, how serious are trade diverting effects in the remaining instances?

Trade distorting effects of existing border adjustments probably have been largely compensated by past changes in relative rates of exchange, tariffs or price levels. But, under present conditions, exchange rate or tariff changes no longer are flexible instruments of adjustment to changes in competitive position among industrial countries. Consequently, possible trade distorting effects of new border adjustments now are of much greater concern than they were in the past, although even past changes—with the greater adjustment possibilities then available—probably have produced a world trade pattern rather different from that which would have come about under systems which truly neutralized the international trade effects of differential national tax systems.

To remedy the situation one could, first, consider fundamental changes in the basic system of border adjustments. These might range from elimination of the entire practice to a broadening of the practice to include various taxes now considered ineligible for adjustment. Complete elimination of current practices clearly is not a practical possibility, partly because adjustments to earlier trade distorting effects—such as may have occurred in relative rates of exchange for example—would need to be unwound. But more importantly, in the absence of border tax adjustments, countries with a high degree of trade involvement and a close tie to world prices would find forward shifting of indirect taxes (i.e., full reflection of the tax in export prices) virtually impossible. Thus their basic tax structure might have to be modified to the extent that it relied heavily on indirect taxation.

Inclusion of a broader range of taxes, such as the corporate profits tax and social security charges, would meet with considerable administrative problems. Even if the degree of shifting, which to complicate matters may actually vary from product to product and from country to country as well as over time, could be accurately determined, it would be virtually impossible to determine the precise amount of tax embodied in the price of a specific product. This problem is analogous to that encountered in rebating cumulative turnover—or so-called cascade—taxes, where "average" rates are being rebated, which leads to over- or under-rebating in individual instances and to distortions of the competitive position among individual firms. The elimination of this problem is one of the advantages cited in favor of the value-added tax system which is to replace the cascade type systems in Germany, Italy and the Benelux countries by 1970.

In any event, as shown in table 2, extension of border tax adjustments to virtually all types of taxes, except the personal income tax, would not redress the balance of competitive advantage in favor of countries, such as the United States, now having no or few border adjustments. This is so because the tax burden, relative to GNP, is higher in most continental European countries than it is in the United States or the United Kingdom. In this respect a truly "ideal" system of border adjustments designed to produce tax neutrality in international trade should probably take account of government expenditures also. For instance, where tax revenues are employed to reduce production costs, countries rebating indirect taxes may actually reap a double competitive advantage. For example, if an excise tax is levied in order to fully finance a national transportation system, domestic producers would in effect have zero transportation costs on their exports, since the excise tax would be rebated at the border. If in addition, the tax is not fully reflected in final prices, a full rebate would give the exporter a second trade advantage over outside suppliers.

TABLE 2.—*Selected countries: General Government revenues and expenditures as percent of gross domestic product, 1965*

	United States	United Kingdom	France	Germany	Italy	Netherlands
1. Indirect taxes	9	14	18	14	12	10
2. Personal income taxes	9	9	4	7	(1)	10
3. Contributions to social security	2	3	4	5	(1)	3
4. Total, 2 plus 3	11	12	8	12	(1)	13
5. Corporation tax	5	2	2	3	(1)	3
6. Empl. contributions to to social security	2	2	10	5	(1)	8
7. Total, 5 plus 6	7	4	12	8	(1)	11
8. Direct taxes, 4 plus 7	18	16	20	20	17	24
9. Other	--------	2	1	2	3	3
10. Total current revenues	27	32	39	36	32	37

[1] Not available.

Source: "National Accounts Statistics, 1956–65," Organization for Economic Cooperation and Development, Paris, 1966.

On the whole, it is fairly clear that it is currently not practicable to construct an "ideal" system of border adjustments. However, this does not mean that nothing can or should be done to remedy clear existing and future inequities arising from the current border tax treatment.

Impending or recent changes in taxation with definite favorable trade effects for the countries which impose them include:

1. Change from a system of cumulative turnover taxes to one of value added taxes, where tax burdens are now generally not fully compensated under the cascade system (such a change is now pending in Germany and the Benelux countries);
2. Change from a system of retail sales taxes or cumulative turnover taxes including investment goods and fuels (which currently are not rebatable) to a value added system which excludes these items and imposes a higher rate on consumption goods.

3. A shift from direct taxation or social security charges (which are not rebatable) to indirect taxation (which is) to the extent that the former taxes were shifted into final prices or the latter are not so shifted (such a change was effected in Italy);

4. Upward changes in adjustments for so-called "taxes occultes" (indirect taxes charged on certain inputs, such as fuel, at some earlier stage of production) or for cascade type taxes because of earlier under-rebating (such changes were effected in the United Kingdom and Germany).

The greatest promise for ironing out inequities arising from trade-favorable effects of border tax adjustments lies perhaps in treating them in a manner similar to that now applying to changes in tariffs. The recent discussions within the Organization for Economic Cooperation and Development, which aimed at a standstill on border taxes with possible countervailing concessions for changes with definite trade effects—such as those cited above—point in this direction. Such a system of countervailing concessions, broadened to not only achieve a standstill in, but perhaps also a rollback of, border tax adjustments, would solve the problem of distorting effects on the trade patterns between two countries with different tax systems. However, beyond this there still remains the problem of trade effects in third markets, which may require further accommodation, such as possible selective waivers of GATT rules currently prohibiting export subsidies.

APPENDIX I. GATT AND TREATY OF ROME PROVISIONS RELATING TO TRADE ASPECTS OF NATIONAL TAXATION

1. GATT PROVISIONS ON BORDER TAXES AND EXPORT SUBSIDIES

a. Import equalization charge for "product" (interpreted to read "indirect") taxes as set forth in article III:2:

> The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products. Moreover, no contracting party shall otherwise apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in paragraph 1.

Article II prohibits import charges above rates agreed upon and bound in tariff negotiations, but a specific exception is made with respect to indirect taxes: article II:2 (a):

> Nothing in this article shall prevent any contracting party from imposing at any time on the importation of any product:
>
> A charge equivalent to an internal tax imposed consistently with the provisions of paragraph 2 of article III in respect of the like domestic products or in respect of an article from which the imported product has been manufactured or produced in whole or in part.

A similar exception is made in article VI which defines and prohibits dumping practices: article VI:1:

> Due allowance shall be made in each case for differences in conditions and terms of sale, for differences in taxation, and for other differences affecting price comparability.

and article VI:4:

> No product of the territory of any contracting party imported into the territory of any other contracting party shall be subject to antidumping or countervailing duty by reason of the exemption of such product from duties or taxes borne by the like product when destined for consumption in the country or origin or exportation, or by reason of the refund of such duties or taxes.

b. Export tax rebates and subsidies. The GATT is generally opposed to export subsidies as stated in article XVI:2:

> The contracting parties recognize that the granting by a contracting party of a subsidy on the export of any product may have harmful effects for other contracting parties, both importing and exporting, may cause undue disturbance of their normal commercial interests, and many hinder the achievement of the objectives of this agreement.

But there is no outright prohibition of export subsidies. Their existence for exports of primary products is explicitly recognized and condoned in article XVI:3 which, however, deplores the practice and states that it should not be used to obtain "more than an equitable share of world trade in that product." For other than primary products article XVI:4 holds that:

> Further * * * contracting parties shall cease to grant either directly or indirectly any form of subsidy on the export of any product other than a primary product which subsidy results in

the sale of such product for export at a price lower than the comparable price charged for the like product to buyers in the domestic market.

Rebates of indirect taxes on exports do not constitute subsidies according to a note in annex I to article XVI:

> The exemption of an exported product from duties or taxes borne by the like product when destined for domestic consumption, or the remission of such duties or taxes in amounts not in excess of those which have accrued, shall not be deemed to be a subsidy.

But remission of direct taxes or social welfare charges was defined to contravene article XVI:4 at the 17th session of the contracting parties as was overcompensation for indirect tax burdens:

> (d) The exemption, in respect of exported goods, of charges or taxes, other than charges in connection with importation or indirect taxes levied at one or several stages on the same goods if sold in internal consumption; or the payment, in respect of exported goods, of amounts exceeding those effectively levied at one or several stages on these goods in the form of indirect taxes or of charges in connection with importation or in both forms.

Under article XVI:1, countries are required to notify each other of any practice considered as subsidies and to enter into discussions with countries feeling themselves injured by such practices. Article VI:3 permits countries injured by subsidies involving direct tax credits to impose countervailing duties.

2. TREATY OF ROME PROVISIONS RELATING TO BORDER TAXES

The rules governing the treatment of export tax rebates and import equalization charges among Common Market countries appear to be patterned fairly closely after GATT regulations. But they specify somewhat more clearly than does the GATT that by "* * * charges * * * applied * * * to like domestic products" only indirect taxes are meant. The relevant provisions are laid down in article 95:

> A member state shall not impose, directly or indirectly, on the products of other member states any internal charges of any kind in excess of those applied directly or indirectly to like domestic products.

Article 96:

> Products exported to the territory of any member state may not benefit from any drawback of internal charges in excess of those charges imposed directly or indirectly on them.

Article 97:

> Any member states which levy a turnover tax calculated by a cumulative multistage system may, in the case of internal charges imposed by them on imported products or of drawbacks granted by them on exported products, establish average rates for specific products or groups of products, provided that such states do not infringe the principles laid down in Articles 95 and 96.
>
> Where the average rates established by a member state do not conform with the above-mentioned principles, the Commission shall issue to the state concerned appropriate directives or decisions.

Article 98:

With regard to charges other than turnover taxes, excise duties and other forms of indirect taxation, exemptions and drawbacks in respect of exports to other member states may not be effected and compensatory charges in respect of imports coming from member states may not be imposed, save to the extent that the measures contemplated have been previously approved for a limited period by the Council acting by means of a qualified majority vote on a proposal of the Commission.

Source: Sidney Weintraub, "Border Tax Adjustments and the GATT," The Tax Executive, July 1965, pp. 317–320; Treaty Establishing the European Economic Community.

Section II

INSTITUTIONAL ASPECTS

82-246—67——4

THE FREE TRADE AREA CONCEPT AS APPLIED TO THE UNITED STATES

BY THEODORE GEIGER and SPERRY LEA *

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I. THE NEW SETTING FOR U.S. FOREIGN TRADE POLICY

This paper explores in broad outline the relevance of the free-trade-area concept for the United States. Until recently, such an inquiry would have been largely of academic interest. However desirable free trade has been in economic theory, it was generally recognized that, in practice, it was not an attainable objective for U.S. policy. The commitment to some significant degree of protection was so strong among influential sections of American industry and labor and the extent of dependence on foreign trade of the American economy was so minor that the national interest considerations favoring free trade were insufficient to offset these negative factors. In the circumstances, the goal of U.S. policy was trade liberalization; that is, freer trade, and not the complete removal of all barriers to the flow of imports and exports. Indeed, at times during the postwar period, resurgent protectionism was strong enough to force significant—though temporary—retreats from even this limited objective.

Moreover, because the national and group interests favoring freer trade were comparatively weak, this goal of U.S. policy was pursued as much for political as for economic reasons. In essence, the political rationale was that the security of the United States rested in part upon the stability and progress of the international system, many of

* Theodore Geiger is chief of international studies of the National Planning Association, and Sperry Lea is the American director of research, Canadian-American Committee of the National Planning Association, Washington, D.C. The views expressed in this paper are the authors' only.

whose member countries were substantially dependent for their own domestic stability and welfare upon the gains from foreign trade. By promoting the growth of world trade, the general reduction of barriers fostered the prosperity of many nations and, therefore, greater willingness and ability on their part to behave responsibly and cooperatively in their relations with one another.

In the early 1960's, however, these political considerations were reinforced by certain economic developments with the result of strengthening the U.S. commitment to freer trade.

The progress of the European Economic Community (EEC) toward internal freedom of trade and a common external tariff confronted the United States with both a danger and an opportunity. The danger was that the closer the EEC came to the completion of its customs union, the larger would be the degree of its discrimination against U.S. products. The opportunity was that of persuading the EEC to open its rapidly growing common market more widely to U.S. exports in return for reciprocal tariff reductions in U.S. import barriers.

Politically, the early 1960's marked the culmination of the U.S. effort to realize its "grand design"—the formation of an equal partnership between the United States and a unified Western Europe willing and able to share the responsibilities of protecting world peace and fostering world progress. These economic and political possibilities were dramatically underscored in 1961 by the application for membership in the EEC of the United Kingdom and other European countries, which brought within sight the achievement of the European union that was the precondition for Atlantic partnership.

The U.S. response was the Trade Expansion Act of 1962, in which the Congress granted to the President unprecedented authority to reduce virtually all U.S. tariffs by 50 percent in return for reciprocal across-the-board reductions by other countries and, in the "dominant supplier" provision, to abolish tariffs on products for which the exports of the United States and those of an enlarged EEC represented "80 percent or more of aggregated world export value." This bold trade liberalizing initiative was supported by American congressional and public opinion as much to hasten the realization of the "grand design" for an Atlantic partnership as to counter the possible threat of increased discrimination by an enlarged EEC.

The subsequent Kennedy Round of tariff negotiations proved to be very much longer and more difficult than originally anticipated, and for most of their 4-year course seemed unlikely to result in substantial reductions in trade barriers. Moreover, early in the negotiations, President de Gaulle vetoed the British application for membership in the EEC and the prospect of imminent enlargement of the Common Market vanished—and, along with it, the usefulness of the U.S. "dominant supplier" authority. Nevertheless, at the 11th hour, agreement was reached on surprisingly large reductions in tariffs over a broad range of commodities. While interpretations of the details are not yet complete and, in any event, the quantitative significance of tariff reductions varies according to the method used to calculate it, the Kennedy Round has clearly resulted in the largest advance in trade liberalization yet made under the GATT. Indeed, with the exception of certain admittedly important commodities, it is not an exaggeration to say that, insofar as tariff barriers are concerned, the limited goal of trade liberalization has now been achieved.

Once again today, as in the early 1960's, the United States is confronted with an opportunity and a challenge. The opportunity is made possible by the unexpected success of the Kennedy Round. If freer trade—the objective of U.S. policy for more than three decades—has been substantially accomplished, then it is no longer of purely academic interest to investigate the possibilities of free trade—that is, the abolition of tariffs and other restrictions to trade—as a relevant and practicable goal of U.S. policy and the methods by which it could be realized. In other words, owing to the six postwar GATT rounds of tariff reductions, the remaining duties on a very broad range of products are now low enough to envisage abolishing tariffs completely on most or all of these commodities in the next negotiation. True, there are certain industries, such as textiles, shoes, and other consumer goods, as well as agriculture, which continue to enjoy a high degree of protection and where the prospects for free trade are still remote. But, a large enough proportion of internationally significant commodities are already free of tariffs or within striking distance of that situation to make free trade a relevant goal of U.S. policy for the decade or so that lies ahead.

This possibility is strengthened by the challenge of the new period in world politics that began during the mid-1960's.[1] The two preceding postwar decades were an era of major structural changes in the international system made necessary and possible by the deep dislocations caused by World War II. Chief among these postwar changes were the great decolonization movement that brought into existence 60-odd new nations, the clear-cut global United States-Soviet confrontation of the cold war, and the rise of Communist China. In turn, World War II and these and other subsequent developments provided both the incentive and the opportunity for such unprecedented acts of creative restructuring as the establishment of the United Nations and many other international political and economic organizations, the Marshall plan and the process of European unification, NATO and other mutual defense pacts, and the large-scale programs of financial and technical assistance to Asian, African, and Latin American countries. If it had produced an effectively integrated Atlantic Community willing and able to protect and help its allies and friends in all parts of the world, the "grand design" for an Atlantic partnership would have been the culmination of the postwar process of international restructuring.

However, in the course of the 1960's, it gradually became evident that the intensity and clear-cut global dichotomy of the cold war was being diffused and confused by fundamental changes on both sides: the growing rivalry between the Soviet Union and China, the gradual loosening of Soviet control over the East European countries and their increasing independence in both domestic and foreign policy, the waning revolutionary fervor of Soviet communism and its concomitant waxing concern with fostering Russian prosperity; and, on the Western side, the parallel decline in U.S. influence over its NATO allies, the new "isolationism" in West European attitudes, and the marked

[1] For a fuller analysis of the characteristics of the new period and their implications for U.S. policy, see Theodore Geiger, "The Ending of an Era in Atlantic Policy," in the Atlantic Community Quarterly, vol. 5, No. 1, spring 1967, pp. 87–98.

slowing down of the movement toward European economic and political union. During these years, it also became evident that recurrent crises would be occurring in Asia, Africa, and Latin America in which the United States would feel impelled to become actively involved without the support—and sometimes despite the disapproval—of its now-isolationist NATO allies.

Thus, the new period in world politics is much more complex, ambiguous, and intractable than that of the immediate postwar decades, and the possibilities for grand designs and other major world political and economic restructuring become correspondingly more remote. An Atlantic partnership effectively organized and willing to play an active role in protecting the security and fostering the progress of Asia, Africa, and Latin America is no longer a realistic goal of U.S. policy. In the long term, there may well be other compelling reasons for Atlantic unification than the now waning external menace of revolutionary communism—although there could perhaps be a revival of the latter's worldwide messianism. However, it is likely that efforts to press toward this hitherto pivotal objective of U.S. postwar policy will be futile during the medium term and, indeed, could well result in further weakening of NATO and greater European disaffection from U.S. leadership in the shorter term.

In place of an Atlantic partnership serving as the organizing and supporting nucleus of an international system, less focused, less integrated and less institutionalized developments alone appear to be feasible in the period ahead. In place of great new structural political creations, more modest functional economic arrangements may be all that lie within the limits of the possible. These cannot now be premised upon and aimed at completing a grand Atlantic design. While as a practical matter, they may begin with some or all of the major Western nations, there no longer are political reasons for giving them an exclusively regional Atlantic focus. Indeed, to attempt to do so would arouse suspicions not only in Asia, Africa, and Latin America but also in continental Western Europe, and thereby make their realization impossible.

Thus, today, when free trade has for the first time become a realistic eventual goal of U.S. policy, it can—and must—now be pursued in a more flexible manner and in a less explicitly political context than was characteristic of the past. The basic and generalized political reason for U.S. national interest in free trade, as previously in freer trade, still holds: its contribution to world stability and progress and hence to the security and welfare of the United States. But, in considering how to reach this goal, it is no longer necessary—indeed, it would probably be counterproductive—to place much emphasis on an Atlantic community rationale. Formally organized arrangements—for example, a free-trade area—may well be needed, if not to achieve free trade, then to preserve it, as we shall explain below. If so, however, their justification is largely economic in nature and their chances of being accepted by most other countries—including perhaps even the United Kingdom and Japan and certainly the main continental West European nations—are likely to be enhanced to the extent to which they are conceived and presented in economic terms.

In this new setting for U.S. foreign trade policy, we believe that the achievement of free trade by the end of the next decade or so has now become a relevant and realistic goal for U.S. policy. On this assumption, the remainder of this paper considers and compares the two ways open to GATT members to reach an ultimate goal of free trade—the traditional approach of multilateral bargaining in successive GATT rounds, and the establishment of an appropriate form of free-trade arrangement. In assessing their relative merits, two kinds of considerations need to be taken into account. The first are qualitative and analytical, involving comparison of the characteristics of the two approaches and of how they have affected the efforts so far made to implement them. The second set of considerations are quantitative and empirical, consisting of attempts to measure the probable effects of the two methods on the volume and composition of imports and exports; on particular industries, regions and types of enterprises and workers in the countries concerned; and on the general conditions of internal and external equilibrium of these nations.

In this paper, we have scope only for a preliminary assessment of the first kind of considerations, and they would certainly have to be analyzed much more thoroughly than we are able to do here before definitive conclusions about them could be reached. Quantitative estimates of the comparative costs and benefits of the two approaches are equally important but neither the time and personnel nor the empirical data required for such an evaluation have been available. This underscores the preliminary character of the analysis and conclusions in the remaining sections of the paper.

II. Two Paths to Free Trade

THE MULTILATERAL APPROACH

Since World War II, the multilateral approach has dominated U.S. participation in negotiations to liberalize trade. These have taken place in six rounds held under GATT auspices, the last and most active being the Kennedy Round. The essence of these multilateral negotiations is universality and nondiscrimination. All GATT members participate in exchanging concessions and do so according to unconditional use of the most-favored-nation (MFN) principle—described in annex A—which dictates that concessions granted to one country are automatically extended to all.

The six GATT rounds have made substantial progress toward free trade, both in the depth of tariff cuts and in the range of products affected. But, unlike a formal free-trade arrangement, the multilateral approach has not committed participants to a defined goal and a fixed program for reaching it. The extent of tariff cuts and other concessions, the breadth of commodity coverage, and how often to stage the periodic rounds—these questions have been settled ad hoc by the participating countries and, indeed, the two former have been key elements in the negotiations themselves.

The outcome of the multilateral approach has, therefore, been unpredictable. It has been animated by initiatives from the most eager countries and from the GATT secretariat. But, in the last analysis, the pace setters have been those major trading nations least willing or able to offer meaningful concessions. The unconditional application of the MFN principle has committed the multilateral approach to proceed, like a wartime convoy, at the speed of its least active participant. Otherwise such a country would have been given, through the operation of the MFN principle, a "free ride."[2]

The successful conclusion of the Kennedy Round has largely dispelled the feeling, nurtured during its early years of frustration, that the multilateral approach was no longer workable, owing to the presence of laggards among the major trading countries. But the question remains whether or not the "convoy effect" will prevent adequate progress in the future. With tariffs lowered substantially, the next range of tasks makes for a challenging agenda with emphasis on such stubborn nontariff barriers as border taxation and government procurement, and such "hard-core" sectors as agriculture and textiles. For the multilateral approach to function effectively on these issues, the willingness of all major GATT members will be required to break difficult new ground.

These past limitations and continuing uncertainties for the multilateral approach make it desirable to look much more seriously than hitherto at the alternative free-trade arrangement approach now that free trade appears to be a realistic longer range goal of U.S. policy.

THE FREE-TRADE ARRANGEMENT APPROACH

In the multilateral approach, all trading partners move as far and as fast as they can together. A formal free-trade arrangement involves a more limited group—at least initially—of countries sprinting ahead to reach a state of completely free trade for virtually all products. Since it is the assigned subject of this paper, we need to go into more detail in introducing and defining the free-trade area concept as applicable to the United States.

To date, the official U.S. view has been that regional free-trade arrangements are desirable to support economic growth and political integration in Europe and economic development in Asia, Africa and Latin America but that they have not been relevant to the United States itself nor preferable as a tactical means to the multilateral approach when the United States was involved. Private individuals and groups in the United States have, however, proposed from time to time that the United States consider participating with other countries in some kind of free-trade arrangement.[3] To some extent, these views were born of frustrations during earlier stages of the Kennedy Round, especially during the latter half of 1965 when the French

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[2] For years, a limiting factor has been the U.S. negotiating authority, which only twice (1934 and 1945) permitted the President to negotiate for tariff cuts exceeding 20 percent and was generally hedged by peril points and escape clauses. During the agonizing course of the Kennedy Round, it appeared that it was the EEC that was holding down the pace of negotiations, at one point stopping them entirely. The conclusion of the Kennedy Round has dispelled this contention. All of the major trading countries—including the United States—proved to have their areas of reluctance or inability to negotiate.

[3] Published proposals for considering one or another type of free-trade arrangement as an appropriate approach for U.S. trade policy include: "After the Kennedy Round, What?" a speech by Howard S. Piquet, senior economist, Library of Congress, January 1965; "The United States Should Adopt a Free Trade Strategy," a private paper issued in July 1965 by David J. Steinberg, chief economist of the Committee for a National Trade Policy; "The U.S. Role in Britain's Economic Crisis," a speech by Senator Jacob K. Javits at the Savoy Hotel, London, November 1965; "A New Trade Strategy for Canada and the United States," a Policy Statement by the Canadian-American Committee of the National Planning Association (U.S.A.) and the Private Planning Association of Canada (Washington and Montreal: May 1966): "A Reassessment of Trade Policies," one of the recommendations in the "United States Balance of Payments: An Appraisal of U.S. Economic Strategy" by the Economic Policy Association (Washington, D.C.: 1966) pp. 146–151; Ralph I. Strauss, "A Proposal for New Initiative in U.S. Foreign Trade Policy," Orbis, vol. XI, No. 1 (spring 1967).

boycott of the EEC's operations paralyzed negotiations. More recently, private interest in free-trade arrangements and critical response to this approach [4] no longer view it as an alternative to an unpromising Kennedy Round, but rather as the next logical step for U.S. trade policy regardless of the outcome at Geneva.[5]

Almost without exception, these proposals for free-trade arrangements have been unconcerned, or at least unclear, about the nature of the basic agreement. Therefore, it would be useful to describe the general outlines of the kind of free-trade arrangement that would be appropriate for U.S. participation.

The starting point is the GATT rule permitting a group of members to form a new free-trade arrangement that discriminates against other GATT members in violation of its basic principle of nondiscrimination. Annex A describes in greater detail how the GATT reconciles this apparent conflict. Suffice it to say here, the GATT does sanction discriminatory arrangements but only if they meet strict requirements aimed at preventing them from becoming loose preference systems or protectionist trade blocs. Specifically, it allows its members to form either a free trade area or a customs union that meets four standards:

Complete, not partial, elimination of "duties and other restrictive regulations" among its members.

Commodity coverage accounting for "substantially all the trade" among participants.

No increase in restrictiveness of trade barriers against nonmembers; and

Full development "within a reasonable length of time."

As defined by the GATT, a free trade area is formed when two or more countries agree to abolish tariffs and other barriers to trade among themselves. Unlike the alternative customs union (a traditional arrangement with a long history in Europe), the free trade area does not require its participants to form a common external tariff affecting imports from nonmember countries.

This simple distinction between the two types of free-trade arrangement permitted by the GATT holds important implications for their applicability to the United States. Members of a customs union must, and members of a free trade area need not, develop a common commercial policy toward nonmembers.[6] In the context of possible U.S. participation, the need for concerting commercial policy appears to preclude the customs union, for this requirement would clearly pre-

[4] For recent assessments of the free-trade arrangement as a policy option for the United States that do not find it preferable to a continuation of multilateral approaches see: John Evans, "U.S. Trade Policy: New Legislation for the Next Round" (New York: Harper & Row for the Council on Foreign Relations, 1967) especially ch. VIII, "Atlantic Partnership and Free Trade Areas"; Bela Balassa, "Trade Liberalization Among Industrialized Countries: Objectives and Alternatives" (New York: McGraw-Hill Book Co. for the Council on Foreign Relations, 1967) especially ch. VII, "A Trade Policy for the Atlantic Area."

[5] It is worth noting the rise of private interest in Canada, and later in the United Kingdom, in some form of free-trade area which would encompass them and the United States as a nucleus. As we shall discuss in greater detail below, the U.S. view as to the eventual scope of such an arrangement is wider than the Atlantic free trade area that Canadian and British supporters usually have in mind.

[6] A subsidiary technical implication of retaining individual tariffs toward non-members is the need for a free trade area to prevent goods from outside the area entering a high-tariff country via diversion through a lower-tariff member. This "origin problem" has apparently been solved by the European Free Trade Association.

empt congressional prerogatives to set U.S. trade policy. A free trade area, however, would permit U.S. trade policy toward nonmembers to be determined as it now is. In addition, the absence of a common external tariff and a common commercial policy makes it possible to have an arrangement with a minimum need for policy integration among the members and with less extensive adjustment problems than in a customs union. Between the two forms of free-trade arrangement permitted by the GATT, therefore, the free trade area appears to be the only practicable choice for the United States.

Experience to date among industrialized countries shows that achieving a stable free-trade situation that provides fair competition requires more than merely abolishing tariffs and quotas. Participants must also take steps to control the discriminatory effects of nontrade regulations and practices affecting freely traded products. In addition, they may wish—as does the EEC—to coordinate certain of their national economic policies that significantly affect comparative production costs, for example, taxation and social welfare, energy and transportation, etc. A group of countries desiring to reach full economic integration and eventual political unification, as did the EEC, will aim to go even further in developing joint policies and arrangements, such as a common currency, a single capital market, etc. But, it is realistic to assume that even the simplest free trade area—one leaning over backwards to limit economic integration—will, as did the EFTA, find it necessary to set some "rules of competition" to prevent frustration of the benefits expected of free trade.[7] Such a relatively nonintegrated free trade area would probably also have to develop mechanisms for harmonizing members' domestic economic conditions so as to enable participants to avoid or, if not possible, to deal jointly with, severe problems of internal and external imbalance by means other than the reimposition of restrictions on imports and exports.

Taking together the distinction between the two forms of free-trade arrangement permitted by the GATT, the GATT rules and the practical requirements governing them, and assuming that the United States will continue to adhere to the GATT and that the Congress will maintain its role in determining U.S. trade policy, we conclude that: *A free-trade arrangement involving the United States would have to take the form of a free-trade area in which participating countries would, over a specified time period, completely abolish barriers affecting virtually all mutually traded products, and set other rules to coordinate policies as may be found necessary to provide fair competition for the commodities being freely traded and to preserve free trade despite the changing internal and external conditions of its members.*

POSSIBLE CHARACTERISTICS OF A FREE-TRADE AREA INCLUDING THE UNITED STATES

This basic definition notes only the most general features of a free-trade arrangement involving the United States. There still remains a wide scope for choice as to its specific characteristics. An illustrative

[7] For an account of how EFTA approached these questions, see "Building EFTA, A Free Trade Area in Europe," prepared by the EFTA Secretariat (Geneva: December 1966) pp. 100–120; and J. S. Lambrinidis, "The Structure, Function, and Law of a Free Trade Area: The European Free Trade Association," (New York: Praeger, 1965) pp. 117–158. As applicable in a hypothetical free trade area involving the United States, the whole range of ancillary commitments to tariff elimination are discussed in "A Possible Plan for a Canada-U.S. Free Trade Area," op. cit., pp. 33–41.

checklist of questions, grouped by areas of decision, is given in annex B. How these questions would be decided could only be known at the conclusion of negotiations. On the basis of previous inquiry by the authors into the possible characteristics of a Canada-U.S. arrangement, however, it is reasonable to assume the following broad outline [8]:

For reasons given above, the free trade area appears clearly preferable to the customs union as the basic form of the arrangement. Rules of origin would probably be patterned after those used successfully by EFTA.

The important question of membership, that is, the geographical scope of the free trade area, will be discussed at greater length below.

Following the precedents of Benelux, the EEC, and the EFTA, commodity coverage would probably include all industrial products and raw materials. As an indispensable adjunct to free trade, especially with blanket coverage, the arrangement would be expected to provide various measures (such as adjustment assistance and prolonged timing) to help particular industries and producers meet the threats and realize the opportunities of a wider and more competitive market. Unless the participants were prepared to harmonize their agricultural policies, however, they would exclude this sector, at least at the outset, as did the EFTA.

The arrangement would probably shun explicit steps toward closer economic integration; but, as discussed above, it would include certain measures considered indispensable to insure that the benefits expected from free trade would not be counteracted by national policies, especially those with preferential effects. These steps might include certain rules of competition and, where necessary, facilities to insure that internal and external imbalances would not be remedied by abrogating free trade.

The common institutions (council, secretariat, etc.) would, like those of the EFTA rather than the EEC, be as simple as possible and would not have scope to act supranationally.

The timing arrangements incorporated in the treaty would need to include a transitional period as short as possible, but long enough to enable reinvestment and restructuring of affected industries and flexible enough to recognize special adjustment problems in certain industries and countries.

The question of membership requires fuller discussion, although the complexities involved and the contingent perplexities that could develop preclude our giving as clear an answer as for some of the other characteristics of a free trade area. In the event that the United States were to opt for the free trade area approach—the circumstances of which are discussed later—the most likely initial group of full members would consist of the United States, Canada, the United Kingdom and some other EFTA countries if they had not entered the EEC by then.[9] Others interested in full membership

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[8] See two publications of the Canadian-American Committee of the National Planning Association (U.S.A.) and the Private Planning Association of Canada: Sperry Lea, "A Canada-U.S. Free Trade Arrangement: Survey of Possible Characteristics," and "A Possible Plan for a Canada-U.S. Free Trade Area," a staff study (1963 and 1965 respectively). The characteristics broadly outlined here reffect to some extent those developed in ch. II, "Choices Among Options," of the latter publication.

[9] A bilateral nucleus of the United States and Canada is theoretically possible, and such a North American free trade area has sometimes been suggested as an end in itself. But, for somewhat different reasons, Canadians and Americans interested in mutual free trade appear to prefer a wider arrangement.

initially might be the EEC, Japan, Australia, and New Zealand, and perhaps a few Asian, African, and Latin American nations, as discussed below. In line with the global purposes of the arrangement, reflecting considerations mentioned earlier, the other economically developed countries would be invited to participate at the outset but, for various reasons, some or all of them may be unable or unwilling to become founding members. Therefore, the charter members would want to design their free trade area to facilitate subsequent entry of the other developed nations that did not opt for initial accession.

The two major uncertainties are the EEC and the less developed countries of Asia, Africa, and Latin America. The question of EEC membership is so closely related to the considerations that the United States would face in choosing between the two approaches to free trade that it can best be discussed in that context later in this paper. Here, we can briefly consider the problems involved in participation by the less developed nations.

In keeping with the nonregional, nonpolitical character of an arrangement relevant to the new period in world politics, participation in a free trade area would be open to Asian, African, and Latin American countries. But, it would be neither realistic nor even desirable to expect them to meet the same schedule of tariff cuts as the economically developed nations of North America, Western Europe, and the Pacific. A possible way to overcome this difficulty would be to permit the less developed countries to abolish their tariffs over a long period, say 25 to 30 years—as the EEC did in extending associate membership to Greece and Turkey—and, conversely, to grant free entry for their exports to the industrialized members in half the time, or even less, that the latter envisaged for themselves. In this way, the nonindustrialized countries would have an incentive to develop their export capabilities; they would have the advantage of temporary preferential access to the free trade area since they would not have to meet the export competition of the industrialized members for the first 5 years or so; and their own home markets could be protected for a long enough period from the competing exports of the latter.

Two difficulties can be forseen in such an arrangement. The first relates to the fact that a handful of Asian, African, and Latin American countries are markedly more developed than the great majority and could, in consequence, be expected to preempt most, if not all, of the benefits of early free access for industrial products to the markets of the developed countries. The second is the fact that their manufactured exports would consist in large part of precisely those goods (textiles, clothing, etc.) that would create the most sticky adjustment problems for the United States and the other developed members. Hence, it would probably be politically necessary to distinguish between the more and the less advanced among the developing countries, with the former receiving the benefits of participation in the free trade area later than and not as fully as, and meeting the reciprocal obligations of full membership much earlier than, the latter. Indeed, a valid argument could be made for expecting them to conform to the same transitional schedule for opening their own markets that the developed members would be following. If they were to do so, they would, of course, qualify for full membership along with the initial nucleus of founding countries. The really less developed nations enjoying the benefits of participation would be associate members until they, too, were able and willing to open their own economies freely to the exports of the other members.

III. The Two Approaches Compared: A Preliminary Evaluation

Our original question remains of how relevant such an arrangement would be to the future needs of U.S. trade policy; specifically, whether, and if so at what point, it would be desirable to shift from the multilateral approach to the free trade area approach. It is quite beyond the scope of this paper adequately to analyze all of the factors involved in this question. But without presuming to reach definitive conclusions, we shall briefly discuss certain key issues on which the free trade area option is likely to be tested.

First, let us clarify what is to be compared. If, as in the past, Americans clearly distinguish between free trade and merely freer trade as ultimate objectives—and generally continue to prefer the latter—then the free trade area concept is irrelevant as a means of policy, and has to be evaluated as an alternative goal. We have assumed in this paper that Americans will now increasingly recognize the relevance of the proposition that free—not just freer—trade is a realistic objective. Thus, we are comparing multilateral bargaining with the free trade area solely on their merits as means to a free trade goal.

It should also be recognized that we are comparing two approaches whose differences, while now considerable, would in all probability gradually disappear. After another successful round of multilateral negotiations, freedom of trade among the participants would be so close that the question "Where do we go from here?" would inevitably assert itself. Many GATT countries would be likely to feel the need to set some specific target date for achieving free trade and a timetable for reaching it. Moreover—and, as already indicated, probably more important—the closer the GATT countries approach to free trade, the stronger their desire to insure that freedom of trade would be irreversible and that it would be conducted under conditions of fair competition. Thus, we could expect them to undertake a variety of commitments—mentioned above—that would duplicate most of the characteristics of a formally organized free trade area. The participants in future successful multilateral negotiations might, therefore, come in time to form a free trade area through a process of adaptive mutation without having initially launched it, fully rigged, according to the rules and rites of the GATT.

For these reasons, we assume in the following comparison that the free trade area approach is to be tested against the traditional U.S. multilateral approach on the basis of whether it would be a better way to proceed—not whether it would be a better place to end up—when conditions are propitious for a new trade policy initiative within the next few years.

SOME BASIC CONSIDERATIONS

An essential question is how each approach handles those tasks which assure the meaningfulness of free trade. One such task is to stimulate more efficient use of resources—the major economic raison d'être of the free trade objective because of its enduring benefits to producers, consumers, and the economy as a whole. The weakness in this respect of multilateral negotiations, at least as practiced thus far, has been to permit participants to protect many less efficient sectors indefinitely. A free trade area, assuming that it would not allow significant exemptions among nonagricultural products, offers from the outset the prospect of shifting resources from virtually all of the less to the more efficient sectors. The inefficient industries would either be forced to modernize or their resources would be transferred to activities in which they could be used competitively. In either case, adjustment assistance of various kinds would, of course, have to be made available to both management and labor.

A second important consideration is the degree of certainty on the part of producers that the new market situation, with its greater growth opportunities as well as competitive threats, would be here to stay. Without such assurance, the investments required to increase efficiency would not be made, or at least not made extensively enough. On this question, too, a free trade area appears to be superior in terms of its psychological and economic effects, for it would offer comprehensive treaty commitments considered firmer than the limited "bindings to zero" reached by the multilateral approach as hitherto practiced.[10]

The third criterion of an effective approach—one now recognized as of greatly enhanced importance—is the ability to deal with nontariff barriers. Here, the free trade area appears to have several advantages. By abolishing tariffs, it automatically eliminates tariff-related problems; e.g., the methods of valuing and classifying imports for the purpose of setting duties, etc. For other nontariff barriers, such as border taxation, official procurement policies, indirect governmental aids to production and exports, etc., the institutional mechanisms of a formally organized free trade area seem to offer better means for formulating and implementing the necessary accommodations than the intermittent and ad hoc procedures hitherto characteristic of the multilateral approach. A clearer understanding of this difference would be gained by evaluating the performance to date of the EFTA with respect to nontariff barriers.

CONSIDERATIONS RELATED TO THE EEC AND THE UNITED KINGDOM

The United States cannot decide upon its method of approaching free trade or, indeed, whether this would be a desirable objective without considering the probable reactions of its principal trading partners. Its largest trading partner is Canada, whose approach would probably continue to be similar to that of the United States. The major uncertainty would be the reaction of the EEC and the United Kingdom.

Prior to the question of the comparative willingness—or reluctance—of the EEC and the United Kingdom to participate in either of the two approaches to free trade is the basic issue of whether either or both of them are now, or will be in the next few years, disposed to contemplate eventual free trade with the United States. Indications are that strong resistance may be expected, particularly among Euro-

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[10] Canadians, whose main concern in any free trade situation is assured access to the U.S. market, often stress these advantages of a formal free trade arrangement over free entry as bound by the conventional GATT agreement.

pean businessmen, to making free trade with non-European nations—especially the United States—a goal of European trade policy. It should be remembered, however, that many European businessmen were also opposed to the formation of the EEC, but their governments were nevertheless able to move ahead to establish a common market. European governments could do the same with respect to free trade with North America provided they were convinced that, in the sense defined at the beginning of this paper, the free trade objective is today as relevant for Western Europe as for the United States. Hence, it is legitimate to assume that the Europeans may also come, sooner or later, to see free trade as not only a realistic but also a desirable eventual goal.

With respect to the existing six-member EEC, whether and when it may be prepared to contemplate free trade with North America are questions closely related to the future role of its common external tariff, whose functions are in turn determined by the EEC's own long-term goal. In addition to its conventional protective function, the common external tariff has been serving the broader purposes of helping to maintain the identify of the EEC during the period of its evolution into a full economic and political union and of providing an inducement for the participating countries to remain members of it. Prior to the achievement of a European union, abolition of the common external tariff, particularly in order to participate in a wider free trade area, would probably result in dissolution of the EEC unless other binding and benefit-conferring relationships had by then developed; for example, a common currency, integrated tax systems, common policies in the major economic sectors, increased supranational authority for the European Commission, etc. Conversely, unless the EEC remains committed to, and continues to make some significant progress toward, a European economic and political union, some or all of the six might prefer to participate in a much wider and, therefore, potentially more beneficial free trade area than to continue as members of a customs union that would be little more than a protectionist bloc. The marked slowing down in the course of the 1960's of the movement toward European union raises this possibility.

In view of these questions, the next 3 or 4 years are likely to be a critical period for the future of the EEC. One event that would force its members to make decisions on these questions would be an explicit commitment by the United States to an eventual free trade goal. Should the EEC decide to resume the advance toward full union, then the other binding relationships, noted above, would rapidly develop to fulfill the noneconomic functions hitherto performed solely by its common external tariff, and it could still participate in a wider nonpolitical free trade area without loss of identity and cohesion. Conversely, should the Europeans decide not to move toward union, the EEC's Customs Union might well prove to have been no more than a transitional arrangement that prepared its six members to participate more effectively in a broader free trade area including North America.

If the United Kingdom succeeded in joining the EEC in the next few years, the critical decision period would undoubtedly be prolonged. But, the basic issues outlined above would remain, except that

United Kingdom membership would probably be one of the factors working against resumption of the movement toward full union. Should the United Kingdom fail to join the EEC, the British may be expected to investigate other kinds of free trade arrangements in which they could participate, especially with North America. Indeed, several private groups and individuals in England are already exploring an open-ended free trade area for the United Kingdom.[11]

A definitive judgment about the implications of these complex and ambiguous considerations for the U.S. choice between the two approaches to free trade cannot be reached at this time. On the one hand, if the U.S. decision has to be made in conditions of continued uncertainty about whether the United Kingdom could join the EEC and about resumption of the latter's movement toward European union, another round of the multilateral approach would probably be indicated. On the other hand, the failure of one or both of these possibilities in the next few years would argue for resolving the ambiguity in favor of a free trade area approach by the United States.

CONSIDERATIONS REGARDING THE FEASIBILITY OF THE MULTILATERAL APPROACH

Regardless of the foregoing considerations, the United States could well decide to stay with the much more familiar multilateral approach. In that event, it would direct its initiative to shaping and animating a new GATT round to deal with the new agenda of tasks. But, as noted above, multilateral negotiations have in the past been paced, through the "convoy effect," to the speed of the least willing major participant. If this limitation could not be obviated through advance agreement, it might be that one or more of the main participants would prove unwilling or unable to reciprocate for concessions offered by the others. This situation would confront the willing countries with the choices of (1) giving the reluctant nation a "free ride," (2) seeking progress in areas not involving the latter, which might amount to becoming reconciled to accomplishing little, or (3) proceeding themselves to form a free trade arrangement under the GATT rules.[12]

For the United States to consider seriously the latter course would require weighing several crucial questions:

Would the loss of momentum in failing to move ahead provide an opportunity for the resurgence of protectionist forces?

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[11] Such an arrangement is viewed in England both as an alternative should the United Kingdom fail to join the EEC and as a future development of Atlantic policy if the U.K. application for EEC membership succeeds. These Britons conceive the initial scope of such an arrangement as comprising the United States, Canada, and the EFTA countries, with Australia, New Zeland, and possibly Japan also included. There seems to be less interest in Japanese participation in the United Kingdom than in the United States. The Britons interested in this possibility believe that the EEC would prefer to abstain from participation until the process of internal unification progresses much further. Such a free trade area possibility and its implications are being clarified by the Atlantic Trade Study, a corporate group recently formed to sponsor a series of research projects outlined in footnote 14. At first sight there appear to be some differences between their concept and the free trade area we have described above, but they could well be only matters of emphasis and semantics deriving from the nature of Britain's current "great debate" about its role in the world. The British almost always talk of an "Atlantic free trade area" or a "North Atlantic free trade area." The word "Atlantic" is shunned, however, in the discussion, as well as in the titles, of the two most fully articulated American proposals to date ("A New Trade Strategy for Canada and the United States," op. cit.; and R. Straus, op. cit. Yet the British studies are explicitly based on the first of these publications.

[12] We reject the feasibility of changing the U.S. MFN commitment to a conditional basis in dealing with other major trading countries for the reasons given in "The Most Favored Nation Principle: An Appraisal of Its Current Validity in World Trade" (Washington, D.C.: Chamber of Commerce of the United States of America, February 1966).

What reaction might be expected from the reluctant country or group of countries if the United States and other important trading nations were to decide to form a free trade area without them?

What would be the reactions of other countries willing to move ahead in multilateral negotiations but which would not be in a position to participate in a free trade area from the outset?

At that time, an evaluation of the two latter points would be particularly important. While, in the event of the failure of a new multilateral round, the United States might decide to take the initiative toward forming a free trade area, it would clearly wish to encourage all GATT countries to participate eventually, if not initially. Hence, it would be necessary to weigh carefully the possibility that major trading nations not part of the nucleus group might be alienated indefinitely from the free trade arrangement. Considerations of this kind, particularly as related to the EEC, could only be settled in the context of the situation existing at the time.

TACTICAL CONSIDERATIONS

A final set of considerations relates to the private reactions to the two approaches. Essentially, the question turns on whether or not it would be good tactics to make the free trade goal explicit. Some people claim that the best way to gain support and neutralize opposition for a process leading to free trade would be to present a fully articulated plan with its ultimate end clearly proclaimed. This view would favor use of the free trade area concept from the start. However, it could well be that it would be better tactics not to publicize the free trade objective and a timetable for achieving it until one or more successful multilateral rounds reached the stage, described above, where the participants felt impelled to adopt many of the attributes of a formally organized free trade area.

Only an empirical investigation of potential support for the goal of free trade—not only in the United States but also in the other major trading nations—could settle this question. However, one bit of evidence relevant to such an inquiry is the reaction of the U.S. business community and trade unions to the unexpectedly large tariff reductions made by the Kennedy Round. While the response has not been as enthusiastic as could be wished, it has also not been as hostile as was anticipated. U.S. business and labor generally seem resigned to coping with the more competitive situation that will develop as the Kennedy Round cuts go into effect, and their neutral reaction would augur well for the free trade area approach.

IV. CONCLUSIONS

Before summarizing our conclusions, we wish to reiterate the point made at the beginning of the paper relating not to the means we have compared but to the end they would serve. The fact that it has become relevant and realistic for the United States to commit itself to reaching the goal of free trade by the end of the next decade or so is of overriding significance compared with the choice between the two possible ways to achieve it. In the next few years the primary need is for decisionmakers and opinion leaders in the United States to become accustomed to think about U.S. trade policy in these new terms, viz, as aimed at free trade and no longer at freer trade. Once this way of thinking becomes sufficiently widespread—as happened two decades ago with the idea of trade liberalization—then the question of whether to continue to follow the traditional U.S. method of multilateral negotiations or to shift, sooner or later, to a free trade area approach becomes largely a technical question of choosing the most effective means to an accepted end.

Assuming that Americans can think in these new terms about where U.S. trade policy should end up, then the free trade method has to be regarded as a major practicable technique for getting there. Our preliminary evaluation indicates that the free trade area concept is relevant to the long-range perspective of U.S. trade policy almost regardless of what happens. Our reason is that, sooner or later, the United States appears likely to find either that its next logical step would be to participate in establishing a free trade area or that it would be moving gradually into relationships that would amount to much the same thing. These possible outcomes could be reached in three ways:

1. The earliest that a decision about U.S. trade policy is likely to be taken would be after the presidential election of 1968, most probably not until the spring of 1969. If the United States continues to think in terms of the multilateral approach, an evaluation at that time of the prospects for another round of negotiations might indicate slight chance for success owing to lack of agreement as to objectives or agenda or to the unwillingness or inability of one or more major trading nations to make their share of concessions (the "convoy effect"). In that event, the United States might conclude that it would be appropriate to maintain momentum toward eventual free trade by the only alternative approach available under GATT rules—a formally organized free trade arrangement consisting of those countries in a position to move ahead. As outlined above, such an arrangement would probably be a free trade area that would eliminate tariffs and other barriers to mutual trade in all nonagricultural products; being functional in purpose, it would limit steps toward economic integration to those that proved indispensable to insure the benefits of free trade; it would have simple institutions and flexible timing arrangements to deal with problems in certain products in certain countries. It would aim to be ultimately global in scope, welcoming all industrialized countries as members and providing for special arrangements for less-developed countries. Such a free trade area, unlike all other postwar free trade arrangements, would not be regional. To be sure, it would probably start among Atlantic countries, but it would strive to expand beyond that beachhead to include within the area of free trade as many other nations as possible.

2. A more likely prospect would be for the United States to enter into multilateral negotiations, focusing its efforts on successfully coping not only with further tariff reductions but also with the challenging new problems of nontariff barriers. This development would probably not mean, as might appear, permanent U.S. rejection of the free trade area approach; it could

mean quite the opposite. If the next round of multilateral negotiations, despite early promise, gets stalled for the reasons mentioned, then it is quite possible that the United States would decide to shift to the alternative approach of a global nonpolitical free trade area, as outlined above. A U.S. decision to make this change could be accelerated by the EEC's definitive rejection of United Kingdom entry, if the British were then to take a serious official interest in a free trade area including the United States and others.

3. If, however, the next round of multilateral negotiations turns out to be successful, the major trading nations would then be so close to free trade that they could be expected to commit themselves to this objective by a fixed future date, and to create—if and when required—institutions to develop, concert and implement the policies needed to preserve free trade, once attained. In this case, the distinctive characteristics of a free trade area would evolve gradually and tacitly rather than be established explicity in a formal treaty.

We must also admit the possibility that none of these three developments would occur owing to the unwillingness of a number of important trading nations to reach free trade with the United States. In this case, the chances are that GATT countries would inch ahead together in future rounds, gradually evolving a world trading system that, for want of a better name, might be called a "freer trading area" with significant economic sectors still protected but perhaps with some progress made in reducing nontariff barriers. Even so, the free-trade area concept would still be relevant to describing the ultimate situation that would be approached, although not reached.

Because the free-trade area concept appears in greater or lesser degree relevant to almost every foreseeable development affecting U.S. policy—excepting only prolonged complete blockage of forward movement—it is important for Americans to use the present pause before a new trade policy initiative to acquaint themselves better with its nature, applicability to future tasks, and probable impact on the United States. Specifically, we recommend:

A. An evaluation of the practical experience of the postwar free-trade arrangements among developed countries, especially the EFTA which most closely reflects the spirit and purposes that would animate a scheme involving the United States. Particular attention should be given to four aspects: (i) The difficulties actually encountered within EFTA—compared to those anticipated—from completely eliminating tariffs affecting all nonagricultural products; (ii) the adjustment policies that proved to be most effective; (iii) the ancillary commitments found necessary to assure fair competition; and (iv) how EFTA has dealt with, or has considered dealing with, nontariff barriers and the eventual inclusion of agriculture. The problem of nontariff restrictions promises to figure prominently on the agenda of any future trade negotiations whether for further multilateral tariff reductions or to form a free trade area.

B. Quantitative empirical studies directed to determining the probable impact of a free trade area on a range of aspects affecting the United States. Research programs currently being completed in

Canada [13] and launched in the United Kingdom [14] would be useful guides, but clearly a U.S. effort would in addition cover such particular concerns as balance-of-payments effects.

In summary, the United States might opt for establishing a formal free trade area if the traditional multilateral approach appeared, before or after a new round of negotiations, to have no prospect for success. This decision might be influenced by official British support for a free trade area in the event that the EEC rejected the United Kingdom's application for membership. Conversely, a successful multilateral round could lead GATT countries to creating gradually arrangements to ensure fair competition and to handle problems of internal and external imbalance that would amount to a free trade area. For these reasons, the free-trade approach is already a relevant, and could soon be an applied, means of U.S. policy. Americans need, in consequence, to explore its potentialities and limitations and its benefits and costs much more seriously and thoroughly than they have hitherto done.

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[13] The Private Planning Association of Canada is completing the Atlantic economic studies program, a 3-year project to assess the implications for that country of freer or free trade among Atlantic nations. Nearing publication are over 20 studies grouped under the following subjects: discussions of policy options; economic impact studies (covering agriculture, a number of specific industries and geographical regions, and capital movements); analyses of appropriate harmonization policies and of transitional arrangements; appraisals of the long-term prospects of the Canadian economy under freer and free trade; and the implications of closer Atlantic trading relations for Canada's trade with other areas.

[14] The recently initiated Atlantic Trade Study, whose objectives are noted in footnote No. 11, is reported to comprise at least seven studies covering the following aspects of a "North Atlantic free trade area" from the British viewpoint: trade policy alternatives, monetary problems, political aspects, U.S. investment in Britain, problems of harmonization, agriculture, and relations with the less developed countries.

ANNEX A

THE GATT PROVISIONS FOR FREE TRADE ARRANGEMENTS

The General Agreement on Tariffs and Trade (GATT) was formed in 1948 at the intersection of two conflicting impulses in international commercial relations. One was the determination to reestablish the principle of nondiscrimination, which had badly eroded before World War II. The GATT thus selected as its cornerstone the unconditional most-favored-nation (MFN) principle; its very first sentence states:

"With respect to custom duties [and other charges on imports and exports] any advantage, favor, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like products originating in or destined for the territories of all other contracting parties." [1]

Thus, GATT countries would treat the products of all other members on an equal basis, concessions that were negotiated would be passed on to all, and any new preferences were to be prohibited. (But members might retain previously established preferences such as those among commonwealth countries, or then in effect between the United States and Cuba and the United States and the Philippines.)

At the same time, the GATT had to accommodate a new and irrepressible movement—at first confined to Europe—toward regional free trade through arrangements in which participants shared this privilege among themselves alone. Indeed, on the same day that GATT was born in Geneva to encourage multilateralism, the Belgium-Netherlands-Luxembourg Economic Union (Benelux) was launched in Brussels to initiate the postwar movement toward regional free trade.

The delicate task of reconciling these trends fell to Article XXIV.[2] The first relevant paragraph recognized that regional free trade might be so oriented and organized to serve its participants without frustrating the basic goals of the GATT, and to this end permitted members to form new free-trade arrangements, either as customs unions or free trade areas.

"The contracting parties recognize the desirability of increasing freedom of trade by the development, through voluntary agreements, of closer integration between the economies of the countries party to such agreements. They also recognize that the purpose of a customs union or of a free-trade area should be to facilitate trade between the constituent territories and not to raise barriers to the trade of other contracting parties with such territories." [3]

The remaining six paragraphs of article XXIV then went on to provide rules designed to prevent the new project from violating the spirit of the above paragraph by imitating the commonwealth preference system or becoming an inward-looking protectionist trade bloc.

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[1] From paragraph 1 of article I, entitled "General Most Favoured Nation Treatment."

[2] The relevant text of article XXIV of the GATT, setting forth the conditions for new free-trade arrangements, is presented verbatim and accompanied with a brief commentary in Lea, op. cit., pp. 99–107. A more extensive discussion is to be found in James Jay Allen, "The European Common Market and the GATT" (Washington, D.C.: The University Press of Washington for the Institute for International and Foreign Trade Law, Georgetown University Law Center), 1960; and Lambrinidis, op. cit., chapter XII, "Compatibility of the EFTA Convention with GATT."

[3] Article XXIV, par. 4.

Specifically, article XXIV stipulated that, in forming customs unions or free trade areas (or interim arrangements leading to either), members must meet certain substantive and procedural provisions.

SUBSTANTIVE STANDARDS

Complete, not partial, elimination of "duties and other restrictive regulations of commerce" applied to products originating in members' territories.

Commodity coverage accounting for "substantially all the trade" among participants.[4]

No increase in restrictiveness of trade barriers against nonmembers; and

Development "within a reasonable length of time."

PROCEDURAL REQUIREMENTS

Article XXIV requires also that GATT members submit their proposed project to the GATT for sustained examination, with approval deferred until its real characteristics are revealed in operation. Where a free trade project clearly fails to meet the substantive standards, a waiver must be granted by two-thirds of its membership under article XXV. Such a waiver was granted in 1952 for the European Coal and Steel Community, and in December 1965, for the Canadian-American automotive agreement, both of which violated the MFN clause of the GATT without amounting to a free trade area or customs union as defined by the GATT.

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[4] The precise meaning of "substantially all the trade" has never been given, but precedents for about 80 percent of total trade appear to have been set. The question of whether this rule would have to be waived to permit the exclusion of agricultural products might raise itself more seriously in a free trade area involving the United States, Canada and Australia than it did in the case of EFTA.

ANNEX B

Major Questions Involved in Considering the Possible Characteristics* of a Free Trade Arrangement Involving the United States

DECISION AREA AND MAJOR QUESTIONS

1. *Basic form.*
   a. Choice between customs union or free trade area as each is defined in the GATT.
   b. If customs union, method of determining the common external tariff.
   c. If free trade area, method of handling the "origin problem."
2. *Geographic scope.*
   a. Composition of the initial membership.
   b. Provisions for the accession of additional new members.
   c. Treatment of territories or countries having special trading relationships with member countries, (such as the Commonwealth countries have with the United Kingdom).
   d. Whether or not the arrangement should be open-ended to potentially fully participating members, or to linking with established free trade arrangements.
   e. Whether the arrangement should accept associate members (such as Greece and Turkey with the EEC) with special long-term transitional provisions.
   f. Whether and how the arrangement might extend free trade on a one-way basis to developing countries.
3. *Commodity coverage.*
   a. Extent of coverage among nonagricultural products (manufactures and industrial raw materials). This could be all inclusive (EEC and EFTA) or under a doctrine of "maximum possible coverage," permitting exemptions (Australia-New Zealand free trade area).
   b. Extent of coverage among agricultural products and close derivatives. If covered, guidelines for common agricultural policies.
   c. Handling of nonagricultural products with special situations (most naturally, petroleum).
   d. Various forms of adjustment assistance, seen as an alternative to exemption from commodity coverage of products with acute problems.
4. *Economic integration.*
   a. Purpose: Limited to providing meaningful free trade (EFTA), or undertaken for its own sake, or even to lead to political integration (original EEC purpose, apparently opposed by De Gaulle).
   b. Approach to "rules of competition":
      Handling of government aids to exports, production, transport, procurement, etc.
      Restrictive business practices.

*These decision areas are explored in detail in Lea, op. cit. and "A Possible Plan for a Canada-United States Free Trade Area," op. cit. Choices for some of these questions are given under "Possible Characteristics" in sec. II of this paper.

c. Approach to policy coordination:

That concerned with growth and stability (monetary policy, responses to balance-of-payments problems, etc.).

That related to redefinition of "domestic producer," "export market," etc., in laws affecting dumping, anti-trust, and pooled export legislation.

5. *Common institutions.*

a. Basic purpose: Limited to serving free trade arrangement (EFTA), or as means to "institutional integration" with political overtones (most especially ECSC, but also EEC).

b. Approach to institution building: Fully defined in basic treaty (EEC), or left to be created by the central organ as it deems necessary (EFTA).

c. Extent of powers: Voting formulas, possibility of supranational elements.

d. Distribution of powers: Single central body (EFTA Council), or in different bodies holding balance of powers (EEC).

e. Techniques for settling disputes.

f. Location of common institutions.

6. *Timing arrangements.*

a. Timetable for abolishing trade barriers between the member countries, including possibility of recognizing special adjustment problems by prolonged or staggered transitional periods.

b. In a customs union only: Timetable for forming the common external tariff.

c. Timing the entry into force of other aspects of the agreement.

d. Provisions for accelerating or delaying the basic timing arrangements.

e. The duration of the free trade agreement: A definite expiration or renewal date (NATO), or indeterminate.

Glossary:

ECSC—European Coal and Steel Community.
EEC—European Economic Community.
EFTA—European Free Trade Association.
NATO—North Atlantic Treaty Organization.

THE RESTRUCTURING OF FOREIGN TRADE NEGOTIATIONS

BY ROBERT B. SCHWENGER*

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INTRODUCTION AND SUMMARY

A NEW APPROACH BASED ON UNDERLYING IMPERATIVES

This paper presents and explains a new approach to international trade discussion. Its principal conclusion is that future foreign trade policy should be conducted on different principles. This is not a criticism of what has been done in the past. In fact, the five principles presented here were derived in very large part by observation of certain present trends in intergovernmental discussion. The U.S. foreign trade program should be modified and adapted to the changed environment which imposed these trends.

To bring out their relevance for the next stage of policymaking, after the expiration of the powers granted under the Trade Expansion Act of 1962, the principles are incorporated in a specific proposal for restructuring future trade negotiations. To emphasize, the principles do not supply immediate solutions to present problems; they are elements for a policy framework—a modified approach—within which such problems may prove more readily solvable. In particular, they were not developed for application to the Kennedy Round of GATT trade negotiations, now successfully ended as a worthy sixth episode in that remarkable series of negotiations that began in Geneva in 1947. They envisage, as a sequel to the GATT negotiation series, certain new and continuing discussions along a somewhat different track.

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*Lately Foreign Economic Policy Adviser to the Assistant Secretary of Labor for International Affairs.

This paper presents the central thesis of the manuscript, "Rethinking Foreign Trade Policy," Washington, February 1966. That manuscript was a product of a sabbatical year spent at Gunnar Myrdal's Institute for International Economic Studies, University of Stockholm, reviewing 30 years of personal experience in the trade agreements program and comparing notes with others in the field.

These discussions would, in effect, institutionalize the revolutionary acceptance among governments and people in the great trading countries, brought about largely through the GATT experience, of the obligation to discuss acts distorting trade with a view to avoiding injury to one another as far as practicable. It is proposed to dispense with the ideas of reciprocity and "balance" in negotiations, over which the GATT countries have publicly bickered and inveighed in recent years, often with little meaning and even less useful effect. The new discussions would move a step farther toward international principle and law, and a step away from national economic power, in determining trade questions. They would be based on lessons learned in the past three decades as to how, and how not, in the changing circumstances of our times, to bring trade discussion to constructive agreement. They would look to a dynamic competitive process in a world mixed economy—not to a world free trade area. They would put tariffs and quotas on the same footing as government subsidy: justify or eliminate! They would emphasize the positive contribution trade policy can make, not only to harmonious coexistence among the private ownership developed countries, but also to resolving differences with the less developed and with the government ownership countries. They are thought to respond to underlying imperatives and, therefore, to open the way to more rapid progress toward such ideal objectives of U.S. foreign trade policy as peace, freedom, efficiency, and growth.

EFFORTS AT "TRADE BARRIER" REDUCTION THROUGH BARGAINING ARE BECOMING LESS EFFECTIVE

A review of the trade agreements program reveals two intertwined tendencies:

(a) To bargain away government action affecting trade; and

(b) To reach intergovernmental understanding regarding continuing government action affecting trade.

In recent years, the former, which is the declared purpose of U.S. policy, has slowed down. Governments are reaching more and more "resistance points" beyond which they will not reduce their trade-affecting actions. More and more the bargaining is becoming an effort to escape the pressures inherent in the present negotiating process; one invents new measuring devices or new terminology intended to put one's opponents on the spot, to reduce their intervention and, at the same time, to justify one's own intervention; one finds new forms of intervention which maintain the effects of the old forms; one turns to subterfuge or strained interpretation. Thus, the dynamic, productive world economy—particularly that major portion of it in the private-ownership industrial countries—is governed unpredictably by groups who differ over trade intervention theories. The confrontations become frankly protectionist.

A MECHANISM FOR REACHING UNDERSTANDING: ELIMINATE UNNEEDED INTERVENTION AND COORDINATE THE REST

Meanwhile, the second tendency noted—the growing tendency to reach understanding about intervention—has frequently succeeded in limiting intervention to that which serves necessary ends and in reducing its adverse effects; moreover, the effort to understand one another's acts provides a basis for meaningful trade conversation with countries which will not accept the reduction of government intervention as an ideal objective. The proposals may be characterized as a shift of emphasis in U.S. foreign trade policy toward this process of seeking understanding. The five principles may be crudely summarized as follows:

1. Governments should collaborate in administering their trade barriers.
2. Collaborating governments require a means for distinguishing trade barriers which serve the public interest from those which do not.
3. Barriers which do not serve the public interest should be scheduled for elimination.
4. The public purpose behind a given trade barrier should be served in the most efficient way and with the least harmful side effects.
5. The conduct of foreign trade policy—in its details—should be open to informed public surveillance.

The essence of the proposed mechanism is:

(a) A continuing (rather than sporadic) multilateral trade barrier forum, for discussion of the trade effects of specific government actions, including actions taken to meet the domestic problems of individual nations;

(b) All procedures of the organization to be public rather than behind closed doors, with machinery for getting all relevant facts meaningfully considered;

(c) Individual governments to publicly reconsider their actions, through their own constitutional processes, in the light of the public purpose of the action and of the findings of fact at the multilateral examination; and

(d) Individual governments to consider cooperating to help in the achievement, most efficiently and with minimum adverse side effects, of the public purposes of actions examined intergovernmentally and maintained after public national reconsideration.

A SHIFT OF HYPOTHESES FROM BARGAINING TO DELIBERATING

Adoption of such a program calls for a shift of emphasis in the official view as to the actions which will accomplish our objectives in the foreign trade field. Since the end of the great depression, we have been committed to the hypothesis that "trade barriers" prevent desirable economic activity and cause conflict with foreign governments; therefore, reducing them makes for prosperity and peace; eventually, they should be eliminated (free trade). One reduces them progressively by bargaining between governments.

Underneath this hypothesis, however, there has developed a tacit, qualifying counterhypothesis: Certain "barriers"—old and new—ours and other countries'—are exceptions to the rule; they are necessary to maintain or bring about desirable national economic objectives; reducing them would be disruptive or otherwise undesirable; but the government imposing them cannot refuse to discuss them with other governments adversely affected by them; these "barriers" must be administered so as to hurt one's trading partners no more than is essential to accomplishment of the public purpose for which they are needed. The proposal in this paper involves recognition of the existence of these exceptions and adoption of a method for including them in intergovernmental deliberation.

Argument

Many barriers are responsible government actions even though they hurt trade.

U.S. foreign trade legislation and policy should contemplate continuing active collaboration with other governments in dealing with mutual trade. *This basic principle* is imposed by growing economic interdependence. It is not enough to seek agreement on the reciprocal reduction (or even elimination) of trade barriers—and let market forces do the rest. The very word, trade barrier, hides some of the problem. It is "loaded" with laissez-faire assumptions regarding the domestic economies of nations. A barrier may, as the word suggests, be an obstacle imposed at the nation's border to prevent desirable foreign competition, but it may be a byproduct of the fact that a government is involved in supporting its agriculture, rebuilding a depressed area, defending its currency, checking an antisocial business activity, or acting toward some other phase of its national economy in a way that affects trade—and, therefore, other countries' interests. And other countries may similarly maintain trade barriers that reflect their involvement in their own economies. The effect of these various actions on foreign trade varies considerably with changes in the domestic problems to which they are principally directed. It is not useful to attack these measures as "barriers" to be "reduced" by reciprocal bargaining. They are responsible government actions; their trade impacts must be coordinated on the basis of mutual understanding.

MUCH U.S. LEGISLATION PROVIDES FOR INTERGOVERNMENTAL COLLABORATION—BUT THE TEA THRUST IS TO LET MARKET FORCES DETERMINE TRADE

Some U.S. legislation relevant to foreign trade provides for coordination of action with other governments. Some awareness of the need for such coordination can even be read into parts of the Trade Expansion Act of 1962 (TEA), although the thrust of that act is to get rid of government action affecting trade on the hypothesis that this will cause U.S. exports to expand and will thus stimulate the U. S. economy. The Congress was, of course, aware that much intergovernmental coordination of trade intervention was already going on in the trade program and in other programs affecting trade. The language of the act is broad enough not to prevent such coordination and, in fact, multilateral agreement is specifically contemplated in some cases. Other legislation, designed for particularly difficult trade problems, contemplates even more specifically that there is to be policy coordination. Thus, the legislation authorizing participation in certain international commodity agreements provides for continuous coordination—with international councils and secretariats to institutionalize it. The famous Public Law 480, for providing surplus food to less developed countries on special terms, contemplates various steps for coordination of policy both with the recipient countries and with other countries exporting the kinds of commodities involved. Section 204 of the Agricultural Act of 1956 contemplates that the export controls and import controls of foreign countries and the United States, respectively, shall be coordinated to carry out an intergovernmental agreement; the present long-term cotton textile arrangement was concluded under this authority as amended. But when it comes to basic trade policy as such, legislation and announced program alike largely ignore the need for collaboration. They look the other way. They count on the freeing of world market forces to achieve U.S. trade objectives.

THE UNGOVERNED MARKET PLACE CANNOT DO ALL OF THE JOB

But the free flow of trade among national economies can do only part of the job. Alone, it is not adequate, in the modern industrial world, for pursuing even the economic objective of maximizing the community's total income by allocating productive resources to the most efficient use. There would also have to be enough free competition within the several national economies to bring about a strong tendency toward general economic equibrium. Such equilibrating domestic competition is part of the model from which economists reasoned out the neoclassical theory of international trade, including the doctrine of comparative advantage which is so frequently mentioned as a guide in the conduct of United States trade policy. The theory has advanced greatly in sophistication over the years, but the main policy conclusions drawn from it have not yet been demonstrated to be valid except for a relatively simple, static model where competition free of government intervention does the economic determining within the individual countries.

The theory conveyed highly relevant and practical insight for members of the vigorous, competitive commercial-financial community of early 19th-century England with its small, technologically relatively simple industries, its mercantilist-protectionist foreign trade barriers, and its unchallenged economic nationalism. The theory again gave valuable insight for the industrial world in the throwback of the inter-war depression with disintegration of internal economic organization and suicidal, isolationist trade intervention by every government. At that time, the genius of the trade agreements program—for the reciprocal reduction of trade barriers—lay in its blending of this theory-of-international-trade approach with an international peace objective. As a result, many leaders of opinion came to associate the freeing of trade with emergence from the traumatic experience of the depression; this association, taken together with the traditional success of free trade during the rise of Victorian England to wealth and power, has surrounded free-trade theory with an aura of proven validity and even, for some, of moral imperative.

Meanwhile, the economic world has changed and the theory has become archaic. The model whose main elements were selected for relevance to the intuitively perceived need of early 19th-century England yields many conclusions and insights that are irrelevant and backward looking in today's industrial world.

An Integrating Production Process

WITHIN EACH COUNTRY THERE IS A DYNAMIC COMPETITIVE PROCESS—A MIXED ECONOMY—IN WHICH INTERVENTION IS A NECESSARY PART

Competition within a modern industrial country, while a driving force, does not do all aspects of the job it is traditionally supposed to; it is not relied on as a general equilibrating mechanism for the national economy as a whole. It is supplemented by direct government action in many sectors of the market economy such as those determining farm prices, oligopoly prices, investment, savings and wages. The theory of international trade has not found a way to live with this fact.

However, effective competition persists in the form that John Maurice Clark describes as a dynamic process. Something like it prevails within most of the private-ownership industrial countries. It may perhaps be thought of as the economic aspect of the way of living together being evolved through the centuries by our expanding society. There is freedom for initiative and innovation. There is a tendency to try to better, or to join, one's competitors. Individuals operating in groups often have an advantage, and most advances in technology seem to increase this advantage and to make the optimum group size larger. However, limits are imposed on excessive economic power-seeking in conformity with basic social and moral concepts—e.g., business methods must be socially acceptable, they must not unduly restrict community progress and the benefit pattern must not outrage egalitarian ideals. As necessary, government intervenes in response to political pressures—some (often secret) from special interests—some from informed public opinion.

The economic process comes to be carried on by a dynamic combination of heterogeneous units—individuals, firms, associations, combinations, public corporations, labor unions, community action groups, clubs, societies, and all the complex and conflicting units of government. All of these, in a sense, compete for the custom and support of the paying and voting public. Any of them may influence the market or check and balance the influence of the others. The sum of all this—and more—is the dynamic mixed economy.[1]

It has been a dramatically successful combination thus far. However, eternal vigilance seems necessary to keep it in dynamic balance. It must grow and change to meet its challenges. Not the least difficult of those challenges come from economic relations among the different mixed-economy countries.

THESE COUNTRIES ARE INTERDEPENDENT PARTS OF A WORLD ECONOMIC MECHANISM

The major economic forces in these dynamically growing national mixed economies are not prevented by trade barriers from crossing

[1] This is not to detract from the significance of the frequent contention in trade discussions that the United States is a great "free-trade area" and that this has been part of the secret of its economic growth. However, a free-trade area means an area throughout which there are no arbitrary geographic lines across which the movement of goods is obstructed. The term may also carry other implications, e.g., that the governance of the entire area is to some degree centralized and that there is a common currency. However, it can not meaningfully imply the assumption that there is no government interference with the operation of market forces on trade within the area.

national boundaries (although their interplay is affected and the growth of the world economy may be slowed). Not only is there a good deal of trade but also a movement of production methods, distribution systems, skills, capital, and all of the things and ideas that each economy develops to enrich the consumption pattern of its people. The various national economies, particularly in the industrial countries, have become inextricably intertwined; they are parts of a single, production-consumption process. One national part of the whole cannot be governed without regard to what is done in governing the other national parts. Moreover, the mechanism is growing dynamically, so that a national gain contrived by the government of one of the countries at the expense of others tends to be short lived; the adverse repercussions on the overall growth can more than wipe out the gains.

In this mechanism, what we call international trade is not a natural component entity. It is an arbitrary aggregate. The figures for total exports and imports represent a sort of partial "clearinghouse record" with significance only for national payments accounts; beyond that, they suffer from all of the whimsy and heterogeneity that characterize any system of accounts drawn on an arbitrary basis of ownership or location. Focusing of attention on them can become a distraction that inhibits rational analysis and policy. The dimensions of trade are not established primarily at the national boundaries where trade is perceived. They are established within worldwide product economies—wheat, steel, chemicals, etc.—and their worldwide subeconomies, whose interrelationships are determined in the complicated arrangements of the mixed economy. Therefore, to understand the effects of government action, one must examine the whole product economy of which a trade flow is a part. Where intervention is required, it cannot be carried out efficiently by one government without the cooperation of others having jurisdiction over related parts of the product economy.

This last point epitomizes the interdependence problem as it is often seen in practice from the perspective of our present U.S. foreign trade posture. If our Government actions affecting foreign trade are to achieve their public purposes, other governments must be persuaded to reinforce, and not counter, them. If we are to raise our domestic cotton prices, holding down the level of our production in an effort to give our farmers acceptable incomes (when technological ferment would otherwise impoverish them in the free market), other governments must also limit cotton production and certainly must not encourage its expansion. If we set certain health or quality standards for a perishable product, other governments must not let lower grade products spoil the market. If we give surplus wheat to an exchange-short government for its poor people, that government must not let the wheat be used in place of our normal commercial exports. If we raise tariffs against imports or subsidize our exports to compensate for costs we consider special to us, foreign governments must not pay subsidies to offset our action. If we limit the rate of expansion of a certain import trade in order to avoid market disruption, foreign governments must help by limiting their exports. How are we to persuade them to cooperate adequately in these efforts, inconsistent with our declared trade policy, to use the power of government to serve our idea of the public interest?

ELEMENTS OF A WORLD MIXED-ECONOMY STRUCTURE ARE IMPROVISED TO MEET THE NEEDS OF THE MECHANISM

But there is another way of looking at it—a larger one—which can serve as a better intuitive guide in serving our national purposes. The growth and integration of the world's production mechanism is making an economic community of its beneficiaries. They have a common interest in the dynamic operation of the world mechanism, whatever their country.

Now, as has been pointed out, the social-political structure evolved for operating such a production mechanism within an industrial country is the mixed economy; it is an underlying free market system constrained by a variety of individual and organizational forms of "intervention," of which government action is probably the most important component, to operate within the bounds of the public interest of the national community. A modern production system, when associated with this kind of a social-political structure, comes to give to a greater and greater proportion of the people of the community substantial economic benefit in the form of increased income and welfare; moreover, the more the system extends benefits to new groups of participants, the more it increases those of the old.

A comparable structure is needed for the evolving world industrial community; there, too, such a mixed economy offers promise of transcending national bickering and beggaring over undesirable alternatives. It should express in action the essential unity of economic interest among the different countries just as the mixed-economy structure within a country reflects in action the essential unity of interest of labor and management, farm and city, rich and poor.[2]

The need for such a structure is slowly, unevenly, but increasingly being met. Not only is cooperation developing among firms such as shipowners, traders, and underwriters, whose operations are naturally international, but more and more originally domestic firms are extending their operations over a number of countries. Ties and affiliations are being developed among labor unions, trade associations, chambers of commerce, and all sorts of groups whose roles in the national economies must be played in the larger economic community too.

In a world of sovereign democratic nation-states, however, operating across national boundaries creates difficulty beyond the obvious technical and physical problems There is public distrust of the untried, the unfamiliar, the foreign. Many individuals and groups oppose a wider area of both competition and cooperation. They may fear it will imperil the balance achieved, not without difficulty, on the more limited national scale—the balance which made possible the dynamic national mixed economy. There is more than the usual difficulty of reaching agreement as to where national interest lies.

The difficulty is greatest where cooperation among governments is concerned. Their electorates are accustomed to look to them more for national unity in an emergency than for steps toward the human unity essential for economic peace and survival. Yet, governments must improvise at least quasi-world measures to meet pressing world trade problems if they are not to stand marked as failures. They must analyze the substance behind the conflicting drives for their intervention,

[2] For the insights out of which this and related paragraphs were written, a particular debt is due to Prof. Gunnar Myrdal. (See especially his "Beyond the Welfare State," Yale University Press, 1960.)

distinguishing and acting upon only the necessary cases. They must see and make prevail the point that the national interest is sometimes the world interest rather than the local interest, or they will frequently cut off bits of the national nose to spite some foreign face.

INTERGOVERNMENTAL COORDINATION

EXTENSIVE EFFORTS AT GOVERNMENT ECONOMIC COLLABORATION

Governments are responding to the imperatives of this situation surprising well. Intergovernmental collaboration is being found, or at least sought actively, in a number of fields affecting trade.[3] There is, of course, the general world forum for economic discussion—the Economic and Social Council of the United Nations. But there are also many specific arrangements, some of them providing quite active trade-influencing collaboration.

Some of the more dramatic examples are:

(*a*) The International Monetary Fund's efforts to remedy the inadequacies of the means of payment available to finance international trade;

(*b*) The OECD Economic Policy Committee's discussions of the maintenance of the levels of economic activity and employment on which expanded international trade depends;

(*c*) The FAO (and the world food program) efforts to bring together those unhappy twin offspring of the technological revolution—surplus in the rich countries and underconsumption in the poor;

(*d*) The International Wheat Council's and other agricultural and mineral commodity bodies' efforts to achieve adequate supply to importers at prices fair to exporters;

(*e*) The UNCTAD efforts toward trade and financial cooperation to speed economic development in the poorer countries;

(*f*) The International Labor Organization's efforts to prevent labor exploitation as a basis of trade; and

(*g*) The GATT procedures dealing with intergovernmental trade problems.

Although governments have no fully agreed rationale in the matter, most significant government actions affecting trade are discussed intergovernmentally; a few are discontinued; many are agreed to (sometimes tacitly) in modified form; some are maintained by concerted action.

OTHER COORDINATION DEVELOPING; MUCH LONG ESTABLISHED IN LESS DRAMATIC FIELDS

In addition to established arrangements for active multilateral intergovernmental collaboration affecting trade, there are a number of areas where less formal consultation takes place. Examples are transportation rates and subsidies and international corporations and business combinations. Mention should also be made of the many fields in which coordination has long proceeded without much public debate.

[3] It will be noted, however—and this reflects the conceptual problem in the foreign trade policy field—that most of them either are fields generally considered not to be part of trade policy or are thought of as requiring action only temporarily and exceptionally, until foreign trade policy shall have succeeded sufficiently in its goal of discontinuing government actions affecting foreign trade.

Thus, there are health and sanitary regulations (which sometimes burst out in controversy when abuse is suspected but, for the most part, go forward from day to day without difficulty), standardization of technical specifications or qualities, overlapping taxation, patent regulations, postal service, telecommunications, insurance rates, traffic laws, etc. There is a continual exchange of information and visits by officials concerned with hundreds of fields of government activity which can affect trade. Intergovernmental consultation and coordination is a pervasive fact in international trade.

A NUMBER OF IDEAL OBJECTIVES ARE SERVED BY SUCH COORDINATION

Thus far, the argument that U.S. foreign trade policy must contemplate some continuing coordination of intervention in trade relations among national mixed economies has been made largely on the basis of the traditional economic ideal objective of maximum efficiency—production of the greatest possible income from available resources. It is evident, however, that intergovernmental coordination of trade intervention is also necessary (and undertaken) to serve other ideal objectives significant in prevailing U.S. opinion and relevant for trade policy. Some of these objectives are even more important than maximum production. Thus, under usual circumstances in our affluent society, minimizing intergovernmental economic conflict and maximizing individual freedom in trading are both probably held to be of greater importance in foreign trade policy decisions than is maximum production. In addition, a good deal of importance as an ideal objective is given to the maintenance of economic growth and full employment—and even to providing a certain minimum of basic food for people (including foreigners) who are in absolute want. None of these objectives, nor an acceptable balance among them, can be properly served by the Government of the United States acting alone within its area of jurisdiction. All of them require intergovernmental coordination and, as necessary, collaboration.

BUT FOREIGN TRADE THEORY AND POLICY HAVE BEEN HOSTILE TO COORDINATION

Yet when discussion turns to foreign trade as such, U.S. policy statements tend to revert to the old language, "disencumber trade from government barriers," which stems from the archaic model of separate, laissez-faire national economies whose governments prevent trade and do not talk to one another on economic matters. To the extent that Cordell Hull's emphasis on the peace objective is considered, it is indirect or negative—the maintenance of peace by not letting the governments deal with the contested trade questions. In the resultant confusion, the officials focusing on the trade program are often pitted against those working on some of the coordination programs mentioned above. By a mysterious process that at times seems compounded more of faith and fear than of reasoning from facts, the trade officials take the general position that freeing trade tends toward that efficient distribution of resources dictated by the doctrine of comparative advantage and that, therefore, acts of government affecting trade result ipso facto in a decrease in national income. In that ideology, there is little logical basis for selecting among different government acts. At various times over the past 30 years, the writer has seen this thesis used to oppose intergovernmental action directed to such varied purposes (with such varied merit) as maintaining surplus farm product prices above "natural" world market levels, regulating primary commodity trade, rehabilitating the European economies after the war, preventing the wealthy classes in less developed countries from importing luxuries, transferring food surpluses to hungry people, limiting the rapidity of trade increases under especially disrupting circumstances, and many others. From this trade freeing point of view, the conflict among acts of intervention by different countries is sometimes thought of as one of the weapons for use in getting rid of the intervention; coordination is opposed because it tends to continue the intervention by making it intergovernmentally acceptable.

In any case, since all intervention is considered bad intervention "theoretically," there is no underlying ethical or moral or public policy basis except expediency—measuring the power of the persons and interests exerting political pressure—for deciding which intervention to tolerate. The fragmented and sometimes internally inconsistent pattern of current intergovernmental steps (some firm, some faltering) to impose a representative surveillance on the emerging industrial world production mechanism is considered a generally unfortunate drift with the stream of history. As a result, if the various trade affecting elements in U.S. policy at times add up to a coherent expression of public purpose, it is more a matter of administrative genius than the result of an announced overall policy.[4]

Telling Good Barriers From Bad

TO BECOME PART OF A COHERENT FOREIGN ECONOMIC POLICY, TRADE POLICY MUST DISTINGUISH INTERVENTION THAT MUST BE MAINTAINED IN THE PUBLIC INTEREST FROM INTERVENTION REQUIRING REDUCTION

Here then is another key to change, *a second major principle.* For U.S. foreign trade policy to contemplate collaboration with other governments in needed actions which affect trade, it must also contemplate a method of distinguishing, other than by naked power or static economic theory, between desirable trade intervention and undesirable trade intervention. We have seen that the process of dynamic competition in a modern nation requires some government intervention in economic matters to assure service of the public interest. We have seen that the economy of the industrial world is becoming a single production mechanism, so that intervention by one government must be coordinated with related intervention by other governments.

[4] There are doubtless other elements to explain the hostility of trade officials toward intergovernmental collaboration in actions affecting trade. One, for the United States at least, is the historical antigovernment attitude expressed in the famous line, "That government is best which governs least;" a basic distrust of government, with its inefficiency, lack of imagination, and proneness to corruption, becomes a supporting argument for laissez-faire even in cases where it may not serve social purposes. Another element may be the separation of powers; the laying of duties and regulating of commerce is a congressional power under the U.S. Constitution while the conduct of foreign relations is an executive one. The consequent cumbersomeness of our own Government may subtly slant our thinking away from the needed coordination of action with other governments. In this connection, it is interesting to watch the consequences of the development of even greater cumbersomeness of the same general kind in the new economic quasi-governing unit, the EEC, allegedly established to gain the internal advantages of a large free trade area such as the United States.

We have seen that this proposition is given de facto recognition in much of our foreign economic policy but that our foreign trade program and legislation are basically inconsistent with it; they treat all intervention affecting trade as being, in the last analysis, contrary to the public interest because it interferes with the results of competition in the marketplace. If we are to have a coherent foreign economic policy, this public posture must be changed. U.S. foreign trade policy must explicitly embrace the understanding that, in international as in domestic affairs, government does not abridge dynamic competition, but preserves it by making it socially acceptable, when it intervenes in the marketplace to the extent required by a public interest which would not otherwise be served adequately.

HOW TO DISTINGUISH INTERVENTION IN THE PUBLIC INTEREST FROM OTHER INTERVENTION

But how is one to determine in practice which trade intervention is in the public interest? *Within the national mixed economy*, government does this job with the aid of the complicated representative structure already mentioned. Individuals, firms and the other entities of the mixed economy carry on their economic functions and exercise their economic strength in the marketplace and, when they do not accept the resulting "arbitraments," express their objections and try to get government to help them or stop helping others against them. If government decides to intervene, its act becomes the expression of the public interest at that moment of decision. But the process is dynamic. Continual challenge and reconsideration are necessary to keep government action responsive to public interest as it changes with changes in the economic environment. This is the democratic process. *Extending it to the international level*—to serve the larger community created by the world industrial production mechanism—is, in a sense, our fundamental foreign trade policy problem.

ONE CANNOT DISTINGUISH BY CATEGORIES

An effort to preserve at least part of the automatic character of the intervention-withdrawal policy, by getting intergovernmental agreement on the acceptability or unacceptability of different categories of trade affecting action, has not worked. A government can bring about a particular trade effect through different categories of intervention. Such things as public purchase and sale, taxation, subsidy, tariffs, interest rates, government-controlled freight rates, patriotic exhortation, fiat, and the like, can often be used either alternatively or in combination with one another. This is widely recognized and is evidenced by the many kinds of government action complained of as trade damaging in GATT discussions; no government can contract and "pay" for the reduction of a particular trade barrier by another government unless it is assured against possible substitute actions by the barrier reducing government. In discussions of principle centered around the GATT, certain categories (e.g., quotas) have been censured at one time or another as being particularly difficult to discontinue when not needed (and, therefore, opposed to the public interest in trade barrier reduction); other categories (e.g., certain kinds of subsidies), have been branded as particularly susceptible of abuse on behalf of special interests. Still others (e.g., direct payments to producers) have been recommended as being easily susceptible of public surveillance. Most judgments as to the merits of alternative categories of action have been found to have numerous exceptions, and some of the judgments have been at least tacitly reversed. A more relevant kind of distinction among categories is based on adverse "side effects"—consequences not sought by the government acting. Thus, trade barriers incident to agricultural income supports are judged partly according to whether they discourage consumption by raising market prices. These and other similar considerations can be valuable in reaching intergovernmental agreement on the appropriate kind of intervention for a purpose considered necessary in the public interest, but they offer no guide to a satisfactory formula or automatic technique for deciding whether or not a given act of trade intervention is in the public interest. There probably is no such technique to be found. Extending the economic governing process internationally must be done by people who govern—not by rule and doctrine.

GROPING FOR CATEGORIES, GOVERNMENTS HAVE FOUND THE ELEMENTS OF A MECHANISM FOR DISTINGUISHING

However, whether or not the motive was escape, the effort to name good and bad categories made a very constructive contribution. It pioneered ways of working together toward agreement on specific trade affecting actions which had to be maintained. Thus, discussing whether particular quotas were bad per se led to discussion of their purpose, how small they had to be, and whether other measures might substitute for them eventually. From the traditional viewpoint of our announced trade barrier reduction policy, these actions are referred to as "exceptions" and are generally deplored. It is sometimes said that the GATT rules (meaning the formal rules of the GATT text into which we wrote our long-run free trade principles—and aspirations) have so many exceptions that they are practically meaningless. There shall be no quotas, except; export subsidies must be avoided, except; there shall be no preferences, except; etc. There are exceptions for the protectionist use of internal taxes and regulations, for discrimination in applying quotas, and for all sorts of other proscribed categories of action. Then there are certain general exceptions to all rules—a whole list of them in a separate GATT article. And then there is provision for waiving any obligation of the GATT "in *exceptional* circumstances not elsewhere provided for." It is true that almost all of the exceptions provisions have some temporary, self-terminating quality written into them; the idea was thus to force gradual change so that, in the end, there would be no need to use the exceptions. But, on the whole, it has not worked out that way. In fact, there is little protest nowadays when an official says, whether in disgust or in an effort to persuade, "You can do anything you want to under the GATT!" But, with equal validity (and perhaps more significance for the future) one can say the opposite—"You can't get away with anything important without its coming up in the GATT!" Most of the exceptions are made on condition that the governments acting under them report what they do and why. Moreover, there is a general requirement that governments shall consult with a government which challenges their actions as being against its trade interest. There are many such challenges and even more such reports. There is an almost continuous discussion of them, not only in the GATT but also in other intergovernmental forums.

THE PUBLIC INTEREST IS "DEFINED" BY CURRENT AGREEMENT AMONG GOVERNMENTS

In these discussions, what is sought is agreement—not adherence to rules. The GATT exemption (from any of its rules) for actions taken under an international commodity agreement openly arrived at has, in practice, been extended to any action which no substantially interested government complains of. Thus, agreement satisfies the rules even if it is no more than "negative" agreement—i.e., failure to object. Seeking agreement, or averting complaint, sets up a wide compass of discussion at many levels which prefigures the international extension of the mixed-economy process. Each government, in its actions affecting trade, finds itself forced to consider in some measure the public interest as it is seen by the governments of the other mixed economies involved; and all of the interested governments together are constrained to persuade one another in the perspective of the whole dynamic economic process—the "bigger pie." The result is a beginning of a mechanism for focusing the expression of world public interest in trade matters. It is proposed that such a mechanism now be consciously employed so that its functioning can be widely understood and continuously improved. It is proposed that the intergovernmental forums originally dedicated to the reduction of intervention be now rededicated to distinguishing between needed intervention and unneeded intervention.

Bargaining Favors Bad Barriers

INTERVENTION NOT NECESSARY IN THE PUBLIC INTEREST SHOULD BE SCHEDULED FOR ELIMINATION

Thus far in this paper, the argument for an agreed intergovernmental process to make the distinction between needed and unneeded intervention has been presented largely on the basis of the imperatives for trade intervention that (even when yielded to) are not formally accepted as part of our trade policy. We have seen that unilateral government responses to those imperatives must be coordinated if they are to accomplish their objectives. Let us now turn to the other side of the coin—intervention which is avoidable because it is not needed in the public interest. This includes the barriers most commonly in mind when discussing present trade policy. It is almost tautological at this point to state *as our third principle* that such barriers should be discontinued—i.e., not reduced but eliminated.[5] This can be accomplished more effectively through a nonadversary intergovernmental examination of the barriers than by bargaining.

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[5] It will be recognized that a reduced barrier—whether a very low tariff, a large quota under which licenses to import are granted freely to all applicants, or other measure modified so as to approach freedom of trade—is substantially more restrictive than no barrier at all. The administrative processes involved and the psychological situation faced by the trader are themselves barriers.

THE HISTORIC MERITS OF BARGAINING

Let us consider the merits and weaknesses of the trade bargaining technique—and where it is leading us.

Bargaining made possible great achievements. It was a natural bridge across which opinion in the great trading countries moved away from the concept of a tariff or other trade barrier as a domestic instrument for the expansion of the national economy or protection from unfair foreign competition toward the concept of a reciprocal interest in reducing barriers to trade. It institutionalized the lesson—so disastrously learned in the fruitless national efforts of these trading countries to protect themselves out of industrial depression—that a unilateral act affecting trade can be completely frustrated by a foreign counteract. It became the basis for the concept of the GATT as a contract, giving each participant a sense of the value of the GATT as an instrument for obtaining some degree of fair treatment of its export trade from other countries as a matter of right. The bargaining technique has been the strength of the GATT and has often frustrated efforts to "unravel" the GATT. Why, then, shift emphasis to a different process?

BARGAINING DOES NOT BRING THE PUBLIC INTEREST TO BEAR ON SPECIAL-INTEREST QUESTIONS

In answer, let us examine some of the weaknesses of the bargaining technique in present circumstances. The logic of the bargaining technique does not run to the public interest; therefore, bargaining is not very effective in reducing an unneeded trade barrier if there is vigorous protest from a domestic interest involved. The rationale of the bargaining program is that the barrier must be reduced for the good of a foreign country; the foreign government will, in return, reduce one or more of its barriers in order to try to help U.S. exporters. The bargaining format dramatizes a distorted and oversimplified conflict of interest: On the one side, domestic producers keenly conscious of current foreign competition; on the other, a loose alliance of foreign sellers, international traders, and domestic producers vaguely hopeful of expanding foreign markets.

Other considerations, the consumer interest, alternative profitable use of the domestic producing resources, expected market expansion to offset the alleged injury, the effect of the barrier on dynamic competition and growth in the national economy, even the facts proving the alleged danger from foreign competition tend to be neglected in the emotions generated in the bargaining conflict. In the moment of negotiation decision, a government will rarely decide to risk injuring the going concern, however undesirably protected. Due deliberation of the general national public interest in the matter, not to mention the world public interest, is hardly to be expected.

THE BARGAINING TECHNIQUE IS SUFFERING FROM AGE: RIGIDITIES OF BARRIER MEASUREMENT, ACCOMPLISHMENT OF PART OF PURPOSE, AND RESIGNATION TO FAILURE FOR THE REST

This does not leave much for the bargaining technique to achieve. Current imperatives transfer most needed intervention from the bargaining process to intergovernmental discussion. Much unneeded intervention is able to resist the process; that which cannot resist is usually of lesser trade importance. In this situation, the technique is beginning to show the weaknesses of age.

One weakness showing up in the bargaining process is a loss of flexibility. Many of the ploys, developed by negotiators trying to persuade or otherwise overcome their opposite numbers from other governments, have become formalized over the years and thereby given the status of limiting concepts and even principles. Thus, the idea of reciprocity in negotiations was originally a general one. In the first GATT negotiations in 1947, each country was to lower all of the obstructions to each other country's trade that it could, using as a guide regarding nontariff barriers the rules of good trade conduct in what then became the general provisions of the GATT. Our negotiating arguments ran primarily to whether all participants had satisfied that requirement on a reciprocal basis—had shown fairness to one another in judging what they could and could not do. To that end, the probable effects of individual concessions were debated in as realistic a way as possible. However, in the efforts at persuasion, there came to be brought in various aggregative measures by which to compare tariff concessions: The average percentage reduction of tariffs offered, the amounts of trade in a base year covered by the offers, the weighted average percentages of reduction, and so forth. Eventually there developed a sort of pseudomathematical game in which reciprocity came to mean a balance between figures representing the offers made by the two countries in a negotiation; much negotiating effort went into disputes as to which figures were meaningful; the arguments became public and there was resort to new terms (écrêtement, disparity, etc.) with abstruse statistical meanings but little if any known meaning in terms of the probable effects of concessions. These developments tended to limit the effectiveness of the bargaining technique in reducing barriers, since the negotiators with most to offer had to hold some of it back in order to report that they had obtained "reciprocity."

Another weakness, to which tariff bargaining, as opposed to negotiation of nontariff trade barriers, is particularly vulnerable, is loss of power. We have seen that the process was strongest during the prosperous postwar years when the excesses of the war and depression could be bargained away. Now, however, the tariffs that we are able to lower have been taken down to relatively low levels. When the Kennedy Round reductions take effect, most of these tariffs will have been reduced by a total of over 85 percent.

A third weakness arises from the practice of evasion. As tariffs became more or less frozen by the bargains made under the program, Government concern with foreign competition led to a search for other methods of trade control, some of which were more effective than tariffs. These nontariff barriers, of ever-increasing variety, are difficult to treat in a bargaining process directed to firm agreement to reduce specified trade barriers. They are often directed to some domestic intervention purpose with which they vary, regardless of the effect on trade. Agreements to reduce them or bind them, though they can be formulated and sometimes are made, tend to become unstuck.

A final weakness in this list is the tendency to be resigned to permanent compromise on the objective of getting rid of trade barriers entirely. Perhaps it is partly a result of the mathematical-balancing game. There comes to be a measure of agreement, as a byproduct of the bargaining process, that a certain level of tariff—perhaps about 5 percent—is "reasonable" and even desirable. A certain amount of "fairness" comes to be attributed to the increase of tariffs which are below that level.

THE ACROSS-THE-BOARD APPROACH CALLED ATTENTION TO THE PROBLEM BUT DID LITTLE TOWARD REMEDYING IT

The "across-the-board" or "linear" approach was put forward by the U.S. Government in an effort to get around some of these weaknesses. It was apparently inspired, on the constructive side, by analogy with the European Common Market which was planning to eliminate, or coordinate, all of its internal trade barriers—reducing tariffs to zero by a series of across-the-board percentage cuts and "harmonizing" other actions affecting trade. This dramatized for the public the weaknesses we have been discussing. But for those who saw the need of specific types of intervention, whether for the public interest or for themselves, it created a strong desire to keep those specific "barriers" from the negotiating process. It gradually became evident that the across-the-board approach was not applicable among governments not otherwise integrating their economic governance. The public—not to mention the negotiators—had difficulty understanding what across-the-board could mean for quotas, price supports and various other nontariff trade barriers.

It is reported that the approach resulted in much deeper and more extensive tariff reductions in the Kennedy Round than would otherwise have obtained because there was a presumption for reduction of each tariff.

However, even for tariff barriers, the use of the bargaining technique as the vehicle of negotiation meant that, after across-the-board offers and their exceptions, adjustments had to be made so that the final bargains were reciprocally equitable. The principal virtue of across the board was then gone.

THE BARGAINING FORMAT IS PROTECTIONIST

The bargaining format, in its basic concept and operation, is economic nationalist and protectionist—that is, barrier raising. Bargaining governments, in order to sell reduction of their trade barriers dearly, must argue that all of them are in their own national public interest and are harmful to foreign countries. Thus public support is enlisted—as, in the United States, for "shrewd Yankee trading" by the negotiators. There is little said of barrier reduction to benefit all countries. The harm being done to one's exports by foreign countries is bitterly exaggerated. To the extent that the merits are discussed, everything possible is done to emphasize the static, short-term validity of the protectionist case. Buying from foreigners is treated as a substitute for producing at home. Trade barriers are thought to "beggar thy neighbor"—thus increasing national product.

The original concept of a high-trade area to be created through reducing barriers reciprocally has been transformed by the bargaining process into one where each government tries to use its bargaining power to beggar without being beggared.

The bargaining process has come to embody the worst of both worlds. It is negative toward the idea that a particular trade intervention might be necessary in order that the market process may best serve the public interest, but it accepts with little question the necessity for increasing a particular barrier (regardless of the domestic public interest) in order to hurt a foreign country which will not reduce one of its barriers to which we object. If the Kennedy Round had difficult going from time to time, criticism of supposedly wrong action by this or that government or official usually missed the point. The whole public posture of the negotiations was one of protectionism.

GOVERNMENTS REMAIN "POISED" TO REINTERVENE

It is not surprising, therefore, that one result of the bargaining process is a good deal of direct discouragement of trade expansion. There is a public fear that reducing a barrier will hurt. Thus, the escape clause of U.S. legislation and article XIX of the GATT provide for restoring a barrier if it results in increased imports which hurt. The great new adjustment assistance approach has not yet altered this basic problem. The government is considered responsible for increases in foreign competition caused by technological or other change. Governments seem to remain poised to pounce with additional restrictions of one sort or another whenever a trade item shows signs of expanding substantially. This not only keeps down expansion in items regularly traded but also discourages the expansion of trade where special effort is required—as for products of relatively small producers without elaborate marketing organizations and not able to afford campaigns to open foreign markets. Trade under a reduced barrier is thus not freer at all. It may be less costly, but the barrier to expansion usually remains. In fact, in the discussion of injury from trade-barrier concessions, it is almost as though governments felt that the reduction of a duty was in itself the concession and that the expansion of the trade was something of an abuse.

IN THE TRADE EXPANSION ACT, CONGRESS CONTEMPLATED ELIMINATION OF SOME TARIFFS

All in all, therefore, the bargaining technique is a poor instrument for further progress toward eliminating unnecessary trade barriers. To use it for barriers other than tariffs, meanings must be so twisted that the process comes into public ideological conflict with itself. If, as here proposed, there were a shift to the technique of identifying barriers (or portions of barriers) which were not needed in the public interest and then eliminating them—not as a matter of bargaining away imagined advantages but through jointly and publicly applying criteria, rules, and principles to get rid of what is disadvantageous, it is to be anticipated that the adversary attitudes of the protectionist bargaining process might recede and there would be set up an attitude tolerant of dynamic competition and trade expansion.

It seems significant that, in the Trade Expansion Act of 1962, the Congress expressed its intention to proceed toward the elimination of a number of tariffs—those on manufactured products where there is little competition from low-wage areas, those already below the 5 percent level, and a few less important classes. As it has worked out, the only one with some potential importance is section 202 permitting complete elimination of any tariff which is now assessed at a level less than 5 percent of the value of the imports. The provision (section 211) for eliminating duties on industrial-country manufactured products was largely tied to United Kingdom admission to the European Economic Community (which has not come about) so that it had little applicability in the Kennedy Round. Some members of Congress wanted to remove the tie to the EEC, but the Government showed an interest in its retention. The provisions (sections 212 and 213) for eliminating the duties on certain agricultural and forestry commodities, also tied to United Kingdom–EEC merger, are written in such guarded terms that they apply to only a small and unimportant amount of trade. The congressional intention in these various provisions was presumably to offer advantages to foreign countries in order to obtain reciprocal advantages in the bargaining; but the nature of the selection of items is such as to indicate that there was also the purpose of eliminating (instead of reducing) those tariffs which, for one reason or another, are no longer considered entirely necessary for our own purposes.

FRUSTRATION OF THAT INTENTION SHOULD NOT BE BLAMED ON THE EEC

There is a widespread current view that the tariff-eliminating purpose of the legislation was largely frustrated by the failure of the EEC to take in the EFTA countries, particularly the United Kingdom. That view is difficult to justify. It overlooks the formidable opposition to such elimination in the European countries. One could argue the opposite: That the inclusion of the United Kingdom in the EEC would have increased the value of external protection as an aid in integrating the enlarged economic community. Even with only six countries to integrate, it was not possible for us to get enough concessions to use the 50 percent reduction authority for many of these industries. With more countries, could we have used 100 percent at this time?

Sector discussions running to the nonbargaining question of what intervention is needed, and in what form, for the major industrial sectors of the world economy, could contribute greatly to negotiations. It is through the achievement of understanding on such broad, industry-wide public questions that an intention to eliminate unneeded tariffs could be carried out to the maximum.

WHERE INTERVENTION IS AGREED TO BE NEEDED, MEET THE NEED IN THE MOST EFFICIENT WAY

This leads to *the fourth and, in a limited sense, completing principle* for future U.S. foreign trade policy (and legislative authority). Where trade intervention exists (or is sought) to accomplish a purpose agreed to be in the public interest, the intergovernmental effort should be directed to accomplishing that purpose most efficiently and with a minimum of harm to other countries. We have noted the interchangeability of many trade-affecting actions. Therefore, there is room for intergovernmental discussion of the incidental trade consequences of alternative actions which would accomplish a given purpose. We have seen that the determinants of a given trade flow lie in the worldwide product economy of which it is a part. Therefore, an overview of that product economy must be part of the information available to governments if they are to find the most effective and least disturbing way of accomplishing a purpose involving that trade.

An International Trade-Policy Mechanism

THE BASIC PRESCRIPTION (ELIMINATE BARRIERS OR COORDINATE THEM) WOULD FACILITATE CONSISTENCY THROUGHOUT FOREIGN ECONOMIC POLICY

Since the proposed trade policy approach does not extend the traditional free-trade prescription to cases where it is in the public interest to bear the cost of giving help to particular producers, it can "ride tandem" relatively comfortably with many policy areas which have come into some conflict with the present program. Since these areas are being dealt with in other papers prepared for the committee, I will not elaborate except to note that, in the 30 years we have come through under the trade agreements program, we have at various times seen the trade-freeing objective of the program publicly held to be inconsistent with progress toward domestic recovery, agricultural support, European recovery and rehabilitation, aid to economic development, monetary stability, and other national objectives. A way through these apparent dilemmas was improvised through pragmatic intergovernmental cooperation. The proposal in this paper derives its inspiration from that experience.

A WAY TO START

How could the proposed approach be launched? There are many ways. The initiative would not have to be American. Since the proposal is essentially to base future intergovernmental trade cooperation (especially among the industrial countries) on recognition of the common interest in the growth and expansion of the international industrial economy, it might be put forward officially by any interested government or by one or more of such international secretariats as the GATT, the UNCTAD and the UN. And there are doubtless many kinds of programs that would launch the approach suitably. It could be put forward as the subject of a new general conference or as a rationale for continuing the gradual shifting of stance and modification of procedures in existing intergovernmental oganizations. There could be emphasis either on the new-approach aspect, on the consolidation of experience, on a combination or on some specialized application. But in any case, something like the proposed approach must eventually pervade intergovernmental discussions if the industrial powers are to live together in peace.[6]

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[6] This sort of approach is necessary, also, if the less-developed countries are to be brought to a decent economic existence during the present era. They should be parties to the entire process.

SUMMARY: AN INTERGOVERNMENTAL FORUM ON THE EFFECTS OF TRADE-AFFECTING ACTIONS

One approach, then, would be for governments to join in recognizing first, that no one government can realize its full national economic potential except through the maximum growth of the international economy as a whole. Secondly, they would note that technological progress—achieved or in early prospect—makes it physically possible, given the will, to develop the world's productive resources so as to provide a decent level of living for every human being. The participating governments would state, therefore, that this minimum production objective can be realized if there is such specialization of production and expansion of trade as would result from permitting the several national economic processes to function as integral parts of a dynamic international competitive process in which all individuals can benefit and contribute. Governments would be committed to maintain (in an appropriate multilateral forum or forums) a continuing public conversation regarding such of one another's present (or proposed) actions affecting international trade as have (or would have) significant repercussions outside national jurisdictions.

Each government would be committed to limit its action to the level (and the duration) which it publicly declared to be necessary for the purpose of the action, and to carry out that action in the form which it publicly decided to be least disturbing (or most helpful) to the interests of other countries and to the international economic process. A government might seek cooperation from other interested governments in order to find or to carry out the particular mix of actions that would serve an accepted public purpose in the most efficient way with a minimum of undesirable side effects; and all governments would be committed to give public consideration to thus cooperating in an action affirmed after public reconsideration in an intergovernmental examination. Finally, governments would establish and maintain a special official structure, independent of the rest of the trade-policy and trade-program structure, the sole responsibility of which would be to assure that the facts and analyses for assessing the effects of trade-affecting actions were fully available and were brought to public attention in all the interested countries.

HOW TO SCHEDULE ACTIONS FOR EXAMINATION

There will be a question as to which actions to examine first and how a concerned government or individual can initiate consideration of an action. A part of the solution might be for governments to agree to put forward for early consideration the actions of other governments which seem to them to have particularly important adverse effects. But, a government-complaint procedure, while probably necessary, would not be sufficient. Supplementary ways of bringing actions forward for intergovernmental consideration might be (a) to make each government responsible for presenting a report and analysis of the economic effects of its own actions; (b) to give the principal officers of the special information structure, set up to see that all relevant facts and analyses are available, the right to suggest an action for consideration; or (c) to bring some of the particularly difficult commodity problems now being wrestled with in more limited groups such as international commodity study groups within the purview of the general forum and its public process.

In addition, it should probably be open to a government to put forward for consideration an action which it contemplates but has not yet taken; this technique might appeal in cases where foreign government cooperation was particularly valuable for insuring the success of the action.

RULES AND PROCEDURES

The intergovernmental conversation would deal primarily with the economic effects of a government action. It would cover all significant effects—domestic and foreign, direct and indirect, concentrated and diffused, immediate and longer term, costs and gains. It would run to specifics. As far as possible, it would be in quantitative terms—estimating or evaluating even when examining doctrinaire allegations of effect. How much does an action change prices, costs, profits, production, consumption? Who is affected adversely, who benefically, when, and to what degree? What is the effect on the growth of the world production process—on innovation—on adjustment to current changes in the economic environment? The format of discussion of these questions would not be one of bargaining between governments. It would be a search for facts on which to base judgments. Conflicts of interest would, of course, be involved; but a participant government would not be called on to take a position as between a national (say, producer) interest that might be helped by an action and another national (say, transportation or consumer) interest that might be injured. Each would be assessed separately; and the presentation of this combination of assessments—for all interests, wherever found, which are significantly affected by the action—would be the entire object of the examination. Disagreements would be reported—and quantified as far as possible; they would relate to facts, not to recommendations for action—although perhaps facts about alternative possible actions might be presented. In form, however, the process would not be of an adversary nature. Neither would it be reciprocal except in the sense that all countries would participate—permitting multilateral intergovernmental examination of their actions which affect trade—and each would join in the discussion of the effects of the actions of the other countries. The examination would involve no negotiating about the status or appropriateness of the different acts—merely a series of findings about the separate economic effects of each. The interrelationships would be brought out as revealed through the effects.

The examination would probably take on some of the constructive qualities of many current nonadversary intergovernmental economic discussions, e.g., the GATT consultations on balance-of-payment restrictions and development program implications, of some of the OECD "confrontations," and commodity study groups, and of many other current discussions. There would, however, be two main differences from most of these intergovernmental discussions, stemming from points of emphasis. In the *first* place, though deriving its *raison d'être* from trade, the examination would not be directly associated with a multilaterally accepted code of trade rules or principles of fair dealing in trade matters. The only really basic principle of the examination would be that governments (on behalf of their own nationals) accept responsibility for their actions, not only vis-a-vis one another but toward the economic objectives of the community of nation-states taken as a whole—toward realization of the abundance of which the world production process is capable. Discussion, therefore, would run exclusively to the complicated real effects of those actions. While such discussion inevitably would take into account the area of common understanding reflected in the rules and principles developed in the GATT, UNCTAD, FAO, UNECOSOC and other intergovernmental bodies, the whole program would be seriously disserved by an intergovernmental effort to agree on a new or consolidated code of rules for trade intervention before starting the examination of specific effects. The *second* difference of emphasis concerns scope. The examination would be held on the basis of a world perspective and yet it would go deeply into relevant facts. It would be accepted that one must look at all of the effects of a given action, both closely and broadly, to judge what purposes it in fact serves. Thus, it would be a new kind of discussion as far as formal definition is concerned, though something like it frequently takes place in fact (e.g., in GATT panels and FAO agricultural policy groups).

ITEM-BY-ITEM CONSIDERATION ESSENTIAL

It is evident that the intergovernmental consideration of trade barriers proposed in this paper would be carried out item-by-item; that is, one traded product at a time. That method of consideration has come under widespread public attack in the past 5 years. Therefore, it seems useful at this point to explain that the item-by-item approach is proposed not only because formula approaches fail but also because of its intrinsic usefulness. There is little merit in the often repeated contention that item-by-item procedures slowed earlier trade agreement negotiations and limited their success. This view apparently originated as a public position during the search for a quick, sweeping approach after the very long (although reasonably useful) Dillon Round of negotiations (1960-62). But the length and frustrations of the Dillon Round can be explained without blaming the item-by-item procedure of negotiation. In the first place, the United States had very little to offer (a 20 percent cut of tariffs that had twice before been subject to 50 percent cuts); and no offer was made at all on sensitive items where this slight cut might have caused imports to increase significantly. This rules out any dramatic success. In the second place, much time went into wrangling about the meaning of a theoretical EEC tariff which had never been in effect. Earlier negotiating rounds bargained almost exclusively from tariff rates in being. In the third place, the United States made it a condition of completion of the negotiations that some of the European countries abandon their traditional technique of supporting farm prices through variable import charges. The negotiations were held up over this as long as politically possible; the issue was then settled for a practically meaningless "standstill" undertaking on the main products involved. In spite of all this, the anti-item-by-item theory in 1962 became a major public posture in which officials have since felt themselves trapped.

This is particularly unfortunate because of the great value of item-by-item discussion in trade negotiations. In the three great negotiating rounds held at Geneva, Annecy and Torquay between 1947 and 1951, at which the weighted average level of *all* U.S. duties was reduced by over 50 percent, item-by-item discussions frequently served to hold the conferences together while governments were deadlocked over a few, unusually difficult concession items. On the other side, of course, one can argue that cutting all tariffs by the same percentage would prevent protectionist selectivity; theoretically, one can pursue a protectionist goal while lowering many duties and not raising any. Expressed from the interest-conflict point of view, getting rid of trade barriers dramatically *en bloc* would better focus the consumer interest and the exporter interest in reduced protection and would make it difficult for powerful producer interests to keep just those tariffs and other barriers which restrain their foreign competition at the expense of the general public. Experience suggests, however, that this interest balancing works out relatively poorly. It is usually the most powerful interests which find it easiest to have their protective barriers excepted from sweeping reductions. They can best persuade officials and the public of the logic of their particular cases for exception from a broad formula. Since no two trade barriers have quantitatively identical effects according to formula, it is only when all of the effects of government action in each specific competitive situation are considered, item by item, that the officials will understand and face the full implications of a decision. For the same reason, public surveillance of trade barrier reduction can be focused intelligently only when the specific effects of each barrier on costs, prices, production, profits, and the like are brought out in an open discussion process—item by item—as here proposed. And the need for item-by-item consideration is becoming even greater because general reduction formulas are applicable effectively only to tariffs and certain quotas—not to most other kinds of barriers; yet the latter are becoming very important. The dream of a policy which can wipe out most trade intervention in sweeping strokes is not geared to modern realities.

INSTITUTIONALIZED ACCEPTANCE OF RESPONSIBILITY IN THE TRADE FIELD

The proposed mechanism, therefore, would attack the problem by shifting trade policy emphasis to the responsibility governments assume in the specific instances when they choose to intervene—not necessarily the responsibility they intend to assume but that which, because of the real effects of their intervention, they cannot in the end evade. Under present U.S. foreign trade policy, as represented in legislation and program, emphasis is on the portion of the tariff or other barrier which it is proposed to get rid of. The portion maintained (and the present program calls for some substantial portion to be maintained in almost every case) is presumably left to unilateral manipulation without direct formal concern for the interests of other countries (and often, as these things work out in the United States at least, with rather less than enough concern for even the domestic general public interest —as opposed to that of some special interests). Yet it is the intervention maintained in force and effect which affects international trade.

Under the program here proposed, each specific act of trade intervention which a government maintains would be publicly declared to be carried out for a specified public purpose. In the consultation with other governments and the reconsideration, discussion would inevitably run to facts relevant to that purpose—how to define it in trade terms, what costs to other objectives must be incurred to satisfy it, what measures would cost least, etc. Many elements of such a process, including the development of criteria, working rules and a tradition of reasonableness, have already emerged in the GATT and in other forums.

With agreement to schedule the elimination of all intervention decided not to be in the net national public interest, the process would take on a new importance. There would be discussion of the magnitudes and duration of the damage to the protected interests and of the service to the public interest. The exchange of information on this and other relevant questions, properly conducted, would serve to narrow differences and even to stimulate action to alleviate unnecessary damage to one another's interests. The more specific the discussion, the greater the possibility of its having such effects. Agreement would rarely be complete, but areas of difference would fall within more and more reasonable "tolerance points." With time and public familiarity, the process should become increasingly effective in achieving a pattern of trade freedom, with acceptable and rational modification where desirable for the effectiveness of the world economy or other publicly decided purposes.

Where reconsideration by one country led to decisions conditional on actions by other countries, there would tend to emerge multilateral discussion going beyond the examination of effects and into policy arrangements—whether to withdraw intervention or to coordinate it. These discussions—essentially product discussions—would usually be carried on in separate forums or subforums—as has already happened for a number of primary products. But under the proposed mechanism, such discussions would have to be carried on consistently with, and responsively to, the course of discussion in the principal trade-intervention forum: They would have to be fully public and would have to consider and investigate full facts. Where, as in wheat and other grains, the decision of governments to intervene in ways affecting foreign trade is widespread and economically almost irrevocable, a continuing forum for intergovernmental program agreement will be required. However, not very many products will both be characterized by market inadequacy and be sufficiently basic to be handled in this way. For those which are so handled, there will never (or hardly ever) be sufficiently comprehensive agreement for these "commodity" forums to be complete or adequate—even within their own product economies, to say nothing of their interrelationships with other parts of the world economy. Therefore, even for such permanent intervention cases as wheat, much of the subject matter will be dealt with in the principal conversations, and this perspective might lead to modified positions in the commodity discussions.

LOCUS OF THE CONVERSATIONS

The question arises as to the "locus" of the proposed intergovernmental conversations in relation to the many organizations and arrangements for intergovernmental trade discussion already in existence. No effort is made in this paper to give a preferred answer to that question. But the proposed review and coordination would be closely related to a number of fields of foreign economic policy other than trade. It would affect the areas of jurisdiction of almost all intergovernmental economic organizations. The secretariats of a number of them would have an important interest in its success. It might be best to have them somehow operate jointly in servicing the proposed conversations. Finally, the proposal would be most constructive if participation were made universal in principle. Therefore, the forum would have to be such as to facilitate the inclusion of any interested country.

The actions whose effects were examined would be of all kinds. At one extreme might be a simple trade barrier with comparatively little to examine beyond the cost, to his compatriots and foreigners, of the support of an inefficient producer. At the other extreme might be an interrelated pattern of costly government subsidies and restrictions such as that designed to govern the world's grain supply and consumption. The institutional framework used should be such as to give the various related current intergovernmental conversations (which would presumably remain in the forums where they are now going on—except as the examination might develop reasons for changing them) significance in terms of representative surveillance of the growth of a dynamic world economy. In this way, the modification of action taken for interests narrowly conceived can be weighted toward the general interest, even though the narrow interests inevitably are the more acutely and urgently recognizable in the details of a particular examination.

RELATION TO PRESENT PROGRAM

The question of whether the proposed policy approach is desirable has often been obscured by the question of "how to get there from here"—and by doubt that it could be done. This is in part the mechanism aspect of the question, whether governments will reduce intervention if they are not given something in return. The GATT is a contract—the end product of a bargain. The threat of retaliation is the force which makes governments honor their GATT undertakings; the protectionist values and objectives in the bargaining concept dominate thinking. If agreement was reached on a new technique (discuss, reconsider and then either eliminate or coordinate) directed toward a new value objective (the public interest conceived as being not necessarily national in its extension but often, in economic matters, shared internationally), would not the GATT fall apart? Would not barriers rise? It must be evident that, if the rethinking of fundamentals that led to this proposal is correct, then questions of this type must be taken as mechanical problems to be worked out—not as arguments for abandoning the proposal.

On a more deliberate look in a wider perspective, however, they will be seen to reflect unjustified fears. The program here suggested as one way of carrying out the proposed policy approach should have a strengthening effect on the GATT. There would probably be no more "rounds" as such (for which fact alone there might be much quiet thanksgiving). However, discussions of trade intervention would not decrease. They would be continuous and much more public. The danger of "unraveling" the GATT might, therefore, be taken care of more effectively than it now is. Barriers would have to be justified publicly as good in their own right—not as bargaining power to use in dealing with opponents. And, indeed, the present concept of a reciprocal "balance" of concessions to be restored when a concession is impaired, has not been very successful in restraining new or increased trade intervention in recent years. Retaliation by "hurting" the impairing one has become commoner, the granting of equivalent new concessions less common. Even in the Trade Expansion Act negotiations, many countries settled down to sweat out reciprocal "suffering" and resigned themselves to the economic costs of this limited economic warfare in the vague hope that it would force their trading allies to agree to an advantageous "armistice" or trade treaty. Under the proposed approach, public intergovernmental trade discussion would not emphasize such adversary alternatives, whether or not there was a contravention of the GATT or some change in its bargained "balance." They would emphasize the economic pros and cons particular to each action.

The new examinations of the effects of trade intervention should probably not—as a formal matter—replace the GATT "bargain," the underlying obligations of which were the basis for the GATT's strength as an institution over the years of national efforts to avoid more thorough or formal coordination. Reciprocity broadly conceived would continue. The mechanism proposed is inspired by successful past improvisations for meeting difficulties encountered in those efforts. If the fundamental approach catches men's imagination, ways to effect it will be discovered—not invented—in the reports of Geneva dinner conversations, in the qualifications of economic pronouncements, and in many places and forums. The ideas in this paper, if they should be noticed, will then be awarded that very high accolade among officials and professors: "Correct, but not very new or original!"

Public Process for the Public Interest

THE KEY ROLE OF INFORMATION

The *fifth and final principle* is that the conduct of foreign trade policy—in its details—should be open. The policy approach proposed in this paper requires that intergovernmental trade conversation and the effects of trade intervention be subject to informed public surveillance, at least proportional in extent and depth to the surveillance exercised by the public over Government intervention in domestic market processes within the United States and the other industrial countries. The responses of governments, separately or in coordination, to the need of the world production and distribution mechanism cannot be representative and, therefore, proportioned to the public need, unless they are open. It is not enough to debate general principles and doctrines, but be secretive when considering their application to cases. There must be informed debate in advance of significant decisions and there must be public scrutiny of subsequent performance.

INTERNATIONALLY, THE EXECUTIVE HAS DISPROPORTIONATE POWER, USED NEGATIVELY AND SECRETLY

A major problem of governance of the dynamic world-production-distribution mechanism is that the governing institutions, both government and nongovernment, are less flexible and less representative than those within the national dynamic competitive economies. At best, the function of "government" is performed by a concert of distinct "sovereign" units, responsible to separate electorates. The "sovereigns" are usually at odds over some aspects of that international trade which evidences the economic cooperation of their electorates. There is little or no formal institutionalized cooperation on an authoritative basis. The various intergovernmental economic organizations which have been set up to pioneer ways of improving this concert of sovereigns are limited because they must depend, or must appear to depend, entirely on persuasion among their component governments.

The governments, whether acting separately, in organizations, or in direct cooperation, are "narrower" and less responsible than they are in domestic matters. It is almost exclusively the executive branches of the various National Governments which participate in the international economic governing. Hence, it is extraordinarily difficult, on the intergovernmental plane, for any economic interests which are not adequately weighed in executive decisions to find corrective expression through legislative, judicial, or "commission" processes. The dominance of the executive branch in these matters may be an inescapable part of our Nation-State system and certainly it is not here proposed to change it.

However, a trade policy proposal must take account of the fact that the executive branches have tended to exercise in a negative sense their power to govern the meshing of their national economic activity in a world industrial production mechanism. They have not reached a common ideological understanding, unless one counts their tongue-in-cheek GATT commitment to gradually cease using their power to govern in the trade field. Their concerting of action is given timid and apologetic publicity. The trade-barrier-reduction ideology has been associated in executive branches—certainly in the U.S. executive—with a certain fear and distrust of electorates. The opinion is widely held in governments that all people are protectionist as concerns their own interests; therefore, as we have seen in analyzing the bargaining technique, specific trade-barrier-reduction moves are given a protectionist format—and they are then carried out secretly. The great marshalings of public support have been based on generalites like freedom of trade, comparative advantage, or across-the-board reductions.

When it comes to deciding on the use of the power of the executive to affect specific trade transactions, however, the great bulk of it is done in closed meetings without prior public debate or subsequent detailed discussion of specific anticipated effects.[7] In these circumstances, the executive acts inadequately and often—against their expressed purpose—protectively. They keep the electorate at arm's length, as it were, and preserve the trade programs in principle, but do not use the programs very much for fear the specific effects would alienate public support. The opportunity is not often taken to marshal public opinion behind decisions in favor of the greater, and more public specific interest—with compensation where justified to the lesser and more private specific interest.

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[7] In escape-clause cases, where damage is alleged to have been done to a domestic interest, there is an expost facto discussion of effect. This will presumably be more frequent under the adjustment assistance provisions of the Trade Expansion Act.

NONGOVERNMENT ENTITIES INFLUENCING INTERNATIONAL TRADE ARE ALSO UNBALANCED—IN FAVOR OF THE MORE POWERFUL INTERESTS

When it comes to nongovernment entities of the sort whose participation in domestic economic governance helps maintain dynamic competition with a minimum of direct government intervention, those that span the international economy sufficiently to exercise some trade-governing influence tend to represent the larger and more powerful economic interests. Smaller producers, who might be able to enter a domestic market and get effective public support against suppression of their competition by more powerful or locally entrenched firms, may find it too difficult or costly to do so in international markets. Consumer and civic groups do not readily discover and express internationally their common interests with their foreign counterparts in the maintenance of market dynamism. Community organizations, unions, and most of the many types of nongovernment entities that can participate in domestic market governance do not easily make their influence felt on an international market scale. The reverse is true, however, for larger firms of great market power. The number of industries with large firms operating over more than one national market is increasing rapidly. Large trading organizations are embracing more and more products. In the management phase, industrial organizations are expanding to embrace and direct the interdependent world production mechanism. Their contribution toward the effectiveness of that mechanism is very great and they sometimes are channels for dynamism and efficiency interchanges which governments might fear to permit. By the same sign, however, their power is increasing. The reticence of the executive branches of government about the concerted public use of trade-governing power gives the large private power complexes an additional advantage, for they can use their power and knowledge to influence the intergovernmental trade discussions which are kept secret from the general public. Hence, the structure of nongovernment entities available for participation in the governance of trade is unbalanced when it comes to representing the full range of public interests involved.

PUBLIC OPINION IS READY FOR INFORMATION AND WANTS CHANNELS FOR EXPRESSION

But if the structure of government and nongovernment entities for the governance of international trade among the industrial countries may be called incomplete and badly balanced for the representation of the public interest, what can be said of the organs of public information and direct expression of opinion, and all the channels for holding governing powers to public accountability and a sense of social responsibility? Only rarely does the public get the information and timely analysis needed to discuss thoroughly the pros and cons of a specific trade situation requiring governance. When it does, however, a very important thing is revealed. In spite of the bargaining postures of governments and of nongovernment powers, and in spite of that major part of the press and communications media which reports these postures and supports one of them or another, the public remains relatively unimpressed. As could be observed in all of the countries supposed to have their interests at stake in the ridiculous "poultry war" during early Kennedy Round maneuverings, the literate populations of the industrial countries do not approve of major government confrontations over economic trifles—even in the name of policy or principle. They are concerned at the sufferings of producer groups, but they want, on the whole, to see the public interest given priority. They have an emerging concept of a world public interest which is reflected in their readiness for wider understanding—they seek channels of specific information and informed expression. In this respect they are ahead of the public postures of their governments, in trade matters at least.

SECRET TRADE DISCUSSIONS ARE INADEQUATELY INFORMED

Where the public does not know what is being considered officially, official considerations will be inadequate for the public interest. The most palpable and pervasive reality observed by the writer in 30 years of association with intergovernmental trade discussions was ignorance—a lack of adequate factual information to judge the economic effects of the government actions discussed. Moreover, there was a direct correlation with secrecy; the more completely the discussions were kept from public knowledge, the less adequate the information and the more suspect the facts relied upon—obtained for the most part either from powerful parties at interest, uninformed generalists or subordinate officials vindicating their advice or program performance. Discussants need to know, in a relevant and reliable form, the economic and physical facts regarding the commodity involved (costs, production problems, utility, the availability of substitutes, trade details, and so forth). Paradoxically, the problem is not primarily a matter of fact gathering resources. The U.S. Government has experts covering almost every angle of information relative to trade—overall and commodity by commodity. The GATT secretariat and those of some of the other intergovernmental organizations, the U.S. Tariff Commission staff, and the hearings of the Interagency Trade Organization under the Trade Expansion Act have done notable fact-finding and fact-correlating work relevant for judging the effects of trade intervention in specific cases. But, while the accumulation and publication of facts is valuable, and more may be needed, the real problem is one of bringing facts and analysis to bear in a timely way as regards a specific situation. If the gamesmanship qualities of the bargaining process or the natural secrecy of governments make the official participants "hold their cards close to their chests," then the analysts and statisticians—in government as well as out—cannot help them with information necessary to discover the public interest (although the more powerful interests can sometimes reach them).

A SENIOR OFFICER FOR TRADE INFORMATION

What practical step can be taken to remedy some of the imperfections of communication and information exchange within the existing system of governing trade—with its concert of overpowerful but uncertain national executives, its self-confident international private-power complexes, and its tradition of secret negotiations inhibiting the focusing of public knowledge and reason on trade-intervention decisions? What seems to be needed is an independent agent, as nearly omniscient as possible, with responsibility and authority for maintaining constant pressure on those involved in the governance of international trade to reveal their actions and show publicly that they have considered all facts bearing on the public interest in the effects of their decisions. He needs to have authority to obtain all relevant facts and to disclose them. He would have no right to guide policy but would give the public—individually and collectively—a substantial measure of insurance against hidden maladministration and malfeasance. It is proposed, therefore, that each country joining in the continuing review of trade intervention appoint an officer for trade information with the power and status necessary to carry out this function.

In addition, there should be an adequate statistics staff, and a fact-finding body on trade barriers. On the international level, there should be a committee of the national officers for trade information, with an independent secretariat, to carry out the information and public consideration function vis-a-vis the intergovernmental conversations and collaboration proposed here. They should have the right to receive reports and complaints from individual traders as well as from governments. This arrangement would be an invaluable adjunct to the search for intergovernmental understanding in trade intervention matters. Without changing any powers or relationships, these officers should force emphasis on openness, trust, and reliance on reasoning where the present arrangements militate toward secrecy, maneuver, and resort to bargaining power.

Economic Unity and Political Fragmentation

THE ETHIC OF ECONOMIC AGREEMENT

Much of the international structure for the governance of trade sketched in this paper is evolving rapidly. Although it does not recommend itself to trade-policy ideas based on assumptions of a separate national economy and a separate national public opinion, it has been evolving through (and, therefore, consistently with) existing political forms and power structures. It expresses the emerging realization that nations (especially industrial nations), while remaining formally independent, are economically interdependent; their governments cannot afford either the national loss caused by withholding cooperation in such surveillance as is required by the common international economy or the strain on political harmony and coexistence caused by trying to dominate that economy at the expense of one another's interests.

Of course, on the international level, each government must remain, as far as its own acts are concerned, the final judge of the interest of its own public—its electorate. Hence, there probably would be little point at this time in seeking further formal agreement on a definition of the general concept of international public interest in trade matters. Criteria enough have been elaborated and given intergovernmental status in GATT, FAO, UNCTAD, ECOSOC and elsewhere. Perhaps a restatement of some sort would have to emerge, in connection with the proposed forum for the examination of acts of intervention in relation to their declared public purposes, but the practical way to move forward with the proposal is through the intergovernmental consideration of specific actions, guided by fairly general value premises (peace, efficiency, growth, employment, egalitarianism, etc.), but guided also by the force of public debate with full disclosure required. While each government must retain the right to interpret any agreement (or lack of agreement) as regards its own acts of trade intervention, this interpretation must be informed by an understanding of the common economic interest. This is an inescapable consideration. Trade conflicts can intensify political bitterness; agreement on their solution among governments determined not to escalate the conflicts can have the opposite effect.

The fact of common tenure of the industrial economy is making imperative among nations, and more and more recognized, a point of view which is the nucleus of an ethic; it might be called the ethic of economic agreement. Stated simply, it is that intergovernment economic discussions must, for the common good, be persisted in to the point of agreement. The hope of the future seems to lie in coordinating economic activities of governments by agreement—without resorting to arbitrary political pressure.

The word agreement need not mean a signed and delivered document. It can be as little as that negative kind of agreement where each keeps the others fully informed of its unilateral acts and the discussion of differences continues in an atmosphere of reciprocal efforts at persuasion. This is implicit in a society of human beings sharing a common living space and a common source of wealth.

Perhaps the greatest contribution that the acknowledgment of this ethic can make, however, is to reinforce the processes by which the greater and greater unity which characterizes economic reality is brought to bear against political fragmentation.

Section III

TRADE AND THE ADJUSTMENT PROCESS

FOREIGN TRADE POLICY IN THE FRAMEWORK OF THE BALANCE OF INTERNATIONAL PAYMENTS

BY HOWARD S. PIQUET*

Expert opinion in the area of international finance ranges from those who believe there will be an international calamity if the United States fails to bring its international accounts promptly into balance, all the way to those who think that continuing deficits are a normal characteristic of the international accounts of a country that has been selected by other countries to serve as their central banker, and who have been using its currency for a long time for both monetary reserves and to carry on trade.

Notwithstanding this wide range of opinion, there is general agreement that it would be desirable for the United States to bring its accounts into closer balance. It is agreed, furthermore, that by "balance" is meant, not the achieving of temporary equality between the inflow and outflow of funds through such restrictive means as curtailing merchandise imports and capital exports, but the attaining of self-sustaining equilibrium. There is general consensus that equilibrium will be the more likely to prevail as countries become willing to allow their economies to adjust to each other.

The effectiveness of capital movements, as an equilibrating force, in response to changes in rates of interest, is generally recognized. What is not always recognized is the importance of the free movement of goods and services as an instrument for maintaining equilibrium. Although the movement of goods and services is not as sensitive a force as international short-term capital movements, the magnitude of international trade is much greater than the magnitude of capital movements and, if not interfered with by governments, can be a potent force for adjustment.

Merchandise trade is the largest single item in the international accounts. Although the borrowing and lending of funds and payments for such services as shipping and insurance are also important, their magnitude is dwarfed by merchandise exports and imports. With respect to the United States, merchandise exports account for close to three-fourths of all receipts from abroad, while merchandise imports account for more than half of its payments abroad—receipts and payments being on both government and private account.

The United States has had deficits in its international accounts every year, with only one exception, since 1950. Unlike Western Europe after World War II and unlike the situation prevaling in the less-developed countries today, the United States has ample productive capacity to make up the difference between its expenditures abroad and its receipts from foreigners. It is obvious from the magnitudes

*Senior specialist in international economics, Legislative Reference Service of the Library of Congress. The views expressed herein do not necessarily represent the views of the Library.

involved (a GNP of over $750 billion, compared with balance-of-payments deficits of between $1 and $4 billion a year) that the difficulty does not arise from economic weakness. It is, rather, evidence of inability, or lack of willingness, of countries to allow their economies to adjust to each other through the free flow of capital and merchandise trade.

Ordinarily, a country having persistent deficits in its international accounts must either increase its international receipts, relative to its payments, or allow the foreign exchange value of its currency to decline. Prior to World War I there was an international monetary mechanism that kept the values of national currencies in line with each other, namely, the international free gold standard.

The Free Gold Standard

What made the free gold standard system of the 19th century so effective was the manner in which continuing equilibrium in the international accounts was maintained. There were no persistent deficits, or persistent surpluses, in the balance of international payments of Great Britain or any other important country. So effectively, in fact, did the Bank of England function as world banker that the system seemed automatic and natural.

In those days most international trade was carried on in terms of pounds sterling. Pounds and gold were freely convertible into each other, and other currencies were convertible into pounds or into gold. The international balancing mechanism seemed to be so close to automatic that countries were not even conscious of imbalances between their international receipts and their international payments.

Gold was free to move from country to country, not by virtue of governmental decisions or licensing but in response to market forces. The freedom of gold to move internationally, together with the willingness of most countries to accept the discipline of the gold standard, by allowing bank credit to expand and contract as the supply of gold expanded and contracted, provided the world with a multilateral payments system that worked well. International commerce was free, not in the sense that there were no trade barriers, but in the sense that tariffs were applicable to all foreigners alike. There was no discrimination against certain suppliers in favor of others through the use of quantitative import restrictions and other trade controls.

The pound was convertible into gold at a fixed rate and the currencies of most countries were freely convertible into each other. Currencies were legally defined in terms of their gold weights. The dollar was 23.22 grains of fine gold and the British pound sterling was 113.0016 grains. The ratio of the weights of the two currencies (4.866-plus to 1) was known as the "par of exchange."

Individuals could convert gold into currency, or currency into gold, at the legal rate, or convert one currency into another at the prevailing exchange rate. Gold was the standard of value and the system provided a mechanism for keeping the values of currencies in line with each other at approximately their gold parities. As a result, gold was distributed throughout the world according to need, as determined by changing prices and by changes in foreign exchange rates.

For example, when prices of certain commodities in the United

States increased, relative to their prices in the United Kingdom, there was a tendency for Americans to increase their imports of those commodities. Unless offset by other price changes in the opposite direction, the increase in U.S. imports, relative to U.S. exports, caused an increase in the demand for sterling in terms of dollars, thereby causing the dollar to weaken relative to the pound sterling. The decline would not go beyond the "gold export point" (4.886-plus per £1), however, for at that point it would be more economical to convert dollars into gold for shipment to the United Kingdom than to pay a higher price for sterling in the foreign exchange market. Since gold was directly related to the supply of money and credit, the exportation of gold would cause price levels in the United States to halt their rise, relative to those in the United Kingdom. When prices in the two countries came into line with each other the exchange rate was close to parity and there was a state of international equilibrium.

Usually, long before the gold shipping point was reached the decline in the foreign exchange value of the dollar would itself attract short-term capital (since a given number of pounds would purchase more dollars than before) thereby tending to bring international payments and receipts into balance with each other. The system worked well largely because the British Government pursued liberal trade and investment policies.

ILLUSTRATION OF ECONOMIC ADJUSTMENT UNDER A FREE GOLD STANDARD

1. An increase of U.S. commodity imports, relative to U.S. commodity exports, causes dollars to become more plentiful in the foreign exchange market, relative to other currencies, so that the value of the dollar drops from $4.866=£1 (parity) to, say, $4.87=£1.

2. Because pounds will now purchase more dollars than before, it becomes more profitable than before to convert pounds into dollars for short-term investment in the United States.

3. The ensuing flow of short-term capital into the United States increases the supply of short-term capital, relative to the demand for it, and causes the short-term interest rate in the United States to fall, thereby tending to neutralize the effect of the decline in the foreign exchange rate.

4. Also, while the dollar is cheapening, relative to sterling, it becomes more profitable than before for foreigners to buy certain kinds of merchandise in the United States. Hence, U.S. exports will increase, relative to imports, tending to correct the previous excess of imports over exports. The effect will be to raise the value of the dollar back toward parity.

It is important to observe that these correctives—capital movements and merchandise trade—are brought about by changes in foreign exchange rates, without the international transfer of gold.

5. If, however, this adjustment mechanism fails to work effectively the foreign exchange value of the dollar will continue to decline until it reaches $4.886 to £1. This is the "gold export point." Since it costs (or used to cost) 2 cents to ship a pound sterling's worth of gold between New York and London it is more profitable to ship it than to pay any more than $4.886 (a 2-cent differential) for a pound sterling in foreign exchange.

6. The movement of gold from New York to London decreases U.S. monetary reserves and increases reserves in the United Kingdom, thereby serving to contract credit in the United States and to expand it in the United Kingdom.

7. In consequence, certain prices in the United States will fall, relative to prices in the United Kingdom, thereby making the United States a better market in which to buy and the United Kingdom a better market in which to sell. U.S. exports, therefore, will be stimulated while imports will be retarded.

Generalizing the illustration, a decline in the foreign exchange value of a currency, by inducing short-term capital inflow, by making it profitable to export gold, and by changing the relationship of exports to imports, serves to distribute the world's monetary gold among countries in accordance with their needs, and prevents prices of internationally traded goods from getting out of line with each other. This is what is meant by "equilibrium under the free gold standard."

The "correctives" under an idealized free gold standard are: freely fluctuating exchange rates, within the gold points; freedom to buy and sell gold; relatively free international movement of capital and merchandise; and fluidity of prices within and between countries, including those of the factors of production (interest rates and wages).

The essence of the free gold standard was the willingness of countries to allow their domestic economies to adjust to each other in response to changes in the external values of their currencies.

Those who favor return to a free gold standard are, in effect, arguing that countries allow wages, prices, and rates of interest to adjust to wages, prices, and rates of interest in other countries, as well as to allow gold to move internationally in response to freely fluctuating exchange rates. Most important of all, the discipline of the free gold standard requires that bank credit be allowed to expand or contract as the supply of gold expands or contracts.

It is doubtful whether any country in the world today is willing to go this far toward fostering a "world economy." Most countries seek to insulate themselves against inflationary and deflationary forces in other countries, and are more interested in domestic prosperity and economic growth than in a functioning international economy. Full-employment policies and programs take precedence over almost everything else in the economic sphere largely because of fears of the deflation which political leaders believe would result from return to a free gold standard.

Because of the unwillingness of countries to allow their domestic economies to adjust to each other, it is probable that return to a gold standard would have deflationary effects. However, if the economically developed countries were willing to make the internal adjustments necessary to bring about the full utilization of productive resources everywhere, it is probable that the cost of making the necessary economic adjustments would be slight.

If countries were to allow their economies to adjust freely to each other, only small quantities of gold would be needed for the purpose of making international settlements. Indeed, if they went the full way and became a true "world economy," with or without a unified world currency, there would be no need for gold at all. This is the situation that prevails in most large cities where banks balance their accounts against each other daily, or even within a national economy where economic forces are allowed to operate freely. One never hears, for example, of a balance-of-payments deficit of an individual State of the United States with respect to other States of the Union. Even areas within a country that are beset by economic difficulties, such as parts of the Appalachian region, do not attempt to solve their economic problems by insulating themselves against trade with other areas of the country.

Equilibrium Without Gold

If countries allowed their domestic economies to adjust to each other by resisting the temptation to interfere with the international movement of goods and capital and by not using subsidies to interfere with internal economic adjustments, there would be continuing equilibrium among them even without the use of any gold.

Countries, however, refuse to allow their economies to adjust to each other because they have learned how to use domestic monetary and fiscal policies to stimulate economic growth and domestic employment. In consequence, with currencies pegged at fixed ratios relative to each other, and with all sorts of obstacles being placed in the way of the international movement of goods and capital, it becomes exceedingly difficult to keep the international accounts of all countries in balance with each other. Because of this difficulty, and because the achievement of balance under such circumstances requires considerable time, there is strong and continuing demand for "increased liquidity" on the part of countries that are in deficit in the form of demands for easy access to additional monetary reserves.

The question of adequacy of reserves is intimately related to the degree to which countries allow their economies to adjust to each other through changes in capital flows, merchandise trade, prices, interest rates, and wages. The greater the resistance to international adjustment, the greater will be the need for monetary reserves. Conversely, the greater the willingness to allow international adjustment to occur, the less will be the need for reserves. Indeed, "adequacy of reserves" may be conceived of as a spectrum, ranging from a need for zero reserves at one extreme to a need for almost infinite reserves at the other, the quantity of reserves needed at any time depending upon the degree to which countries resist international economic adjustments. Attempts to determine the amount of reserves needed, without reference to international adjustments, are futile.

The problem of monetary reserves is the problem of providing a deep enough financial cushion to provide time during which national economies can adjust to each other. Monetary reserves are the shock absorbers of international finance; they are not an elixir that can suddenly bring prosperity to countries that have not yet learned how to support themselves.

If foreign exchange rates were allowed to fluctuate freely no deficit in the balance of payments could occur because changes in rates of exchange would clear the market. Changes in the conditions of demand and supply in foreign trade would be met by adjustments in capital flows and in the volume and composition of international trade. Short-term capital moves internationally in response to small changes in interest rates, and merchandise exports increase, relative to imports, if the currency of a country cheapens in terms of the currencies of other countries. Equilibrium is established, it should be noted, not by the adjustment of average price levels to each other, but by adjustment of the prices of individual commodities.

As the value of a country's currency declines, it becomes increasingly profitable for foreigners to buy in that country. A series of "export points" for various commodities become operative, such as a cheese export point, a wheat export point, and so forth, which are similar to the "gold points" under the free gold standard. Thus, when the Canadian dollar falls in value to a certain point, relative to the U.S. dollar, it becomes profitable for Americans to import Cheddar cheese from Canada. If, on the other hand, the Canadian dollar appreciates in value, relative to the U.S. dollar, it becomes profitable for Canadians to import Cheddar cheese from the United States. Such commodity shipping points serve to adjust national economies to each other through changes in the composition, as well as the volume, of international trade.

However, since international adjustments sometimes cause sensitive prices, including certain wages to decline, governments resist. This is what happened between World War I and World War II. The gold standard had been abandoned by most countries, and national governments vied with each other to protect themselves against exchange depreciation. They depreciated their own currencies in frantic attempts to increase exports relative to imports. Quantitative controls against imports, exchange controls, and a wide variety of other devices were employed to protect themselves against each other's exports.

The wide variations in foreign exchange rates that accompanied competitive exchange depreciation made international transactions hazardous and were a serious deterrent to international trade. Between 1930 and 1932 international trade dwindled to a mere trickle, and the world became bogged down deeper and deeper in depression, with millions of people unemployed.

There is nothing economically illogical about freely fluctuating exchange rates. The difficulties in adopting them lie in the political sphere. There is an all-pervasive fear against allowing a national economy to adjust to other economies or, in popular language, "to import deflation or inflation from abroad." Adoption of either an international free gold standard or a system of freely fluctuating foreign exchange rates would require that governments allow their economies to adjust to each other. It would be necessary that they abstain from interfering with international capital outflows and with merchandise imports, that they allow prices and wages to be determined by the interplay of market forces, and that they not try to prevent the transfer of capital and labor from less efficient to more efficient lines of production.

THE ADJUSTMENT PROCESS

The international transfers of merchandise that bring about economic adjustment need to be conceived of in terms of actual commodities, rather than in terms of statistical aggregates. Adjustment occurs, not only through changes in the total volume of imports relative to the total volume of exports, but also in terms of changes in the composition of trade.

An increase in the imports of a highly competitive product into a country where the marginal cost of that product is considerably higher than its marginal cost in the country of export will have the effect, first, of lowering the price of that product in the country of importation and, secondly, of displacing some of that country's marginal production. In turn, this is likely to lead to some unemployment and some impairment of profits in the industry in question. In accordance with the competitive principle underlying the free enterprise system, the result will be transfer of some capital and labor away from the production of the good in question into the production of goods that have a competitive advantage in a foreign market. These continuous transfers of labor and capital away from areas of higher-cost production to areas of lower-cost production serve to keep the international economic accounts in equilibrium.

THE "NO INJURY" PHILOSOPHY

Not since the United Kingdom abandoned free trade at the turn of the 20th century has any important trading country been willing to require that domestic producing interests adjust to highly competitive imports. Most countries have followed the opposite course of protecting individual firms and groups of workers who are hard pressed by foreign competition by restricting such imports. The world is still mercantilistic; governments are much more concerned over the immediate pecuniary welfare of producers than over the long-run welfare of consumers.

Notwithstanding all the fanfare that has accompanied the liberal trade programs initiated by the Reciprocal Trade Agreements Act in 1934, there has been consistent and active concern over the "injury" that might be caused by the increased competitive imports resulting from reductions in tariffs and other trade barriers. Ever since 1942 there has been provision, either in the law itself or by administrative action, authorizing the President to impose barriers against imports whenever the Tariff Commission finds that imports are causing, or threatening to cause, "serious injury" to any domestic producing interest.

Not until the Trade Expansion Act was passed in 1962 was there even the slightest indication in the law that tariffs and other trade barriers should be reduced even though the increased imports resulting from such action might threaten injury to some domestic producers. Title III of the new legislation provided, for the first time, for subsidizing adjustment in those cases where increased imports might injure domestic producers.

As evidence of this change in thinking was a statement of intent by the Kennedy administration, when the trade expansion bill was introduced in Congress in January 1962, to negotiate for across-the-board tariff reductions with a minimum of exceptions. Prior to 1962 tariff negotiating was confined to those tariffs, the reduction of which would not result in increases in imports sufficient to alarm domestic producers. Under the 1962 legislation, if injury should eventuate it would be in the discretion of the President either to increase tariffs (and impose import quotas) for the purpose of restricting the troublesome imports, or to invoke the adjustment assistance provisions, including the retraining of workers and the rendering of technical assistance to individual producing firms.

The fact that Congress modified the proposed legislation in such a way as to make the adjustment assistance provisions almost impossible to administer does not alter the fact that for the first time the law recognized this fundamental change in trade philosophy.

There has been, and there continues to be, confusion between "injury" and the "inconvenience" of having to adapt to a new and intensified competition. "Injury," resulting from import competition, is essentially a short-run phenomenon. Under free trade most of the workers who are displaced by imports soon find new jobs. The problem of injury is the problem of someone being hurt in the short run.

Injury involves individual workers and the owners of individual firms. The dictionary meaning of the word is clear—"injury" means that someone is hurt. It does not mean, and it should not be confused with "inconvenience."

The inconvenience of shifting from one job to another may be considerable, but it does not mean that a person is necessarily hurt, or injured, merely because he is forced to adust to a different line of activity. In a free enterprise economy this is done every day in response to the pressures of domestic competition.

It is the essence of the individual enterprise system that those who are not suitably adapted to their economic environment should transfer to other lines of work for which they are better adapted. The underlying principle of the individual enterprise system is that the utilization of resources is maximized through the pursuit of self-interest. When the government prevents such adjustment efficiency is minimized.

When injury resulting from import competition is referred to it should be made clear that the reference is not to the mere inconvenience of transferring from one line of work to another. For example, not very long ago, a number of producers of briar smoking pipes in New York City were displaced by import competition. They were not "injured," however, because it was easy for the workers and the owners of the firms to find new jobs and new profitmaking opportunities in the highly industrialized and highly diversified city of New York.

But, when a similar phenomenon occurs in a less-diversified area, such as parts of West Virginia, where only a limited number of economic opportunities exist, the adjustment process—the inconvenience—can itself constitute injury. When a person cannot reasonably locate an alternative job he is "injured". When the same thing happens to a firm it, too, is hurt. This is what should be meant by "injury".

It is important to recognize that "industries" seldom, if ever, suffer injury. "Industry" is a statistical, rather than an economic, concept. Individual workers and owners of capital, not industries, suffer injury.

When firms or workers are unable to find alternative opportunities they are injured, and the question is "what should be done about it?" Most Americans believe that no individual, or group of individuals, should be called upon to bear the economic cost of foreign policy by being deprived of an opportunity to work for a living. This is why it is so easy to jump to the conclusion that job displacement brought about by foreign competition should be remedied by restricting imports.

Although an individual worker, or owner of a firm, should not be called upon to bear the cost of job displacement resulting from a liberal foreign trade policy, it is not correct to conclude that people should be frozen into their jobs by governmental action whenever there is an intensification of import competition.

Only when the problem of injury is conceived of in terms of individuals, rather than industries, does the "avoidance of injury" philosophy make sense. When it is tied to the requirement that imports should be curtailed there is danger of muddy thinking.

Injury to individuals needs to be avoided. Curtailment of imports under the escape clause, however, is only one type of remedy. The escape clause means what it says. It is an escape from a commitment made in good faith between the United States and another country to reduce trade barriers. It is the adjustment assistance philosophy, as yet inadequately implemented in the law, that affords the President a choice, either to impose a higher tariff (or an import quota) after receiving a finding of threat of injury from the Tariff Commission, or to provide for Government assistance to facilitate the transfer of those individuals who are adversely affected into lines of activity for which they are better suited. Adjustment assistance avoids injury to individual workers and firms without restricting imports. It provides the flexibility and the mobility that are essential to a world economy based on free enterprise.

The Magnitude of Adjustment

Although the political resistance would be formidable, the economic magnitude of the adjustments that would be necessary to implement a freely functioning world economy would not be very great. They would be analagous to pruning the trees in a fruit orchard when dead and dying branches need to be removed if the chemicals in the soil are to be allowed to nourish the trees as a whole. Unless high-cost producers at the margin, in various lines of production, are allowed to be displaced by more efficient low-cost producers, the economic body, like the fruit trees, will not be sturdy.

It was estimated a little over a decade ago, that if the United States were to abandon all of its tariffs and import quotas its imports would increase by somewhere between 10 and 24 percent which, in terms of 1965 imports, would be an increase of between \$2.3 billion and \$5.2 billion. An increase in imports of this magnitude might necessitate the adjustment from one occupation to another of between 0.3 percent and 0.6 percent of the country's total civilian work force—which is certainly no greater than the percentage normally affected by technological changes in production.[1]

[1] For estimates of probable imports in the event of suspension of all U.S. tariffs and import quotas, see Piquet, H. S., "Aid, Trade and the Tariff," 1953. For the meaning of increased imports in terms of adjustments in employment see Salant, W. S. and Vaccara, B., "Import Liberalization and Employment," 1961.

SIGNIFICANCE OF THE KENNEDY ROUND

Although the tariff cuts that are to be made as a result of the Kennedy Round are far from negligible, and will assist the international adjustment process, their importance should not be overestimated. Although, according to early press releases, the cuts will apply to a large proportion of all international trade, they do not provide for free trade. Nor will they accomplish much with respect to import quotas and other nontariff trade barriers.

In Western Europe and the United States, where industrial tariffs average between 12 and 14 percent, the overall reduction of approximately 35 percent provided for by the Kennedy Round will reduce them only to an average of between 8 and 9 percent. Clearly, much remains to be accomplished in the way of trade barrier reduction, notwithstanding the arduous efforts that went into the Kennedy Round.

The first need is for recognition by the industrialized countries that the free international interplay of economic forces would be to their own advantage, as well as to the advantage of the less-developed countries. The importance of liberal foreign trade policies to a solution of the problem of persistent international disequilibrium is not the superficial one of increasing merchandise exports, relative to merchandise imports, with respect to a particular country, but rather in trying to secure agreement by all countries to the elimination of obstacles to the free movement of goods and capital.

If goods and capital were free to move internationally, economies would adjust to each other and, in accordance with the principle of comparative advantage, the adjustment would lead not only to self-sustaining equilibrium in the international accounts, but also to the maximizing of world production and world consumption.

U.S. EXPORTS IN RELATION TO U.S. PRODUCTION ABROAD

BY JUDD POLK*

Traditionally, United States, like other countries, has viewed its trade with other nations as the main indication of its concrete economic interest in the outside world. Trade policy in broad historic sweep has moved from preoccupation with the problems of defending particular industries against foreign competition to general acknowledgment of the mutual interest of all nations in freer trade. In this century the movement toward toward freer trade has just achieved its most dramatic manifestation in the successful conclusion of the Kennedy Round of comprehensive and significant trade concessions among the major trading nations.

There is a powerful economic rationale for this trend and for its continuation. But the decisive considerations of policy can no longer be seen from the vantage point of international trade itself or in terms of the familiar arguments which since Adam Smith's day have rationalized the cause of freer trade as a means of reaping the harvest of the international division of labor.

The fact is that international trade is now itself incidental to the broader phenomenon of international production. This term international production is here used to describe the deliveries which one nation makes in the markets of another via the direct expedient of producing there locally, as distinguished from exporting to that market the product of facilities located at home.

As will be shown, the producing stake of United States and other countries probably now accounts for sales upward of some $150 billion, as against U.S. exports of about one-fifth as much. As this tremendous producing establishment has developed, American subsidiaries abroad have come to occupy a very substantial role among our foreign customers. And the free movement of goods, in favor of which our forebears could argue the relative luxury of the gains available from specialized trade, is now more in the nature of a structural imperative of the method of production itself—much in the same way one might urge the structural importance of the interstate commerce clause in the U.S. economic constitution. Moreover, when international trade—especially in the case of the United States—is seen in proper relation to production abroad, very serious doubt is cast upon the workability of any trade-policy initiative, such as export expansion, unless taken in compatible relation to policy initiatives pertaining to the entire range of our foreign production—here namely the encouragement of investment in production abroad.

* United States Council of the International Chamber of Commerce, Inc., New York, N.Y.

International investment is transforming the character of the world economy; for one thing, it is no longer whimsical to speak of a world economy. The output associated with U.S. production in other nations' markets is large in relation to the national GNP's of the industrialized world. While the history of international investment goes back almost as far as the history of international trade, only recently has it emerged as the most important fact of international economic life. The implications of this fact are only beginning to be understood. Here an effort will be made to sketch the basic picture and suggest some of the implications for questions of trade policy.

The Scope of U.S. Deliveries to Foreign Markets

The most important trade concept, and one that is essentially new in the structure of world trade, as fundamentally altered by international investment, is that of total deliveries to a market, in contrast to the traditional concept, now secondary in importance, of deliveries (exports) that happen to cross international borders. The aggregate world GNP, excluding Communist countries, for which compatible market statistics are not available, is in the order of magnitude of $1,600 billion, about half accounted for by the United States. Of this, a rapidly growing portion—perhaps $250 billion, but not definitely estimatable—is product associated with internationally owned and operated plants. U.S. statistics on investment abroad and associated production permit a firmer rough estimate of $150 billion as its share of this international production. U.S. total deliveries to foreign markets are some $180 billion. Of these, about a fifth—$30 billion—are exports; the rest emanating from U.S. production facilities located abroad.

The rapid and steady growth of our foreign investment and production is shown on the accompanying graphs (page 111). The calculated trend rate of growth of the known book value of investment is 10 percent since 1950, and a striking feature of this growth is its regularity: the growth each year has been close to trend.

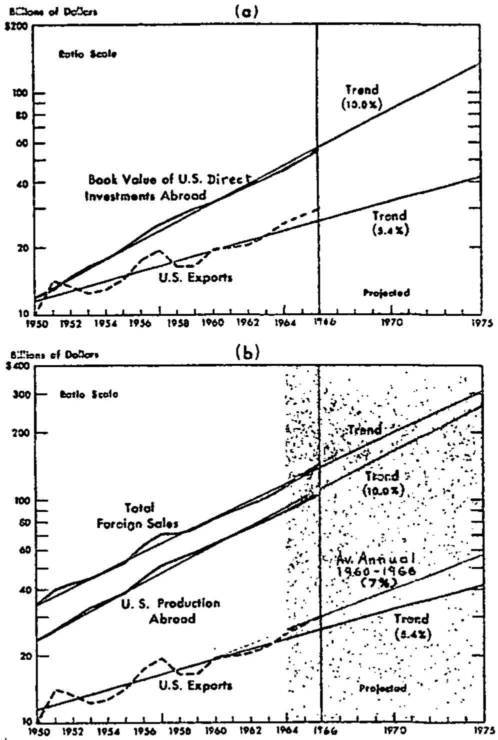
Accompanying growth of exports has been buoyant but somewhat slower. Shown on the graph is an earlier calculated trend rate of 5.4 percent. In view of the livelier growth in recent years, however, the average annual rate of growth of 7 percent from 1960 through 1966 appears more representative and this line has been added to the second graph, where also is shown (1) the inferred volume of U.S. production abroad and (2) the sum of this plus exports—"Total Foreign Sales"—representing the value of total U.S. deliveries to foreign markets from both exports and local (foreign) production.

Production Abroad and Exports Grow Together [1]

The concept of total foreign sales properly brings together U.S. deliveries in response to foreign demands, whether involving product made here or there. Basically the two sources of supply are complementary, and, in fact, they have grown in a parallel and vigorous manner, as can be seen at a glance from the graphs. The fact of their

[1] The discussion here of the relationship between exports and production abroad incorporates material previously developed for the National Export Expansion Council's Subcommittee on Less Developed Countries.

THE U.S. RESPONSE TO FOREIGN MARKET DEMAND



The graph at left generalizes the comparison of exports to sales of output from production abroad, the latter as estimated above (first graph). In 1950 the estimated U.S. sales of goods produced locally abroad were 2:1 over exports—a difference of $13 billion. After 14 years of vigorous export growth, the difference was $64 billion, the ratio 4:1.

The positive effect of investment on exports, which producers abroad commonly report they "see" in their own operations, is strongly suggested in the area growth-rate profiles:

	% Av. Annual Growth 1950–1966	
	Invsmt	Exports
Europe	15	8
Canada	10	8
Lat. Am.	5	3
Other	11	8

Note: Trends shown are least square trends calculated for the period 1950 - 1964. Investment, exports and inferred foreign sales data for 1966 have been estimated and added to the actual performance lines. Similarly, a terminal-year average rate of growth (7%) has been calculated on the basis of the 1960 and 1966 figures, and is shown as being a further useful indication of the prevailing trend.

parallel growth, when coupled to the fact of the overriding quantitative importance which the high level of U.S. investment since World War II has given to production from facilities located abroad, constitutes a fact of utmost importance for United States foreign economic policy. For example, as against our present tendency to discourage investment and encourage exports in the thought that this realinement of delivery methods will have a beneficial effect on our net foreign exchange position, there stands the powerful inference from export and production trends that investment is a major stimulant to exports. Furthermore, detailed work with both national and company statistics suggests that the defense and extension of a sales position achieved through exports will require continuing investment.

Balance-of-payments accounting is trade oriented and largely neglects the economic impact of our foreign investment as the major channel through which U.S. producers operate in foreign markets. The investment shown in the accompanying graphs is limited to so-called direct investment; this is investment in which U.S. business has, by definition, at least a 10-percent equity, and has, in actual fact, outright control in the great majority of instances. The growth in investment includes new dollar capital outflow, which appears in the balance of payments, and retained earnings—which do not, but which are followed and published by the Department of Commerce. In the typical instance of investment, these two sources of financing are of roughly equal importance. But more important in evaluating the local impact of investment is a quantification of the value of product to be associated with the expanded productive facilities. From data now available on, for example, the value of sales by U.S. manufacturing subsidiaries abroad, a reasonable rule of thumb ratio of 2 to 1 can be derived for output to book value. From this, the implication of these figures is that gains in U.S.-initiated output abroad for, say, Europe grew from $6 billion in 1950—against U.S. exports of roughly half that amount—to some $32 billion in 1966—against exports of $10 billion, or less than a third. Moreover, at this level of local output from U.S. investment, a substantial tendency for an increase in local imports—perhaps $1½ billion—may reasonably be inferred as the import share of the increase in local income, and supplementary to imports directly associated with the capital increase, notably capital equipment. In the case of the less-developed countries this tendency to import more as income rises contributes to the chronic foreign exchange shortages with which most of them grapple, and is curtailed by familiar import and exchange restrictions.

The basic income-import relationships have been more fully explored in the National Industrial Conference Board's report, "U.S. Production Abroad and the Balance of Payments" (1966). The recapitulation here is intended to show the extent to which local production abroad has outdistanced exports as a means of delivering goods to foreign markets, and how the gains in local production, so vital to the basic process of development, have been compatible with regular growth in traditional deliveries via exports.

Does Production Abroad Displace Exports?

The answer to this question appears to be clearly "Yes" for specific products, but for total exports, clearly "No" and for products in the same general industrial classification, probably "No." It is a commonplace of policy in less-developed countries to interdict imports in favor of programs of local production.[2] The Mexican industrialization program is a nearby familiar example. A familiar response of U.S. companies to such programs has been to set up local production facilities, where cost-profit-risk factors warrant. In such cases, the alternative export of equipment, raw materials, and even other related finished products more than offsets the loss of the original product export.

In other cases, relative cost considerations lead to production aboard. In still other cases, and these are the most frequent, the marketing advantages obtainable only through the maintenance of a local foreign establishment prompt the decision. The many motivations of foreign investment, and the primacy of marketing considerations among them,

[2] Europe in the days of postwar reconstruction similiarly restricted imports for consumption and favored imports for production.

have been widely studied elsewhere and need no recital here. It is important, however, to note emphatically that intensive case study rarely turns up a situation in which the producer abroad could have continued to export as an alternative to producing locally abroad.

Moreover, an important fact often forgotten in discussions of what impels companies to produce abroad as against supplying foreign markets through exports is that there are no acceptable substitutes produced in the United States for much of U.S. production abroad. This is the case even in manufacturing, but is particularly clear in the case of the extractive industries which establish facilties abroad so as to gain sources of supply rather than new market, and applies also to trading companies, utilities, and other service enterprises that are limited to foreign sites by the nature of their operations. These nonmanufacturing instances have especially close relevance to the LDC's. Even in consumer goods, versions developed for the U.S. market are keyed to income levels and social positions more advanced than those prevailing in the LDC's.

As for new U.S. exports induced by investment abroad, it seems likely that the relationship between exports and local production is close, and is probably particularly strong in the case of LDC's. In 1964, for example, the ratio of U.S. exports shipped to Latin American manufacturing affiliates to sales revenues of these affiliates was 11 percent. The comparable ratio for Europe: 6 percent. The difference is some indication of how much more producers in LDC's must look abroad for their supplies than is the case for those in more developed countries. Comparably competitive sources of supplies and equipment are simply not at hand for the LDC producers, and this relative inflexibility in source has a widespread impact.

In the case of capital goods, for example, the technology necessary to produce the machines for making other machines, as well as machines for making final product, is not readily available in the LDC's. Thus in 1964 Latin America imported $126 million of capital equipment from the United States; Europe imported only $65 million, despite the much more rapid pace of U.S. investment in Europe—six times the rate in Latin America. Available figures also permit a corroborating examination of capital-equipment sources for foreign manufacturing subsidiaries. Latin American subsidiaries obtained half of the materials used in their manufacturing operations from the United States, European subsidiaries about a tenth.

Investment-induced exports appear generally more impressive than those hypothetically displaced, although the latter concededly raise an imponderable question. What might have been the level of U.S. product exports had there been no production abroad cannot be determined. But the question is largely idle; producers did not have the choice in the first place.

The often expressed anxiety that U.S. production abroad displaces exports on balance is not persuasive. For one thing, U.S. foreign direct investment alone now (mid-1967) totals more than $55 billion, and accounts for possibly as much as $115 billion in product deliveries. It is not credible that foreign countries would permit or could finance these deliveries as supplemental exports from U.S. facilities. Moreover, as noted already, this productive activity within foreign markets has in fact been accompanied by a vigorous growth of U.S. exports (7 percent annual average, 1950–66), the more vigorous in areas where investment activity has been more intense. The directness of the relationship between investment activity and export growth is now further supported by various statistical and case-study surveys of the transactions of U.S. affiliates abroad. While so far the United States imports relatively little from foreign affiliates, its exports to them are substantial (about one-quarter) and growing—U.S.' own foreign affiliates already have emerged as a major customer of the United States abroad. Less direct but also significant for U.S. exports is the increase in foreign imports as a result of income gains associated with U.S. local (foreign) production. The increase in foreign imports (including, of course, U.S. exports) from the higher income is now a substantial figure.

It is perfectly compatible with this interpretation of the favorable effect of U.S. investment abroad on U.S. exports to acknowledge the uniqueness of exports as foreign-exchange earners and the importance of increasing exports, especially in periods like the present when dollars tend to accumulate in foreign hands, with the all too well-grounded likelihood that they will be presented for conversion into gold rather than spent on U.S. exports or invested here.

THE UNITED STATES AS A PEDDLER

The charm of exports from a balance-of-payments point of view is that they yield foreign exchange to the country equivalent to their sales value, not just their profit margin. In contrast, production abroad on the basis of U.S. investment, returns foreign exchange equivalent only to the remitted portion of the producers' profits—typically now about 5 percent of the sales revenue (in the case of manufacturing, for which sufficient figures are available to permit a fair estimate). Thus, from the narrow and short-run perspective of the transactions entering balance-of-payments accounting, the proceeds of commercial exports of goods and services constitute the No. 1 foreign-exchange earnings of the country. Even were the export transactions conducted at a commercial loss, there would be a foreign exchange gain.

The fact that U.S.' primary role in the world economy is that of an investor and producer is plainly adventitious for its role as seller of U.S. products wherever made. In contrast, the point is now frequently heard that U.S. producers tend to overconcentrate on the investment/production approach to foreign markets. Those concerned with whatever element of truth there is in this contention argue that the salesmen of our main advanced-country competitors (Europe, Japan—and possibly Hong Kong?) have not forgotten how to hustle and do not disdain individually small (but cumulatively large) sales. Nor do they find that their selling requires a costly investment establishment.

It is not possible to quantify how extensive such presumably drummed-up sales by others may be—and therefore for a more competitive United States *might* be. Nor is it possible to quantify for comparison and by way of offset the volume of U.S. sales that could fairly be attributed to the competitively superior marketing position achieved through the U.S. producing establishment abroad. On the former—the success of sellers from competitive countries—American producers abroad frequently recite offhand instances of the effectiveness of other industrialized countries' salesmen operating without the benefit of an entrenched local marketing establishment, but with the benefit of readily available help from their governments. There is also some corroborative evidence of their effectiveness in foreign balance-of-payments figures of these countries, showing, for example, European surpluses achieved in third areas, say, Latin America. The comparability of available figures is open to question; the various nonuniform balance-of-payments accounts do not yield clear evidence on the geographic sources of export earnings.

Nonetheless, an arresting case can be made out inferentially that major U.S. competitors are earning their trade surpluses—and ultimately their net dollars and their gold—not with this country but with "third countries." No doubt there are real possibilities for improving our commercial competitive position including increased exports to the LDC's. But whatever may be the export gains to be achieved temporarily, a real and sustainable improvement in LDC purchases from abroad, including the United States, depends on the further development of basic LDC income (production), with accompanying growth of LDC earning capacity (LDC exports).

Trade Policy is Production Policy

The U.S. delivery system to foreign markets—based on advancing production, marketing, and above all, organization techniques—has now evolved into an essentially foreign-base plant system of supply. Although this development has carried exports to an ever rising level and at a rate of growth (7 percent) about halfway between that of domestic U.S. production (say 5 percent) and our production abroad (a steady 10 percent), U.S. companies' total deliveries to foreign markets are some six times larger than "conventional" exports alone.

This does not mean that United States has a diminishing interest in good international trade policy. The freer international movement of goods and money—capital goods and capital funds as well as current goods and current funds—is now for us internationally as well as nationally an essential condition of production itself, not just of peripheral trading benefits. Production since the not entirely fictitious Robinson Crusoe has meant specialization and money. The effect of our intensively developed international producing position is a reminder that trade is an integral part of production, internationally as well as nationally. The sweep of international investment since World War II has removed any overtone of whimsy from the concept of a world economy rather than just an international one. From elaborated interproduction among nations, world production is emerging, and from international trade, world trade.

The policy implications of this shift away from the mere swapping of national products and toward world production cannot be fully anticipated. We are at a beginning here, and it is most appropriate, in my opinion, that we pause at this juncture to study, beginning our study with the responsible deliberations of this joint congressional committee.

Some major shortcomings of present policy can be sensed when reviewed against any sober effort to assess the irreversible requirements of our worldwide producing position:

1. We should squarely face the possibility that our present general policy of discouraging the normal growth of our producing establishment abroad by putting restraints and restrictions on investment

is misconceived. This approach adopted as a "temporary" (now in its fifth year) bit of pragmatism thought to be required by the exigencies of the balance of payments and thought to be productive of balance-of-payments relief, is pursued at the direct expense of our economic position in the world and is likely to have been and to be prejudicial to our earning position in the world.

2. The current emphasis on encouraging exports, though highly desirable insofar as it pertains to goods produced at competitive cost, cannot operate as a substitute for our investment and production abroad. An effective export effort in our stage of development can, for the most part, be maintained only on the basis of appropriate investment backstopping in foreign markets. Consistent with this, however, is any step that facilitates exports and thereby reduces the time lag between finanacial commitments we make abroad and the transfer of real resources (exports) to implement them.

3. Problems of improving the terms of credit available for international projects frequently arise in the context of specific export projects, particularly in the capital goods field. Almost certainly the importance of this range of problems, already high, will grow. The adequacy of international credit, of international financing institutions, and of foreign governmental policies to accommodate freer movement of capital and current funds is directly and vitally relevant to the viability of our tremendous position in worldwide production.

4. To a very real extent, international production—unlike national production—must take place on the basis of a very sketchy "legal infrastructure." National laws contain many conflicting policies, many of them simply for lack of occasion or motivation to harmonize them internationally. Among these are regulations already mentioned affecting the transfer of funds; company laws affecting the initiation and terms of operation of companies, often to the disadvantage of international companies; fiscal policies, especially unresolved problems of tax jurisdiction over international operations; antitrust and other laws affecting the permissible methods of operation in different countries.

5. The production context is especially vital to realism in considering any aspect of commercial policy affecting the less-developed countries. By definition, their position of underdevelopment means "underproduction" and "underinvestment"—investment being literally and precisely the process of committing resources to production. The question of their trade is, by the same token, a question of markets for more effectively organized production. Special measures of encouragement and accommodation for their exports may well be in order, but lacking appropriate investment support are almost certain to fall short of maintainable gains in production.

The foregoing are only a few general areas of policy requirement in the new world of international production. They are in a sense the real "nontariff" barriers that embarrass international economic development, and far outweigh the usually specified nontariff barriers such as awkwardnesses of customs procedure.

The real objective of trade policy today is to facilitate international production, and the cost of policies not appropriately responsive to this objective will from now on be measurable in terms of the adequacy of world economic development.

THE ECONOMICS OF INTERNATIONAL TRADE

BY Dr. Lewis E. Lloyd*

The subject of foreign trade has a special fascination for most people. Almost everyone is inclined to take a strong stand for or against it—often without any study of or even information about foreign trade.

This is one of those problems that has a built-in emotional response. It carries with it the lure of strange and distant places. It offers an element of vicarious adventure. In addition, it appeals to the logic of "one world" idealism—are we not all passengers on the same spaceship, earth? And finally, many have been conditioned to believe that trade and travel advance peace and that trade barriers and restrictions cause war; and hence, the trade question reflects emotions involved in the war and peace issue.

In spite of the fact that foreign trade is much discussed, it is little understood. In recent decades, writings on the subject in economic textbooks and current literature have consisted largely of a recounting of various arguments and slogans for "free trade," or "trade liberalization" as it is more subtly called. Little attention is given to the fundamental economics of foreign trade and to the accompanying problems of international finance. Generally, no attempt is made to examine and evaluate the special business problems and relationships involved in operating in international markets. Even the history of foreign trade is neglected.

In short, a simplistic presentation of the free trade theory and a glowing statement of supposed advantages has more often sufficed to reveal the emotional commitment of authors than to illuminate the nature and consequences of foreign trade. In claiming that free trade will solve most of our domestic as well as our international problems, advocates seldom get beyond the point of generalities, cliches, and the uncritical use of statistics. This is not sufficient. Only by delving into the basic economics of trade and examining all the ramifications can adequate judgements be made concerning the best policies to follow and how best to implement them.

This paper proposes to set forth the basic fundamentals of foreign trade and to examine them in some depth. It will also give attention to the practical implications that flow from the basic principles. In this we shall need to extend our attention beyond the subject of trade and take note of all aspects of the economic relations between nations.

Attention will be focused on the economic aspects of the problem of world trade. Recognition has to be given, however, to the political factors and to what extent the economic and political factors are mutually supportive and to what extent antagonistic.

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*Economist, The Dow Chemical Co.

TRADE HISTORY

From earliest times, men have sought to increase the variety of products available to them through trade. As early as 1000 B.C., Phoenician ships were bringing back silver from Spain, tin from Britain, and tropical products from Africa, Asia, and the islands. Much of the early exploration of the landmasses and later the oceans of the earth were carried out in attempts to find better trade routes and new sources of products.

Prior to the industrial revolution, even the most advanced civilizations were based largely on natural products. Land vehicles, ships, the timbers and roofs of most buildings, as well as furniture and even utensils, were largely made of wood. Special woods—spruce, cedar, mahogany, teak and ebony—were prized for special applications. Mineral ores for lead, tin, iron, copper, and silver were only known in those regions where the deposits were at or near the surface of the earth's crust. Many desirable foods, spices, fibers, and medicinals were available only in particular regions.

Accordingly, for thousands of years the variety of natural resources which are useful to man were widely scattered and were a constant incentive to farflung trade.

In 1776, Adam Smith, a professor of moral philosophy at the University of Glasgow, published his revolutionary book, "Inquiry Into the Nature and Causes of the Wealth of Nations." Prior to this date, economic thinking had been dominated by a theory called "mercantilism." Its central theme was the notion that a nation is prosperous in proportion to its supply of the money commodity—gold or silver. Common belief held that one way to increase the stock of precious metals was to expand exports and limit imports, and thereby induce an inflow of gold and silver bullion. This naturally required a host of regulations and restrictions in the country as well as at the borders, and with all a swarm of enforcing agents.

Adam Smith, in his "Wealth of Nations," developed a new concept. He declared that wealth consisted in the quantity of goods and services produced and freely exchanged. He proposed competition as an effective regulatory force in a free economic society and saw government regulations as unnecessary overhead. Complete freedom for trade between areas and different countries was a natural extension of his idea of division of labor and competition.

In Adam Smith's day, society was essentially nonindustrialized. Commerce consisted largely of the exchange of natural products and the products of handicraft. The world consisted of sovereign nations, each with a limited variety of resources. Countries that could grow wheat or corn were not suited for growing cotton. Regions that could effectively grow sheep and supply wool were not effective producers of wheat or bananas. As a consequence, individual items of food, fiber, building materials, or mineral products were shipped from a country having an abundance, in exchange for other natural items of food, fiber, and the like.

As the industrial revolution developed and research brought new insights and new competence to society, men have learned to substitute synthetic products for natural ones. At one time, horn was the only plastic material available. Now there are dozens of synthetic plastics suitable for a wide variety of end-use needs. At one time, man was dependent entirely upon natural products for his drugs and medicines. Today, most of our medicines are synthesized in factories. A century ago, Goodrich learned to vulcanize rubber from the latex of trees and make it an important industrial product. Today, we have literally dozens of synthetic rubbers that for many uses are better than natural rubber. For thousands of years, man was dependent solely upon animal and vegetable fibers for clothing. Today, we make nylon superior to the best silk and a host of other synthetic fibers to meet our needs. In recent years, we have even begun to supply specialized food supplements from our factories—products such as sulphur-bearing amino acids and vitamins. Research and technology has greatly extended man's choices.

As a result of these far-reaching developments, we are no longer dependent upon specialized regions for many of our wants. It is not surprising, therefore, that foreign trade has not kept pace with industrial growth. In the United States, for example, the record shows that our foreign trade has been progressively decreasing as a percent of our total economy, even though it has increased in actual dollars. In 1800, our foreign trade represented more than 12 percent of our gross national product. By 1875, it had decreased to 6 percent and in another 75 years to about 3 percent. Currently, it is in the 2 to 3 percent range. Figure 1 shows the record of our imports as a percentage of gross national product.

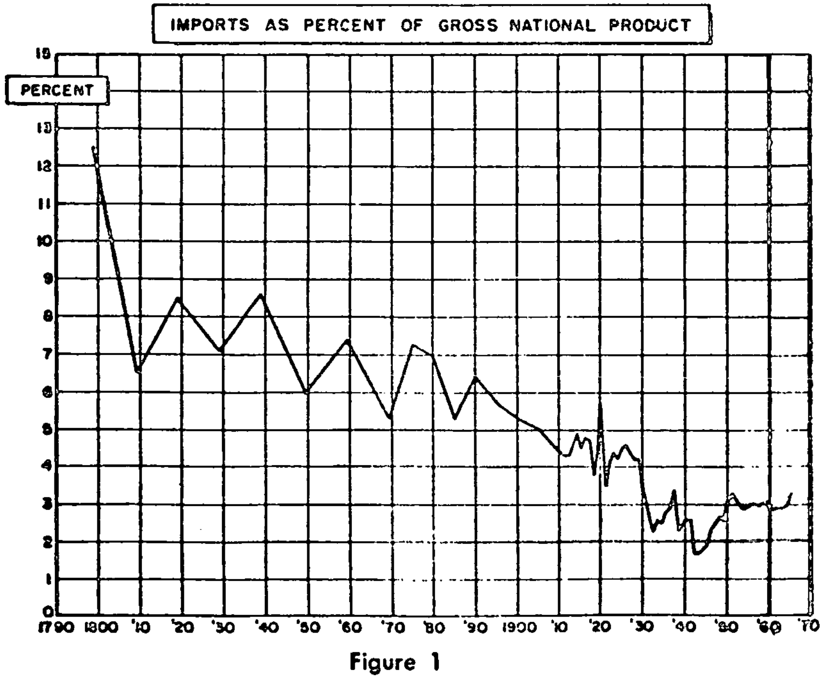

Figure 1

Nor is this trend between internal and external commerce peculiar to the United States. A look at the world situation indicates that the experience is general. In all of the industrial countries of the world, foreign trade has been decreasing in importance as the industrial economies grew. Figures 2, 3 and 4 show curves for total world production and total international trade. These curves only date back to 1925, but such data as are available show that the divergence carries back much farther.

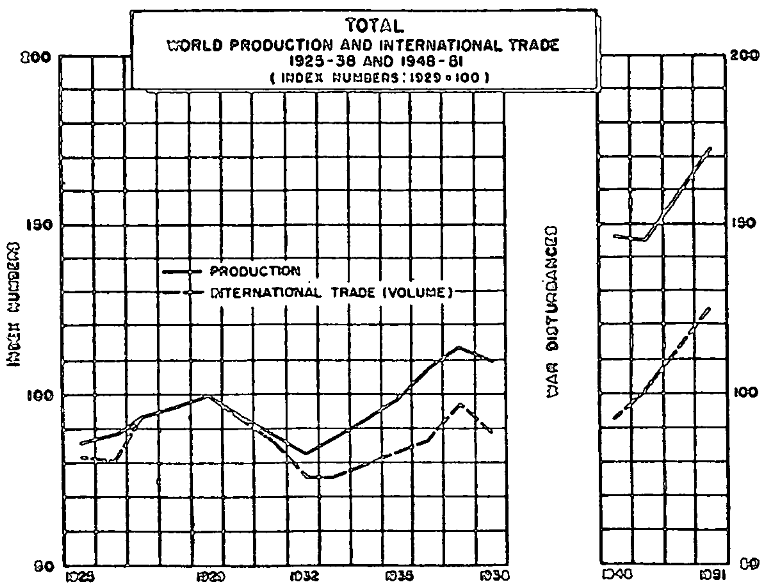

Figure 2

The bar chart in figure 5 compares more recent periods with 1870 and indicates also a progressively decreasing ratio of external to internal trade.

Many writers in recent times have proclaimed the necessity of increasing our foreign trade. The idea is presented as though any increase, all possible increases without limit, would necessarily be good. This is not a valid premise and is not a sound basis from which to build a trade policy. Moreover, history seems to indicate that the economic forces are moving in the direction of less reliance on foreign trade, not more.

For a full understanding of foreign trade, it is necessary to start with more fundamental questions, namely: Why do nations want and need foreign trade? What are the factors that determine the amount and kind of trade that will be advantageous? What is the political frame of reference in which the trade occurs?

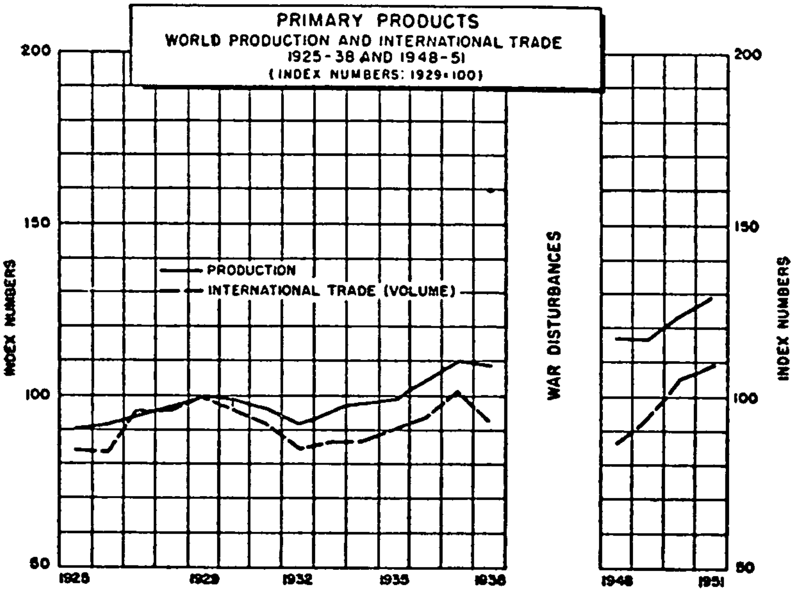

Figure 3

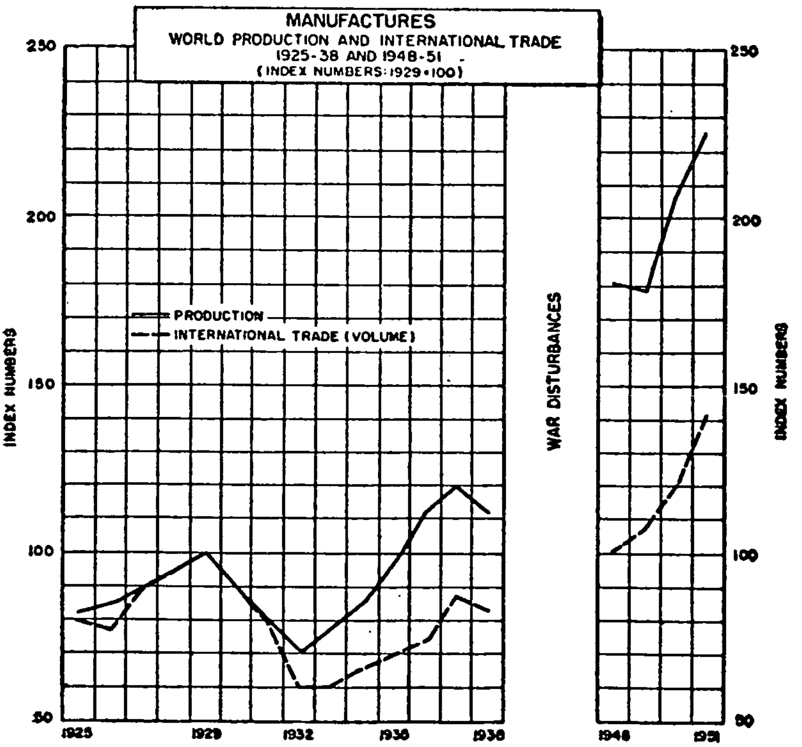

Figure 4

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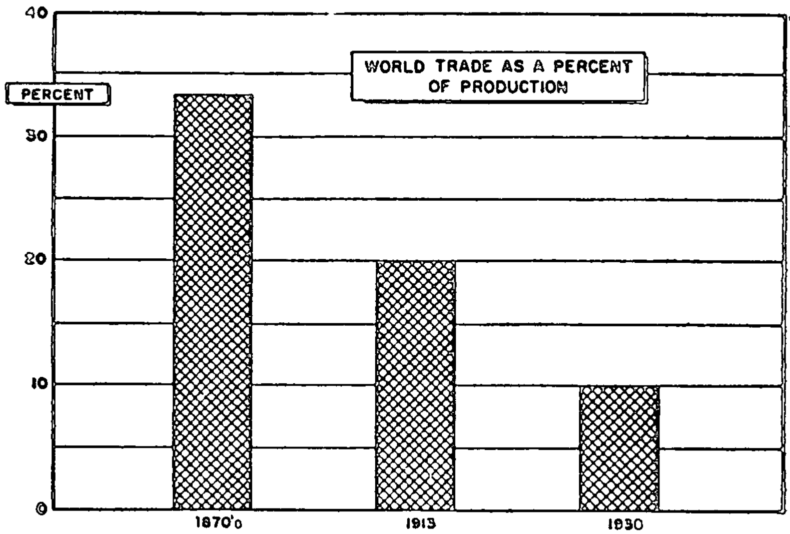


Figure 5

Objectives of Foreign Trade

When we examine the objectives of trade, foreign or domestic, we find that individuals trade to increase the range of choices and, hopefully, to lower the cost of satisfying human wants. How does trade lower costs? To answer this question, we shall need to examine some fundamental economics.

The basic economic problem consists in this: Man has limitless wants; he seeks to satisfy them with limited resources.

Man, being a rational animal having the power of memory, reason, and imagination, persists in forever visualizing new wants which he would like to have satisfied. The natural resources and the human energy available to satisfy these wants are limited.

Faced with this basic dilemma, man must make choices. He must decide how he will allocate the scarce resources and toward what ends. He must make decisions on what will be produced, and then other decisions about how the production will be divided between the members of society.

It is true that man has aspirations and objectives that are noneconomic, but most of them have economic consequences. For example, if he wishes to take time out to enjoy a beautiful sunset or to vacation in the mountains, he must forgo the rewards from productive effort that he could have had.

The Exchange Equation

"Trade" is the term we use to describe the exchange process; the act whereby we increase the variety of goods that we may enjoy. It is an essential part of that production technique called "division of labor" that permits specialization and large increases in efficiencies.

In a division-of-labor society, some workers produce a given goods or service and exchange this with other workers for the products of their labor. When a society becomes industrialized, barter is inadequate to bring about the exchange of goods and services, and so money is used as a tool to expedite the exchange. We can indicate this process by the following equation:

$$\text{GOODS \& SERVICES} \rightleftarrows \text{MONEY} \rightleftarrows \text{GOODS \& SERVICES}$$

It is important to note that the economic exchange process is not complete with the first step of exchanging goods for money, but only after the second step of exchanging the money for another economic good. If one individual or group of individuals exchanges goods or services for money, and retains or hoards part of this money, failing to exchange it for other goods and services, then an imbalance results. It means that others have production for which there is no market.

As we shall see shortly, this basic equation of economic exchange portrays the economics of trade between nations as fully as within a country. In the case of nations, however, if the export and import of goods and services does not balance, then money will flow into or out of the country and from this there are some important economic consequences.

From this equation it is obvious that trade in and of itself does not increase the amount of goods and services available. It merely brings about redistribution of the goods already produced. If a nation or a community wants a higher standard of living, it must either produce more or find a way to get part of somebody else's production.

Producing a Standard of Living

The standard of living of a society consists of the sum of the goods and services that are produced. We can picture the four factors of production and their relationship by the following equation:

$$\text{MMW} = \text{NR}(\text{HE} \times \text{T})^{\text{I}}$$

where: MMW = man's material welfare
NR = Natural resources (land)
HE = Human energy (labor)
T = Tools (capital)
$^{\text{I}}$ = Idea (entrepreneurship)

Analysis indicates that natural resources are a fixed quantity. Man may conserve them or utilize them more efficiently, but he cannot "create" them. Human energy increases only slowly and even then is balanced by an equal increase in consuming units. By contrast, the use of tools and ideas may increase rapidly and without limit. The use of tools permits the effective division of labor in a society. This reaches its ultimate in the modern, automated factory system where productivity can be very high. It is interesting to note that the factor "tools," or "capital" as the economist calls it, multiplies human energy. In the United States, we have substituted mechanical energy to the point where something over 98 percent of our total energy input is now mechanical. The extent to which tools are available in a society is proportional to the savings—stored-up human energy.

Equally if not more important is the input of ideas and innovation. The entrepreneur who conceives an idea for a better product or process, organizes the human and natural resources toward this idea, takes action, and bears the risk for his decisions, is certainly as important, perhaps even more important, than capital itself. Without new ideas and innovation, we would merely replicate the present, and such is the road to a stagnant society.

It is clear that whenever a nation or a community wants to increase its standard of living, the way to do it is to produce more. Not much can be gained by trying to redivide the pie in different ways. It is much more important to increase the total size of the pie. The individual has two options: he may produce more, or he may find a way to get part of another's production. Society, however, has only one option; it must produce more. Of course, countries as a part of the total world society may, through gifts and aid programs, through war reparations, or through unequal trade practices, conceivably benefit at the expense of some other nation or peoples. This, however, is not an effective way for a permanent improvement in a standard of living.

It is clear, then, that trade in and of itself is not a direct way to increase living standards. There are, however, some ways in which foreign trade may affect the factors of production. Examination reveals that there are five economic reasons why a nation may benefit from international trade:

1. If a nation is lacking in certain essential raw materials, it will need to import them. In fact, if a nation's sources yield essential raw materials of only low grade, it may import them more cheaply from nations with sources of high-grade minerals. Some nations are more favored than others in the abundance of natural resources. Few, if any, find themselves with adequate quality and quantity of all desired raw materials. Hence, all nations will probably need foreign trade to get certain raw materials.

2. A second reason why nations may want foreign trade is to get a full variety of animal and plant life. Nations with an overabundance of suitable soil and climate for growing certain products may profitably sell these in world markets. Coffee, bananas, rubber, and spices are products, for example, that grow readily in tropical areas, while edible grains and food animals are more efficiently produced in tempered climates.

3. Another reason for foreign trade is to obtain a mass market. Whenever production can be mechanized, unit costs decrease in proportion to the size of the production unit. Outstanding examples are large steel mills, petroleum and chemical plants, and the production-line automobile plants. Large-scale production is not possible, however, unless there is a mass market. Wherever a country is too small to represent by itself a mass market, it will need trade with its neighbors to expand the market and get the advantages of large-scale production.

4. Conversely, a nation may profit by foreign trade if its technology, ingenuity, and inventiveness lag behind. By trading services and craft products with neighboring nations for mass-produced items, a backward nation can obtain manufactured products not otherwise available to it. Industrial nations can get new and/or patented products that it does not yet produce.

5. Finally, the balance of supply and demand is constantly shifting in each nation—crop failures, temporary imbalance in new capacity, et cetera. Foreign trade often is able to bridge the demand/supply gap in individual countries on a current basis.

FREE TRADE THEORY

The extension of the ideas of division of labor and free markets to a worldwide basis has been formalized in the free trade theory. This proposes that in the absence of interferences, division of labor would take place on a worldwide basis; that, as a consequence, man-hour productivity would increase everywhere and this would mean higher standards of living for all. It would result in the use of the best, most readily available raw materials, the best locations, the most effective human energy, and the best ideas, coupled with the best tools to bring about the lowest cost production. The theory proposes that under such conditions individuals would be employed at their highest skills, the most readily accessible and highest quality raw materials would be utilized, and the ultimate in mechanization reached. In other words, this theory holds that if there is complete freedom for trade throughout the world, man-hour productivity, per capita income, and living standards will be maximized. The theory also holds that unilateral adoption of free trade will benefit any nation that practices it, whether or not other nations reciprocate, and that any nation that does not practice free trade cannot obtain the highest standard of living for its people.

The free trade theory does not even require that each nation be able to do something better than all other nations, but merely that each nation be engaged in that production which it can do better than anything else. Dr. C. E. Griffin, professor emeritus, University of Michigan, states the principle of comparative advantage as follows: "If a country is blessed with advantages it always has greater advantages in some lines than in others. It will, therefore, gain most if it devotes its efforts to the things it can do best and exchanges the products of these efforts for things in which its advantage is least." [1]

The advantages proposed for free trade are both desirable and convincing, since man seeks to satisfy his wants with the least possible effort. The free trade theory is very appealing. In an ideal world, free trade might be as perfect in practice as in theory, but to fully evaluate its application, we must examine the premises on which it is based and see to what extent they are realized in the real world. We shall see that many conditions must be fulfilled if free trade is to give the results claimed.

For several decades, the discussions concerning international trade have focused attention primarily, in fact almost exclusively, on the question of tariffs. There has been a tacit assumption that the elimination of tariffs would in and of itself lead to the advantages of free trade.

Careful examination shows that the free trade theory was conceived as a basic natural law. Its attention is centered on division of labor based on natural advantage—natural advantage associated with either

[1] Clare E. Griffin, "A Tariff Policy for Modern Times," Michigan Business Review, vol. V, No. 5 (September 1953), p. 9.

inherent individual skills or advantages in natural resources and climate. Although the statement of the theory does not say so, it is inherent in its major premise that other factors, let us call them unnatural advantages, are all equal. It means that all the ways other than tariffs by which governments may interfere with or structure the international marketplace must be eliminated or equalized. In other words, it assumes that all of the international economic relations of the peoples of nations are on a completely free market basis. When the economic engineer seeks to apply the free trade theory, he finds that, as a minimum, the following conditions would have to be met in order for the proposed results to be obtained:

1. No government enterprises.
2. No government subsidies.
3. No major variation in taxes on business.
4. Uniform business laws, uniformly enforced.
5. No immigration restrictions.
6. Complete free markets in exchange rates and movement of capital.
7. No overriding defense requirements.
8. No cartels.

When government enters production or engages in state trading, prices are based on political considerations and not economic costs. As a consequence, international trade which involves government enterprise will not generally lead to an international division of labor based purely on economic efficiency. Trade and economic programs that are tailored to political objectives have shown a history of low economic efficiency. This is not surprising because the political rewards system penalizes mistakes so much more severely than it rewards success.

In similar manner, international trade based on government subsidies—whether it be tax forgiveness, whether it be government guaranties of loans, whether it be sales of subsidized products below home prices, or by whatever means—all subvert the price mechanism in the economic allocation process. In fact, the whole object of a subsidy is to negate the consequences of the decision of the marketplace. Thus, subsidies thwart the objective of free trade.

If there are major variations between countries in the taxation of businesses, then government-imposed taxes will be a major factor in determining the economic division of labor. This will thwart the allocation based on true economic costs.

In similar manner, laws governing business activity, man-hours, overtime payments, minimum wage rates, safety standards, and vacation and holiday practices, influence production costs. However socially valuable such regulations may be, when there are wide differences between different countries this may influence the allocation of production more than does true economic efficiency.

Human energy—labor—is one of the key factors of production. If maximum efficiency is desired, then workers must be free to move so that the most effective combination of natural resources, workers, capital, and ideas may be combined.

In a capitalistic, industrialized society, capital is a very important factor of production. Accordingly, there should be no restrictions on the movement of capital across national borders nor on the earnings from the employment of resources in any given area. In like manner, there should be a complete free market in exchange rates so that the exchange rates can adjust between countries and properly relate changes in productivity and wage rates.

No nation will be willing to truly face the ultimate in international division of labor unless it feels secure from war and the necessity of maintaining an adequate national defense. Modern warfare is heavily based upon technology and the products thereof. The implications for national defense are clear.

Finally, businessmen are themselves inclined to try to thwart the verdict of the marketplace. One way is to form cartels. In so doing, producers either collude in setting prices or on dividing the market by territory. Cartel practices are outlawed in the United States but have been a regular part of export practices of the European and Japanese business communities. A cartel may set export prices at, above, or below domestic prices, depending on the immediate objective. If the export is primarily to move surplus, then the export price may be set low. Under other conditions and especially to underdeveloped countries, the export price is often held above domestic prices.

Basically, cartels are formed to reduce or eliminate competition. In foreign trade, cartel pricing may be used to drive competition out of business, or to prevent potential competitors from getting started. After the competition has been destroyed or blocked, then prices are raised to higher and lucrative levels.

Individual firms may also treat the foreign market different than the home market. It is not uncommon for a producer who has some unused plant capacity to reason that, on an incremental basis, the cost of producing additional units, up to capacity, would be very low. Further, that he could sell the extra production at lower prices in foreign countries without disturbing his home price, and thus add some incremental profit. This is, in fact, a very common practice. It distorts the price mechanism, causing it to give a false signal. The undesirability of this type of short-range, shortsighted practice is indicated by the derogatory term, "dumping."

Thus, business practices may also thwart the international marketplace in its allocative function of maximizing efficiency. Within a country, government regulations may be used to prevent collusion and reinforce competition. No government, however, can control what the nationals of a foreign sovereign nation do. The most it can do is to offset at the border the consequences of restrictive practice by foreign producers.

When a theory is applied under conditions different than those which its premises assume, the results are likely to be quite different than promised. When we look at the real world of commerce, we see that there are many ways in which governments structure and interfere in the international marketplace, ways that thwart the ideal division of labor.

To be realists, we must do one of two things: either we must succeed in eliminating all interferences in the international marketplace and accept a large degree of laissez-faire in economic affairs; or we must recognize that we are not dealing with an ideal situation. It may be that the structure of tariffs that has been widely used for many decades is a practical way of dealing with the imperfections in the international marketplace when the world is divided into sovereign nations.

It is interesting to note that when six countries of Europe sought to establish a Common Market, they had to wrestle with these very problems. As they have eliminated, step by step, the tariffs between each other, they have had to try to harmonize the other factors that impinge upon economic efficiency. They have permitted the freedom for workers to move from country to country. They are seeking to harmonize their fringe benefit programs. They are moving in the direction of harmonizing business laws—antitrust and patent laws, etc. They are making progress toward harmonization of business taxes, and they are looking forward to the day of a common currency, which would eliminate the exchange problems.

This is not surprising, because in the great free trade area between the 50 States of the United States, we have met or approached all of these requirements in the premises of the free trade theory.

Theoreticians have steadily set their face toward the ideal of free trade and the maximum division of labor. There is reason to doubt that a maximum division of labor for maximum efficiency on a worldwide basis would, in fact, be a desirable situation. Maximum division of labor would carry with it the risk of maximum instability. Communities, companies, even individuals, find it desirable to spread the risk—to diversify, to apply the insurance principle. Even the Detroit auto industry has seen fit to spread its production units into every corner in the United States and to expand into many other products in addition to automobile production.

Stability is becoming an increasingly prominent objective of industrial systems. It is doubtful that, given a free choice, workers would choose the small increments of productivity increase over the risks of maximum specialization. Countries that are essentially "one industry" countries—coffee dominance in Brazil, copper in Chile, and tin in Bolivia—are in frequent trouble due to instability in fluctuating markets. The ideal would surely be some appropriate accommodation between diversification and maximum specialization.

In the economic reasons for foreign trade, we noted the need for a mass market. The economics of total cost, including distribution to the consumer, indicates that there is a practical limit to the advantages from specialization as between industrial countries. For example, it would not be economically desirable to have the United States make all of the automobiles and Europe make all of the steel. Both Europe and the United States have ample requirements to permit maximum savings from large-scale production in both of these products. To ship half of the cars to Europe and half of the steel to the United States would add unnecessary shipping costs.

The free trade theory presupposes a world marketplace that is unhampered by government restrictions and interferences of any sort. It assumes a worldwide dissemination of pertinent product information. It assumes freedom to advertise and transmit knowledge about products. And, in a sense, it also assumes an openmindedness about foreigners and foreign products—no nationalistic bias.

To what extent are these conditions met in actual practice? What are the conditions and special hazards that the businessman meets and must adjust to in international commerce? To what extent do governments place special hurdles that impede international trade?

In actual practice, most countries apply a whole host of procedures, taxes, and restraints on imports. Some countries, like the United States, rely primarily on duties. Others have, in addition to duties, extensively utilized direct quantitative restrictions and more subtle regulatory practices. The United States has been extensively reducing trade barriers for two decades; by contrast, many other countries have been increasing restrictions, especially in the area of nontariff barriers.

The U.S. Department of Commerce, Business and Defense Services Administration, and the Bureau of International Commerce, have set forth a definition of "nontariff trade barriers" and listed many practices which are or can be used to impede imports:

Definition of "Nontariff Trade Barrier"

A nontariff trade barrier is defined as any law, regulation, policy, or practice of a government, other than the import duty proper, which has a restrictive impact on imports. For purposes of this questionnaire, this definition does not include impediments to trade resulting from the operation of foreign cartels, private monopolies, or other nongovernmental business practices.

Some nontariff restrictions may be specially designed to insulate segments of the domestic economy from the effects of imports from foreign competition. There are, however, many other reasons for these barriers including the conservation of scarce foreign exchange, the promotion of economic development, the protection of domestic business against unfair competition from abroad, the protection of the public health, safety and morals, the protection of the national security, the collection of revenue, and the control of imports of products for the public account in favor of domestic procurement. Some of these barriers are recognized as legitimate under international commitments to the extent that they are not abused.

The following is an illustrative list of trade regulations and practices which may be so drawn or administered as to have a restrictive effect on the sale of U.S. goods abroad, and should be considered as nontariff trade barriers.

A. CUSTOMS LAW

(1) Regulations governing the right to import.
(2) Valuation and appraisement of imported goods.
(3) Classification of goods for customs purposes.
(4) Marking, labeling, and packaging requirements.
(5) Documentary requirements (including consular invoices).
(6) Measures to counteract disruptive marketing practices, e.g., antidumping and countervailing duties.
(7) Penalties (for example, fees charged for mistakes on documents).
(8) Fees assessed at customs to cover cost of processing (handling) goods.
(9) Administrative exemptions (for example, administrative authority to permit duty-free entry of goods for certain purposes).
(10) Treatment of samples and advertising material.

(11) Prohibited and restricted imports.

(12) Administration of customs law provisions (delay in processing goods, inadequate or delayed publication of customs information).

B. OTHER LEGISLATION SPECIFICALLY APPLICABLE TO IMPORTS, UNDER WHICH RESTRICTIONS ARE APPLIED PRIOR TO ENTRY OF GOODS

(1) Taxes.

(2) Balance-of-payments restrictions (including quantitative import restrictions, licensing fees, prior deposit requirements, import surcharges, credit controls on import transactions, multiple exchange rates).

(3) Restrictions imposed to protect individual industries (including measures to protect infant industries).

(4) Taxes applied to imports to compensate for indirect taxes borne by comparable domestic goods (European turnover taxes).

(5) Restrictions applied for national security reasons (other than under customs law).

(6) State trading (or the operation of enterprises granted exclusive or special import privileges).

(7) Sanitary regulations (other than under customs law).

(8) Food, drug, cosmetic, and pharmaceutical regulations.

(9) Patent, trademark, and copyright regulations.

(10) Shipping and insurance regulations.

C. OTHER LEGISLATIVE AND ADMINISTRATIVE TRADE BARRIERS

(1) Government purchasing regulations and practices.

(2) Domestic price control regulations.

(3) Restrictions on the internal sale, distribution and use of products:

(*a*) Screen quotas and other restrictions affecting motion picture film and television program material.

(*b*) Specifications, standards, and safety requirements affecting such products as electrical equipment, machinery and automobiles.

(*c*) Internal taxes that bear more heavily on U.S. goods than on domestic products (for example, automobile taxes in Europe based on horsepower rating).

(4) Restrictions on advertising of goods.

(5) Restrictions on display of goods at trade fairs and exhibitions.

It will be useful to single out a few of the more important nontariff barriers and to examine them specifically:

1. State trading. Obviously, nations such as the U.S.S.R. and its satellites, which set up a political bureau to plan and handle all foreign trade, have moved the foreign trade sector of their economy completely into the political arena. While only a few nations openly apply state trading, many other nations in applying licenses, quotas and the like, start by developing a central plan which includes a specific level of expected exports and imports.

2. Import licenses are widely used means of controlling imports. Most of the underdeveloped countries use licenses extensively. Many countries, even when not faced with unfavorable

trade or balance of payments, leave their import license procedures on the books. They merely make licenses easy to get when imports are desired.

3. Some countries require import deposits, which run from a modest amount up to as much as 200 percent of the value of the merchandise. This is, in effect, a forced loan against the foreign exporter. These deposit systems have been extensively used by South American countries. Even more important than the interest cost is the loss in purchasing power through a rapid and continuing price inflation that reduces the purchasing power of the local currency.

4. Foreign exchange allocations of currency for imports. This has been extensively used in Japan and in some Latin American countries.

5. Price controls have been used by India and Belgium to limit specific imports.

6. Specific requirements such as field testing of pesticides by West Germany and France, or difficulty in registering pharmaceutical products in Spain.

7. Excessive delays in the clearance of import licenses and excessive paperwork are procedural impediments in a number of countries, notably in South America.

8. Cartel arrangements which may be used to freeze out other potential suppliers, as was the case in the EEC for the distribution of ammonium sulphate fertilizer to preclude U.S. entry into that market.

9. The use of turnover, value added or cascade consumption taxes and special surcharges in some EEC countries are another potent nontariff barrier.

In moving to harmonize the taxes on business within the EEC, several countries are adding or adjusting their value added tax. This becomes significant because whereas the total tax against business in Europe does not differ greatly from ours, in most countries half or more of the corporate tax is in the form of a value added or turnover tax, whereas most of our corporate tax is profits tax. When we ship to Germany, we will already have paid income tax on the total income and will, in addition, have to pay a border tax equal to the turnover tax that would have been paid if the product had been made in Germany; so the total tax on exports from the United States to Germany will be considerably higher than on German production.

By contrast, when a German firm—the same is true for many European countries—ships to the United States, it does not have to pay the value added tax that it pays on domestic sales. Thus, the tax on a U.S. export to Germany is about twice as much as the tax that a German producer pays on exports to the United States. This is one example which shows how taxing differences can affect international trade.

U.S. Trade Experience

National trade policy, if it is to be successful, must be sound. To be sound, it must recognize and accommodate to the facts of the real world: a world composed of sovereign nations and less-than-perfect men. Men who are often shortsighted and seek short-term gain over longer term benefits. A world in which in proportion as political forces are injected into the economic process, short-term or irrelevant criteria influence decisions and, as a consequence, basic factors are submerged.

It will be instructive to examine the recent history of U.S. foreign trade and economic policy as a frame of reference for perfecting the future. Past policies need to be examined and evaluated in order to judge what changes are required for the future.

It will probably be adequate to look at our foreign economic history in the period since World War II. Important changes in foreign economic policy that represent a break with our total history occurred in the early postwar years. The practical policy question is whether these policies should be continued and extended or whether some basic and important changes are necessary.

One break with the past was our initiating and joining the organization known as "General Agreement on Tariffs and Trade" (GATT). By this step we shifted from bilateral to multilateral trade negotiations and agreements. The Trade Agreements Acts have authorized the Chief Executive to negotiate reciprocal tariff cuts with other nations. Since 1948, these negotiations have been carried on through the GATT organization on a multilateral basis.

It is difficult to determine the average level of tariff rates for any given nation and, even more difficult, to judge their degree of protection. It seems clear however that, on the average, U.S. tariff rates since 1934 have been reduced by more than 75 percent and that the recent GATT negotiations will have reduced the remaining tariff level by an estimated 35 percent. The reason the average is less than 50 percent, authorized by the "Trade Expansion Act of 1962," is that already many of our tariffs were down to 8 percent or less, and these low tariffs were reduced only 20 percent instead of the 50 percent on other products.

The argument for the Trade Agreements Act in 1934 and for its many extensions since has always been that reciprocal tariff reduction would increase our exports and thereby improve our economy. We have already seen that, on the basis of theory, actual trade practices of other countries, and long-term history, this is a forlorn expectation. Nevertheless, we should examine the trade data for the past couple of decades and see what indeed has happened to our foreign trade.

Figure 6 shows the U.S. imports and exports in the postwar years. The upper curve shows the exports as reported by the Department of Commerce; and the dashed curve, the imports.

A significant part of these exports, however, are goods that we buy with our own money and ship overseas. Included are sizable quantities of agricultural products sold under Public Law 480 to the less-developed nations of the world. These are paid for in the country's local currency and are blocked so that they cannot be converted to dollars and must be spent in the country. To date, about the only use we have been able to make of these currencies is to build elaborate embassies and to finance congressional junkets. So these sales are, in fact, a gift. Also included as exports are the food supplies that we ship as relief to famine areas. Included also are sizable shipments to our military establishments overseas. And finally, included are annu-

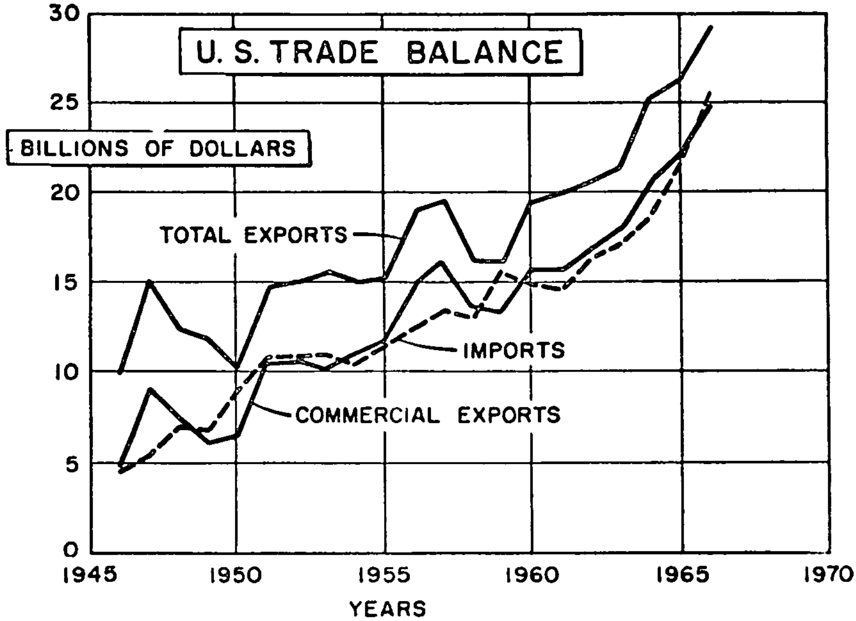


FIGURE 6

ally \$2 to \$3 billion of agricultural products which are subsidized. The grain and produce that are under our price-support programs are sold on the world market well below the support price at home. The difference constitutes a subsidy, which has averaged about 25 percent. When these exports, which are paid for with American dollars or subsidized, are subtracted from the export data, the so-called trade surplus vanishes.

We follow the practice of tabulating our foreign trade on the basis of FOB values (for imports this is the price at the foreign factory or shipping point). Practically all other nations use a CIF basis (cost, including insurance and ocean freight—that is, landed cost). Practically all of our imports and most of our exports move on foreign bottoms. In the case of imports, therefore, we pay out dollars for the landed cost. The ocean freight, insurance, and other transport costs have to be added to arrive at a landed cost. Several studies have indicated that this ranges from 10 to 25 percent. One study shows an average of 17 percent.

In figure 7 the import curve has been converted to a landed cost basis by adding a modest 15 percent. It is clear from this data that our commercial exports (those sold in competition in the world market) and our imports on a CIF basis for which we pay out dollars has not been in balance in the past two decades, and that we do not have a favorable trade balance but a net unfavorable trade balance—gifts can hardly be called trade—and that the dollar value of imports has actually grown more than commercial exports since the end of the 1940's.

Moreover, even the adjusted exports shown in figure 7 exaggerates our competitiveness. A significant portion of our exports are from U.S. firms to their overseas subsidiaries. Department of Commerce data shows that this has varied from \$2½ to \$3 billion in recent years.

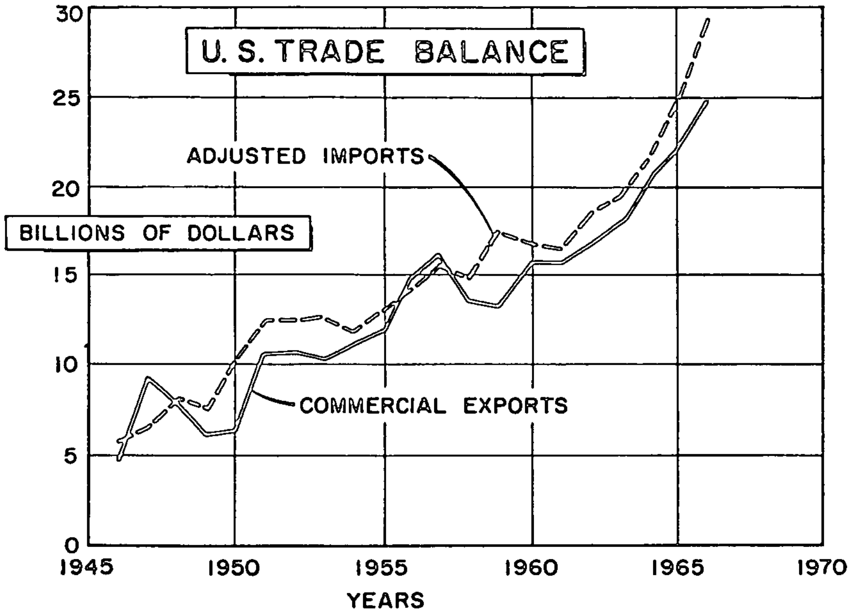


FIGURE 7

In many cases, these exports were not competitive and were justified solely on the basis of internal corporate accounting.

It is clear that we not only do not have a favorable trade balance but actually an unfavorable one as far as our competitive commercial exports are concerned. Instead of our trade data indicating that there would be a large growth in our exports relative to imports if all tariffs were lowered or eliminated, it indicates the exact opposite; namely, that we are not competitive in world markets and that, in the absence of tariff protection, imports can be expected to climb faster than exports. Moreover, there are other independent evidences that we are, on the average, noncompetitive with efficient foreign producers.

One such is the changing character of our exports and imports since the early 1950's. Dating back to early this century, the United States imported primarily tropical products, raw materials, and products of low labor content, and exported primarily manufactured goods. In the past decade and a half, this has been reversed. We now export, on balance, more agricultural products, raw materials, scrap iron, chemical raw materials, and products of low labor content, than manufactured products. More than half of our imports are now manufactured goods of high labor content—cameras, typewriters, automobiles, motorcycles, TV's, dyes, medicinals, etc. (In chemicals, for example, U.S. exports of crude coal tar products increased 746 percent from 1951 to 1960. In the same period, our exports of coal tar dyes and stains decreased by 32 percent, and our imports increased by 51 percent.) This striking change in the character of our trade is a clear-cut indication that our labor costs are pricing us out of world markets.

A final evidence of our noncompetitiveness is a continuing chronic negative balance of payments. Our merchandise exports and imports are, of course, only a part of our economic exchange with other nations. We have to look at the balance of payments to see the whole picture. The economist speaks of "goods and services" and our international economic relations must include the service sector as well as the goods sector.

The balance of payments is the figure that shows the balance or imbalance of our total economic exchange with other nations. It includes the following:

The net of foreign trade.
The net of tourism.
The net of services (shipping, insurance, et cetera).
The net of capital and investment flow.
The net on gifts and loans.

It turns out that our foreign aid policy represents another break with previous history in our foreign economic relations. The massive outflow of dollars through foreign aid gifts have had important implications for our balance of payments. Nevertheless, the most fundamental factor relative to a balance of payments is the competitiveness of a given economy in world markets. If, for example, our competitive position were favorable enough, all of the foreign aid dollars would be spent for our products, and thus, the gifts would not have an influence on the balance of payments.

As shown in figure 8, we have had a negative balance of payments every year since 1949, except for the year 1957 when the Suez crisis

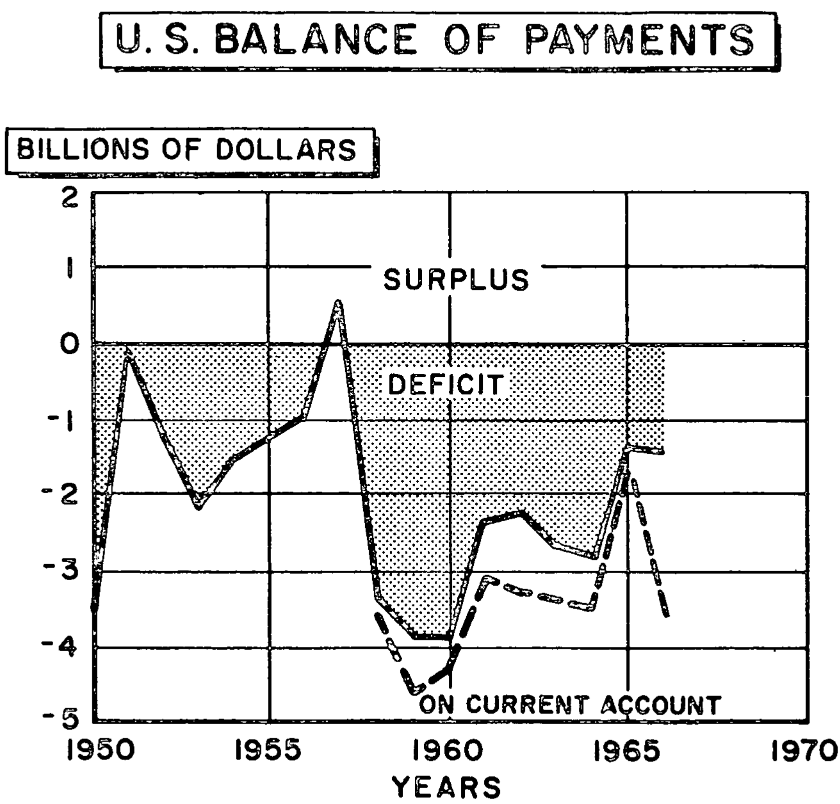
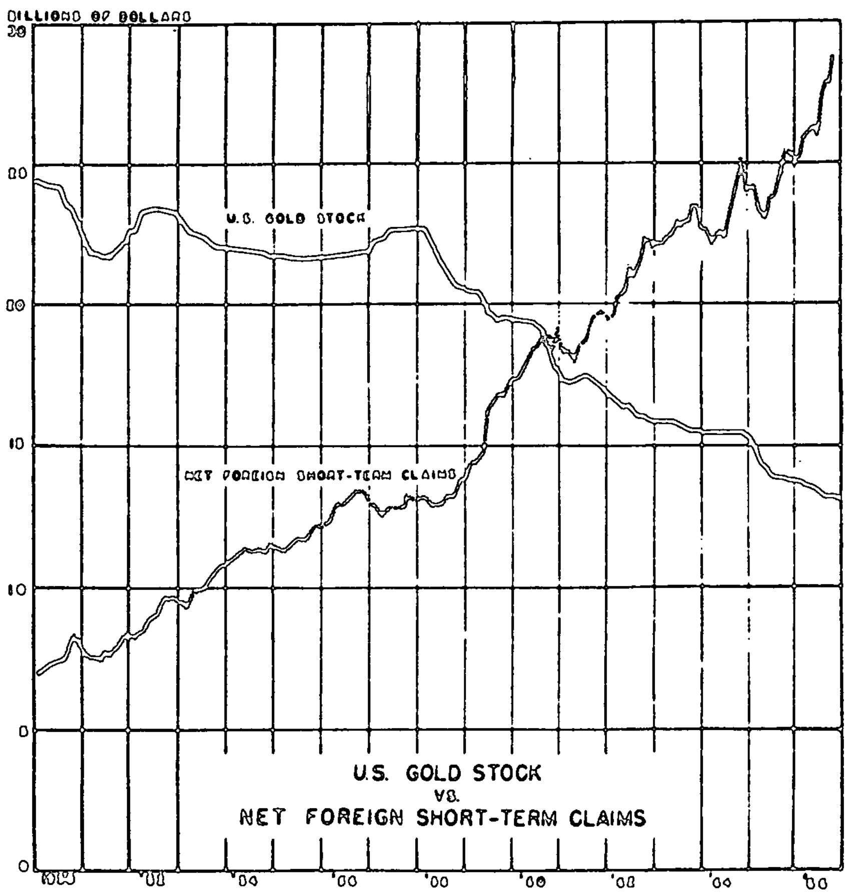


FIGURE 8

forced Europe to buy quantities of oil from the dollar area. This means that year after year more dollars have left our shores than have returned. This continuing and growing deficit exists because foreigners who get dollars from our imports, from tourism, and from gifts can, on the average, use these dollars to buy elsewhere cheaper than in the United States.

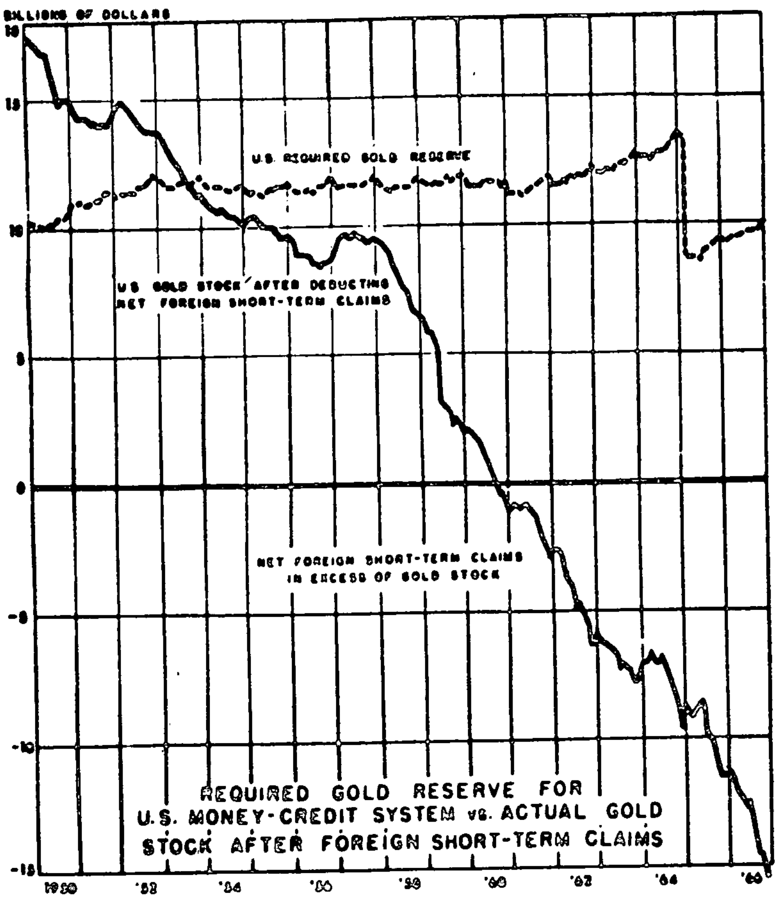
As a result of the continuing outflow of dollars, foreigners have built up dollar claims against us, and in addition, have claimed almost half of the gold that we had at the end of the war. Figure 9 shows our gold reserve, which was $24.6 billion in 1948 and 1949, has now been reduced to about $13 billion. Gross foreign dollar claims are now about $33 billion. The net figure is about $26 billion, after subtracting our claims against other currencies.



Source: American Institute for Economic Research

FIGURE 9

Figure 10 shows the amount of gold we would have left if at any point in the postwar years all of the dollar claims had been cashed for gold. Also shown is the amount of gold required to meet our bank reserve requirements. By early 1965 this latter had gotten up to almost $14 billion. When the gold cover was removed from Federal Reserve deposits in February 1965, the domestic banking requirement dropped to a little more than $6 billion, but has since moved back up to $10 billion.



Source: American Institute for Economic Research

FIGURE 10

It is clear that since 1960 we have not had enough gold to meet all of our foreign commitments, let alone our domestic banking requirements. It is this shortage of gold backing that has reduced foreign confidence in the dollar and has toppled it from its former position as the most sought after currency in the world.

Causes of Loss of Competitive Position

There are two basic causes for our noncompetitive position and its unfavorable consequences for the balance of payments. One has to do with the inflation process, and the other with rigidities in the foreign exchange market. A nation's competitive position is determined by its wage rate divided by its productivity vis-a-vis other nations. At a given exchange rate, if the wage rate divided by productivity turns out to be the same for two nations, then they will on the average be competitive. If the wage rate in one country is twice that of the other and its productivity is twice that of the other, they will have the same average unit cost factor.

But wage rates and productivity factors may change differently for different countries over time. When this happens in a truly free international market, the exchange rate will change to keep the average unit cost factor the same.

Another important change took place following World War II, namely, the establishment of the International Monetary Fund and its control of exchange rates. Exchange rates are now fixed by this international bureaucracy and are not subject to fluctuation in a free market as they were early this century. Here we have a political rigidity which affects one important part of the international market.

The present exchange rates were fixed soon after World War II, long before anyone could foresee the resurgence of Europe and Japan and the phenomenal increase that they have made in productivity. Their productivity has increased about twice as fast as ours, and they have not matched their rapid productivity gains with equally large wage rate increases. As a consequence, they have improved their competitive position vis-a-vis the United States.

Inflation

Another important factor is the inflation which we have sustained and which has not been matched by any devaluation of the dollar or exchange rate adjustment.

We noted previously that money is a tool used to assist in the economic exchange process. If the amount of money is kept in step with the amount of goods and services to be exchanged, the exchange process can operate smoothly. If, however, hoarding (which draws money from circulation) or counterfeiting (which adds excess money) distorts the money supply in relation to the economy, the economic exchange process is disrupted.

Private counterfeiting, although constantly being tried, has never become large. The creation of worthless, paper, fiat money by monetization of the Federal debt, however, has reached major proportions. This type of "printing press" money has an effect on the exchange process similar to that of private counterfeiting. During World War II, Korea, and subsequent years, Federal expenditures have often exceeded income. A substantial portion of the bonds covering this debt has been placed in the Federal Reserve System as new and additional money created out of "thin air." In this way, more than $100 billion of "printing press" money has been injected into the banking system and this has served as a base for further credit expansion. By this process of monetization of the Federal debt, the ratio of money supply to goods and services to be exchanged has more than doubled. There are far-reaching consequences from such extensive monetary inflation.

One is the increase in prices. In the postwar years, two dollars (one good dollar and one "printing press" dollar) have been coming to the marketplace to bid for a dollar's worth of goods. Since the market couldn't tell one from the other, prices have been bid up to twice prewar level. In fact, the price index indicates that the dollar is only worth 43 cents in terms of 1939 purchasing power. Not only have prices of products been bid up, but also wages. The price of labor has gone up along with, in fact a little more than, the price of goods.

This monetary inflation has had important consequences for our balance of payments. The basic difficulty becomes evident when we examine the exchange equation:

$$\begin{array}{c} \text{GOLD} \\ \updownarrow \\ \text{GOODS \& SERVICES} \leftrightarrows \text{DOLLARS} \leftrightarrows \text{GOODS \& SERVICES} \end{array}$$

Normally, when foreigners sell us goods or services or by whatever means get dollars, they would spend these dollars for our goods and services. If this balanced out, there would be no distortion. As a result, however, of our monetization of Federal debt, the prices of our goods and services have more than doubled. There is one economic good however—gold—that still has the same price as was fixed in 1934; namely, $35 an ounce. Thus, gold is the cheapest commodity that we offer to the world. It is not surprising that foreigners prefer to trade our dollars for gold or to hold these dollars against the day when they might wish to trade them for gold. So long as confidence remains, the advantage of holding dollars in the form of Treasury notes or bills is that they pay interest. When dollars are cashed in for gold, not only is there no interest payment, but there is in fact a storage charge.

The monetary inflation and its consequent higher labor costs and prices is the basic reason why our products are not more competitive in world markets. To be sure, the foreign aid dollar outflow has aggravated the problem, but fundamentally our unit costs have advanced higher than that of our aggressive competitors in the Common Market and Japan. We cannot hope to get back to a permanent balance in our foreign accounts until we recover our competitive position. The straightforward and simple way to do this would be to establish a free exchange rate or at least widen the limits for fluctuation so that supply and demand forces can make some real adjustment. In this way, the relative value of the currencies of different countries would again truly reflect the average wage level divided by productivity, and hence, the average price level in each country.

Future Trade Policy

First, in looking at the question of future trade policy, we need to recognize that trade is not an isolated event but only part of our total foreign economic relations. We need to develop a policy that covers and coordinates all of the economic relations between other nations and ourselves—trade, tariffs, quantitative controls, dumping practices, cartels, patents, exchange rates, capital transfers and repatriation, tourism, and aid.

We must also recognize that theories do not operate in a vacuum; that the real world differs substantially from the idealized conditions visualized by the free trade theory. It is essential that our policies be based on the real situation, on reasonable expectations of the behavior of sovereign nations, and on enlightened self interest:

1. We should recognize that the system of trade controls that nations have developed through the years has, in fact, been a system. That tariffs, for example, are only one of the ways of "handicapping" in the world marketplace. In part, tariffs have been used to compensate for other restrictive practices. Further, we should realize that of all the various forms of government restrictions on trade, tariffs are much less objectionable than are quotas, licensing, and other quantitative restrictions. We should be extremely leery of moving in the direction of quotas and licensing in areas where tariffs have been reduced or eliminated, and as a consequence, industry and jobs jeopardized. Quantitative controls inject government policy decisions deeply into the economic process. It becomes difficult, even to the point of impossibility, for government regulations to avoid inequities as between individual enterprises. If we find that on the products of some industries our tariff rates have been reduced too much, it would be better to increase the tariffs than to get involved with licensing and quotas.

2. As a first step, we should recognize the basic cause of our difficulties and readjust the exchange ratios of the various currencies to reflect the average unit costs of each country. The simple way to discover the relative average costs would be to reinstitute a free market in foreign exchange. Those who claim that this would disrupt foreign trade because of uncertainties of foreign exchange rates apparently have never heard about "hedging" by buying exchange futures.

An important side effect of floating exchange rates, or at least a widening of the margins within which exchange may fluctuate, is that it would take care of the so-called international liquidity problem. Experience indicates that when free market forces can adjust the exchange between currencies, very little of the money commodity—gold—is required because there are few imbalances that have to be corrected by the shipment of gold. It is the present system of rigid exchange rates which makes almost any level of gold reserve inadequate to meet all of the imbalances that tend to pile up.

3. We need to put an end to our Federal deficits and monetary inflation in the United States in order that we do not further aggravate the problem of pricing ourselves out of world markets through the well-known inflation process.

4. We need to substantially revamp and improve our antidumping laws. In a world of sovereign nations, it is inevitable that producers with any idle capacity will seek to sell in foreign markets, at dumping prices if necessary. Such a producer can always justify his lower foreign price by incremental costing of

his extra production and by reasoning that dumping overseas does not affect his market price at home. This kind of distress selling, and even more so, direct predatory pricing with an attempt to drive localized production from the market, is disruptive of ordinary marketing processes. It gives false signals both to consumers and producers as to the relative value of competing products. International trade will grow on a sound basis in proportion as dumping practices can be minimized.

The low levels of tariffs to which we are now committed will be an open invitation to extensive dumping practices; therefore, we need to prepare the best possible defenses against this type of market disruption.

A sound antidumping law would establish dual criteria as a basis for dumping penalties, (1) that there be, in fact, sales below fair market value; (2) that there be injury to producers in the country of import.

The crux of the matter comes in the definition of the terms in these two criteria.

To arrive at a definition of dumping, a fair market value must be established. Important criteria for the definition of "fair market value" are: (1) that it should represent a price at which the product is freely offered in the country where produced; (2) in normal wholesale quantities, unless the import is similar to a level of trade in the product for which there is special pricing and conditions of sale in the home market—"condition of sale" here referring to end use, type of shipment, duration and volume of the commitment, et cetera; (3) that the price be taken as f.a.s. (free alongside ship) or f.o.b. ship's rail (depending on whether packaged or bulk cargo) at the time and place of shipment or at the nearest port; (4) that calculations of currency exchange rates used in any antidumping case be the actual involved in trade transactions where there is a difference from official rates.

It is important that an injury test be relevant to the actual market conditions. Any suitable definition should include the following criteria:

1. An antidumping statute should recognize no injury for products that are noncompetitive. For this, the U.S. criteria of "like and similar" in present legislation in defining competitive products seems to be a good one.
2. There should be a presumption of no injury where import sales are not below the prevailing price in the country of importation. There should be no penalty for imports that meet the going price.
3. There should be a finding of injury if the import is sold at prices below the prevailing price in the country of importation and producers have capacity to supply 10 percent or more of the home market.
4. Each product or product line should be considered an industry in and of itself. An injury test which looks to the average profitability of an industry or a company therein is meaningless; in fact, there is no economic basis for applying any profitability test in an antidumping law.

5. Experience has also shown that in a large and diversified country like the United States, regional considerations may be important. Even as we recognize regional pricing under the Robinson-Patman Act, we should also recognize regional areas for antidumping injury cases.

6. Special consideration should be given to shipments from a parent company to a foreign subsidiary. If a product is shipped to a subsidiary and further upgraded by 25 percent or more, there should be the presumption of no injury, since the product does not enter the channels of trade but rather serves as a raw material.

7. Special consideration should be given to "coproducer" transactions. In many instances, coproducer sales will be made at special prices. Since the coproducer buyer is not interested in destroying his own price structure, such a sale, even though technically "dumping," will not tend to injure the market of the country of destination.

It is recognized that the rules of procedure and the ways in which they are applied can greatly influence the effectiveness of any regulation. It would seem that the following principles should be incorporated into any antidumping law, (1) a chance for interested parties to be heard; (2) prompt disposition of cases; (3) safeguards for confidentiality of data; and (4) a requirement that complainant and defendant supply necessary data promptly.

Failure of the former to comply within a specified time would dismiss the case, and of the latter would automatically constitute a finding of dumping.

In the matter of procedures, it is important that the findings be prompt and not delayed, and that they be as specific as possible with a minimum of judgmental leeway. Only if both the regulations and procedures are specific and clear can either the exporter or domestic industry judge what is dumping and what is not.

Section IV

SPECIFIC ISSUES

PROBLEMS OF AGRICULTURAL PRODUCTS IN WORLD TRADE

BY LAWRENCE WITT and VERNON SORENSON *

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SUMMARY PROPOSITIONS

A. Agricultural products constitute about a third of world merchandise exports. For the developing nations their importance is even greater, constituting over half of the total, or three-fourths if petroleum is excluded. Over 20 percent of U.S. exports are agricultural products. Primary products have special characteristics; hence several troublesome problems stem from heavy dependence upon such commodities.

B. The volume of world trade in agricultural products is expanding in absolute amounts but is declining as a proportion of total trade. Growth in trade of some products has been affected by competition from synthetic substitutes. The rate of growth is limited also by the low income elasticity of demand, that is, with an increase of income the increase in demand for food rises less than proportionately. Thus, agriculture does not share equally with other industries in rising levels of income. This may lead to a relative depression of farm income, an outmigration of labor from agriculture and the need for changes in the proportions of productive effort devoted to agriculture, industry,

*Department of Agricultural Economics, Michigan State University.

and other nonfarm activities. The impact on producers varies, depending upon the product they sell.

C. Trade expansion is also hampered by policies. The developed nations have followed a number of policies that lead in the direction of agricultural self-sufficiency. For reasons associated with internal political pressures, governments use tariffs to protect internal markets for farmers, protect consumers from shortages in times of war, et cetera. These have the effect of import substitution policies in agriculture, and militate against an expansion of farm-produced exports.

D. In a significant number of countries, including the United States, areas of specialized production are sufficiently large, or politically vocal, or important for exchange earnings, to induce in government serious consideration—and often acceptance—of export subsidies and other measures to stimulate exports. Consequently, international efforts to reduce the quantity of artificial stimuli to exports become intimately involved in domestic agricultural policy. The combination of restrictive import policies and programs to expand exports has led to international markets that operate without consistent rules and to conditions where international commercial conflict is increasingly focused on agriculture. Progress in resolving these issues is possible only if future negotiators are in a position to discuss domestic farm policy and trade policy jointly.

E. Developing countries face special problems because of price instability and advanced country policies. The nature of the demand for agricultural products exposes these commodities to fairly wide price fluctuations, which leads to government intervention to influence the market, such as minimum export prices, domestic price supports, subsidies to export, marketing boards, and international commodity agreements. In technical terms, this basic characteristic is a low elasticity of demand with respect to price; that is, a small increase in volume brings a larger decrease in the price received. This traditional concept has been less valid during the past decade, primarily because of the increased ability of major consuming nations to maintain economic stability, but still is important. In consequence, the less-developed countries, as they examine their agricultural trade potentials, hesitate to expand most farm exports greatly. Although some have done so successfully, most nations fear that larger volumes of exports will lead to lower prices and lower foreign exchange earnings. This point is more telling when the nation provides a significant fraction of the total world trade in its principal export commodity.

F. Less-developed countries are unable to expand the export of processed farm products, despite the logic of emphasizing this type of industrialization, because the tariff structure of most developed nations is geared to favor raw material imports. The tariff protection to the developed nation's processing plants often is very substantial. Given the desire to industrialize, this situation presses most developing nations into manufacturing for the domestic market, often with special consideration to import substitution industries.

G. The growth in income and population in the developed countries of Europe, North America, and the Far East are likely to lead to a continued expansion in commercial trade in certain farm products. Red meat and feed grains have favorable prospects. Commercial trade among developed countries is likely to be static or decrease for certain other products, such as wheat and poultry, as new or advanced technology becomes more widely distributed. Also, an expansion in the membership of the EEC may lead to changes in the patterns of commodity movement among the countries included and excluded. Countries like the United States will face both export and import problems, if such changes in membership occur, as we and other nations adjust to new market conditions.

H. The rapid growth in population and some increases in income in the less-developed countries lead to high rates of increase in the domestic demand for food in the less-developed nations. Despite substantial increases in agricultural production, many of these countries have required concessional imports from the United States. The evidence indicates a continued basis for a food aid program for the next decade, at least. A substantial program of family planning can influence the need for a food aid program after 1980, but the potential heavy consumers of concessional food aid during the 1970's are already born. Without population control, the "need" for food aid will increase continuously. With U.S. surplus stocks reduced, coupled with the recent expansion in commercial exports, future commitments for concessional shipments will need to be considered more carefully in relation to current production.

I. The relation of trade and domesic interests is becoming ever more comprehensive and interrelated. The United States has a complex pattern of interests in agricultural trade. This interest includes but goes far beyond the economic interest in a large volume of exports. It includes trade from developing countries as a partial substitute for foreign aid. It includes the support which growth in trade can make to improved economic welfare of people around the world. It includes the economic welfare of U.S. farmers and marketing agencies who produce and distribute for the export market. It includes the simple humanitarian interest in making bread, rice, and better nutrition more possible than before. These and more are elements of the broad U.S. interest in agricultural trade.

J. These interests continue to present the United States with major challenges and opportunities for policy leadership. Our efforts should seek to increase the competitive structure of world markets and at the same time encourage cooperation among nations in dealing with food aid and the trading problems of less developed countries. Exploration of appropriate policies and possibilities for coordinated international action needs to continue on such important issues as: (1) Methods of reducing the conflict between domestic agricultural policy and international trade policy, (2) provision and financing of all aid including food aid, (3) preferential trading relations and reduction of barriers on imports from developing countries, (4) financial arrangements and marketing aids to permit expanded trade and improved export possibilities for developing countries, and (5) the purpose and role of international commodity arrangements in future improvement of international agricultural markets.

The bases for the above statements are elaborated and discussed in the following report. We deal first with the agricultural trade patterns, next with certain pervasive problems relevant to agricultural commodities, then with trade problems and policies among the developed, and the less-developed nations. We close with some comments on the U.S. interests in agricultural trade in the short run and long.

I. Introduction

Agricultural primary products, characteristically, face a number of special problems in world trade. Among these problems are the slow growth of demand, price and volume instability, intervention of government in defining the conditions of trade, concentration of exports in one or a few commodities, trade discrimination, and the deteriorating balance between the growth of production and the increase in demand. Some of these problems apply to fishery, forest, and mineral products; and some apply to the processed products of agriculture and other sectors. Thus, uniqueness or exclusivity is not claimed for agriculture in this paper; rather the conditions discussed dominate the agricultural trade sector, with few exceptions, and call for serious attention because agricultural products represent about a third of world trade.

This paper concentrates on the long-run characteristics of international agricultural markets, the nature of the problems after the Kennedy Round, and the kinds of action that may be feasible in dealing with them. It does not discuss the accomplishments of the Kennedy trade negotiations, partly because details are not yet available and partly because the full impact cannot be known for some time. We do suggest that one of the reasons for substantial difficulty in gaining agricultural concessions is the close interweaving of domestic agricultural price policy with trade policy for many countries—the United States included. In consequence, a substantial array of domestic economic interests, in many countries, apply political pressure upon a nation's leadership as they discuss possible trade concessions, which equate to a discussion of internal farm price policy. Finally, the Kennedy Round emphasized trade policy among developed nations, whereas agricultural trade substantially represents exports from developing to developed nations. The agricultural trade interests of developing nations will be dramatized in the forthcoming UNCTAD Conference in India. The U.S. interests and position vis-a-vis the developing nations require substantial attention and imaginative analysis.

In examining trade in agricultural products, it must be conceded at the outset that no precisely measurable criterion exists for suggesting how much trade should exist, whether in relation to developed or developing nations. Yet, overall, three things must be kept in mind in evaluating conditions in international agricultural markets. These are:

(1) The concept of comparative advantage is meaningful in application to agriculture, and further movement in specialization of production toward areas of lowest cost would benefit individual countries and the well-being of the world as a whole. Impediments to trade hinder this movement. At the same time it is necessary to recognize the concept of fixed assets, which sometimes builds an economic case for a gradual process, or for adjustment payments as part of a more rapid process. Possible political pressures are likely to be greater when fixed assets bulk large in production costs.

(2) Trade in agricultural products plays an important role in the total of international transfers related to the problem of eco-

nomic growth. Exports of agricultural products from developing countries as a means of earning foreign exchange are important. The imports of agricultural products as a vehicle of development are of consequence, but easily overemphasized by the nation providing such products on a concessional basis. The importance of farm products in the export trade of developing nations makes them the object of significant political and policy discussions.

(3) International transfers of agricultural products have on various occasions in recent years played a special role in relief and welfare.

We will discuss these three criteria from at least two points of view in various parts of this paper. First, empirical data will be presented to indicate changes in the specific content of these criteria, be they technological advances, exports and foreign exchange earnings, or unilateral transfers, such as the food for peace program. Second, suggestions will be made on the values (objectives) implied by these criteria, and the extent to which the U.S. interests coincide with those of other nations, or of groups within them.

The major concern in this paper is agricultural primary products, but some of the data presented will include partially processed farm products. Some attention will be given to the development of synthetic materials which may substitute for agricultural primary products; also, the trade discrimination against processed raw materials will be discussed. We turn first to a discussion of trade patterns.

II. Present Patterns of Agricultural Trade

The value of agricultural primary products constituted 31 percent of total world trade for 1959–61.[1] Processed agricultural products would add another 1 to 2 percent to this figure. For the developing regions the proportions were: Latin America 57 percent, Middle East 22 percent (but 78 percent if oil exports were excluded), Asia and the Far East 64 percent, and 58 percent for Africa. For the developed nations, including those centrally planned, agricultural primary products represented 25 percent of their total exports (table 1). For the United States, agricultural exports were 23 percent of total exports in 1965 and 1966.

Going behind the trade figures, the reliance on agriculture in the developing nations is reemphasized. Agriculture typically represents 40–55 percent of the national product, and provides the main source of livelihood for 50–75 percent of the population. In contrast, in the developed countries 10–20 percent of the national product is derived from agriculture, with a similar small percent of the population deriving their livelihood therefrom. Despite these small percentages, there are regions within the developed countries in which the role of agriculture is fully as dominant as in typical developing nations.

The expansion of agricultural trade has lagged behind the growth in total trade, as indicated by the FAO statement:

"During the past decade international trade in agricultural primary products was characterized by a relatively slow growth of volume, falling unit values and terms of trade, and consequently a slower

[1] FAO Commodity Review 1964, special supplement: "Trade in Agricultural Commodities in the United Nations Development Decade," vol. 1. p. I–4.

growth of agricultural export earnings. Simultaneously, the share of the developing countries in the total volume and value of this trade contracted, and shipments from developed countries on 'special' or concessional terms, mainly to developing regions, assumed growing importance. Short term fluctuations continued, presenting an additional problem to developing economies." [2]

TABLE 1.—AGRICULTURAL PRIMARY PRODUCTS IN EXPORTS OF DEVELOPING REGIONS, AVERAGE 1959–61

Regions	Exports of agricultural products (millions) [a]	Exports of agricultural products as percentage of—		
		Total exports	Exports other than fuel	Exports of primary products other than fuel
Latin America	$4,877	57	79	91
Middle East	1,105	22	78	81
Asia and Far East [b]	4,783	64	70	94
Africa and developing countries n.e.s.	3,429	58	72	96
All developing regions	14,194	53	74	92
Other regions [c]	24,908	25	27	91
World total	39,102	31	35	91

[a] SITC secs. 0 (food and live animals), 1 (beverages and tobacco), 2 (crude materials, inedible, except fuels), and 4 (animal and vegetable oils and fats), excluding division 28 (metalliferous ores and metal scrap). This classification thus includes among agricultural products a number of raw materials of nonagricultural origin, among them synthetic rubber and fibers, crude fertilizers and crude minerals.
[b] Excluding Japan, and Asian centrally planned economies.
[c] Developed and centrally planned regions.

Source: FAO, Trade in Agricultural Commodities in the United Nations Development Decade, vol. I, pts. I, II, and III, 1964. p. I–4.

The conclusion that agricultural trade expands less rapidly than total trade has been noted in a number of studies made during the past third of a century. One of the latest comparisons, that of the FAO for 1959–61 compared with 1952–53 indicates that the volume of agricultural exports rose 36 percent while manufactured products rose 65 percent. Because agricultural prices dropped during this period the value of exports rose only 14 percent for agriculture, compared with 71 percent for manufactured goods.[3] Since 1961 the unit value of agricultural commodities has risen almost at the same rate as manufactured products, but growth in agricultural exports continue to lag behind total exports, albeit by only a few percentage points. The reasons for such lags will be discussed in chapter III. Table 2 provides annual data to 1965.

On a comparative basis, the change between 1952–53 and 1959–61 was adverse to the developing nations. A 1964 FAO report[4] comments:

"The growth of developing countries' export earnings was even slower than that of the volume of exports because of the widespread decline in the average export prices of agricultural products. For all products combined, the price fall amounted to 16 percent between 1952–53 and 1959–61. With a simultaneous increase of 4 percent in the average export prices of manufactured goods the purchasing power

[2] *Idem*, p. I–10.
[3] Idem., p. I–10.
[4] Idem., p. I–14.

of agricultural exports in terms of manufactures (their "terms of trade") fell by 19 percent."

The report notes certain differences among commodities: [5]

"Among foodstuffs, there was a sharp contrast between meat and fruit, the prices of which rose, in some cases by as much as 20–25 percent, and most grains and dairy products, the price of which fell by more than the average for all agricultural products. The price decline was somewhat more uniform among beverage crops and agricultural raw materials, except for tea, the price of which was relatively stable, and rubber, the prices of which fluctuated widely."

TABLE 2.—INDEXES OF THE VOLUME, UNIT VALUE AND TOTAL VALUE OF WORLD TRADE IN AGRICULTURAL FISHERY AND FOREST PRODUCTS

[Indexes, 1957-59=100]

	Average, 1953–57	1958	1959	1960	1961	1962	1963	1964	1965 (preliminary)
Volume of commercial agricultural exports	92	98	104	109	116	118	124	128	130
Unit value of commercial agricultural exports	107	99	96	97	93	92	99	102	100
Total value of agricultural exports	98	96	99	105	108	109	122	132	131
Average export unit value of manufactured product exports	96	100	99	101	102	102	103	104	107
Total value of world trade (agricultural and nonagricultural)	85	97	103	114	120	126	137	154	167

Source: FAO, "The State of Food and Agriculture 1966," table II-6, p. 35.

The differences in price trends among commodities also had regional impacts: [6]

"Differences in the commodity composition of exports were responsible for considerable differences in the changes of the average unit values in the various regions. . . . The heavy concentration of Latin America on coffee combined with price falls for cocoa, grains, and textile fibers [combined] to reduce the average export unit value of this region by nearly a quarter. Asia and the Far East suffered a much smaller reduction, by only 5 percent, thanks in part, to the exceptional prices of rubber and tea during 1952–53 and 1959–61. Average unit value of exports from Africa and the Middle East declined by 17 and 14 percent, respectively. There were similar differences in the unit value of agricultural exports from developed regions."

Since 1961 agricultural prices have moved upward, so that by 1965 the value of agricultural exports had risen 18 percent. However, the regional picture was highly variable, with a 38 percent increase for Western Europe, 24 percent for North America, 22 percent for Latin America, 18 percent for the Near East, only 8 percent for Africa, and zero for the Far East [7] (table 3).

The volume of trade in all products is substantially higher for developed countries than for developing nations. Over 55 percent of total exports (excluding the centrally planned economies) are from one developed nation to another, with another 20 percent going to developing nations. An additional 18 percent of total trade are exports of the developing to the developed countries. Only 6 percent of total trade is among the developing nations themselves (table 4).

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[5] Idem.
[6] Idem.
[7] FAO State of Food and Agriculture, op. cit., pp. 233–235.

TABLE 3.—WORLD AND REGIONAL INDEXES OF VALUE OF AGRICULTURAL EXPORT PRODUCTS

[Indexes, average 1957–59=100]

	Prewar average	Average, 1948–52	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965 preliminary
Western	30	63	89	91	103	98	99	109	115	118	138	148	158
North America	22	95	76	102	108	96	96	114	123	118	134	158	151
Oceania	29	93	95	99	111	85	105	102	112	113	134	147	135
Latin America	26	92	103	106	105	99	96	99	100	103	113	119	122
Far East [1]	45	97	109	102	102	93	105	108	100	100	107	108	100
Near East	28	91	93	98	110	92	98	104	97	101	113	114	115
Africa	19	72	95	96	98	102	99	99	101	104	111	113	109
World, excluding the centrally planned economies	28	86	94	100	105	96	99	106	108	109	122	132	129
Eastern Europe and U.S.S.R.	----------	----------	76	69	96	88	115	113	135	139	142	128	----------
World [1]	----------	----------	93	98	104	96	100	106	110	111	123	132	----------

Source: FAO, "The State of Food and Agriculture 1966," table 12A, pp. 233–235.

[1] Excluding China (mainland).

TABLE 4.—PERCENTAGE FLOWS OF TOTAL WORLD TRADE AND TRADE IN AGRICULTURAL PRIMARY PRODUCTS BETWEEN ECONOMIC REGIONS, AVERAGE 1959-61

Exports—from/to	Total world trade [1]			Agricultural trade [2]		
	Developed	Developing	Centrally planned	Developed	Developing	Centrally planned
Excluding centrally planned:						
Developed	55	20		43	11	
Developing	19	6		40	6	
Including centrally planned:						
Developed	47	17	2	36	10	2
Developing	16	5	1	34	5	4
Centrally planned	2	1	9	3	1	5

[1] Source: FAO, Trade in Agricultural Commodities in the United Nations Development Decade, vol. II, pt. IV, 1964 table 1.1/VI, p. 5.
[2] Source: Idem, vol. I, pts. I, II, and III, 1964, table 1.1/II, p. I-5.

For agricultural products, the dominance of the developed nations is less severe, since developing nations typically export a higher proportion of these products. Even so, 43 percent of the agricultural exports are among developed nations. But, from another point of view, the developed nations as customers are more concentrated—for total trade, developed countries receive 74 percent of the exports while for agricultural products this proportion is 83 percent.

Significant in terms of future market potential, developing countries received only 17 percent of the total exports, composed of 11 percent from developed and only 6 percent from other developing nations. Table 4 presents these data, along with similar data with centrally planned economies included.

Following heavy wartime shipments U.S. agricultural exports dropped to a low of $2.5 billion in 1945. Since then steady increases have occurred [8] and exports reached nearly $6.9 billion in calendar 1966 (table 5). These increases can be attributed to a number of factors including: (1) an aggressive U.S. export program (too aggressive from some points of view); (2) the successful efforts to prevent a serious postwar depression in the developed world through fiscal and monetary policies which led to increasing purchasing power in North America, Japan, and Western Europe; (3) the successful efforts to restrict, with a few exceptions, a new series of trade restrictions after the early 1950's; and (4) the creation of the Public Law 480 program to expand shipments to developing nations, coupled with the increased rate of population growth.

Concessional grants and sales constitute about a fourth of total U.S. exports since 1955. The total from all nations, including the world food program, Canadian, French, and other bilateral arrangements, range between $1.5 and $2.0 billion annually. U.S. exports, the dominant factor, are shown in table 5.

U.S. grants of food (titles II and III) have ranged from 10 to 20 percent of the noncommercial trade shown in table 5. A clear distinction between concessional sales, export dumping, and food aid is a hopeless task. Some food shipments under these programs represent

[8] Grains, fats and oils provide the major increases. See Robert L. Tontz and Isaac E. Lenon, "Agricultural Exports are Becoming More Important to U.S. Agriculture," *Foreign Agricultural Trade*, ERS–USDA, February 1967.

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true export disposals, while other shipments represent real development assets for the receiving nations. Still other shipments, especially donations, have primarily humanitarian objectives and effects. But the intent and the results are sometimes consistent and sometimes inverted; even detailed country studies cannot fully disentangle the consequences.

The largest single recipient has been India, with countries such as Pakistan, Brazil, Yugoslavia, Turkey, Poland, Spain, Israel, United Arab Republic, and Korea being important recipients for several years during this period. Public Law 480 has been revised periodically since 1954, with changing specifications on country eligibility as recipients. The 1966 revision collapsed the four titles, shown in table 5, into two, and made grants and local currency sales less significant. The decline in the CCC-owned stockpile of agricultural commodies, the change in the law, and tougher eligibility requirements combine to reduce the size of the U.S. bilateral program. The world food program is increasing modestly; while under the Kennedy Round Agreements, the contributions of other developed nations to such food aid programs is likely to increase.

Briefly, these food aid (or agricultural surplus disposal programs) result from (1) a disequilibrium in the domestic agriculture of the exporting developed nations, with excess resources devoted to certain commodities, and probably to agriculture as a whole, and (2) a disequilibrium in international markets with certain developing countries unable to earn sufficient foreign exchange to become substantial commercial purchasers of food products. The economic and institutional barriers to adjustment are deeply rooted and persistent. The developed nations appear to be somewhat closer to a solution than the recipient nations. Further policy implications will be postponed to the final chapter.

TABLE 5.—U.S. EXPORTS UNDER SPECIAL PROGRAMS IN RELATION TO TOTAL AGRICULTURAL EXPORTS

[In millions of U.S. dollars]

	Average, 1955–59	Average, 1960–64	1965	1966
Exports under Public Law 480:				
Title I	629	1,060	926	820
Title II	47	77	73	80
Title III (barter)	223	126	188	260
Title III (donations)	164	160	180	131
Title IV		38	143	226
Total	1,063	1,461	1,510	1,517
Agency for International Development (AID) programs	298	81	26	47
Total, special programs	1,362	1,542	1,536	1,564
Commercial sales	2,575	3,822	4,693	5,321
Total exports	3,937	5,364	6,229	6,885
Exports under special programs as percentage of total agricultural exports	35	29	25	23

Sources: Calculated from annual data supplied by ERS, U.S. Department of Agriculture.

III. Trade Problems Affecting Both Developed and Developing Nations

Any evaluation of agricultural trade problems must recognize the political and economic setting within which agricultural markets operate. From the viewpoint of economic criteria, the level of development is important. The simple breakdown into developed and underdeveloped countries, however, is hardly sufficient to provide a framework for agricultural trade analysis. Among the developed economies, wide variation exists in the resource base and the conditions surrounding agricultural production. On the one hand, countries such as Australia, New Zealand, Canada, Denmark, the Netherlands, and increasingly France are primarily agricultural export countries. Agricultural production rests on favorable soil and climatic conditions, farm units use relatively modern techniques buttressed by adequate investment in rural infrastructures, and education, all of which has led to a high level of agricultural productivity. On the other hand, another group of industrial countries, which includes the United Kingdom, Japan, Germany, and to lesser degrees several other European countries tend to have an inadequate resource base for agriculture, and in some cases, a poorly structured farm organization. Despite a highly productive agriculture they remain major importers. The United States belongs in the first group rather than the second, even with the preponderance of manufactures in its export pattern.

In all of these countries agriculture has declined relatively through time and is likely to continue both from the viewpoint of the origin of national products and the composition of the working population. This process of contraction, however, is not accompanied by a decline in agricultural output; hence the agricultural exporting countries tend to exert a continuous pressure on the world market in products that they produce while those that are importers are able to rely heavily on domestic production.

Among the less developed countries, differences exist in the extent to which agricultural output covers domestic requirements, but where excess production exists this often tends to be in a specialized product or group of products such as coffee, bananas, etc. The more important distinction from the viewpoint of trade problems among the less developed countries is the extent to which change and dynamic adjustment is occurring, both in agricultural and nonagricultural sectors. Among the less developed and most static of the low-income countries, agriculture tends to be of a subsistence type both with respect to production and consumption, and the bulk of the labor force is engaged in agriculture. With many rural households largely self-contained, internal market systems and trading is mainly restricted to the local level, and these economies have only a limited participation in world trade, either as exporters or importers.

Another group of basically underdeveloped economies, however, has an important stake in international trading relationships. While these economies tend still to be largely agricultural, the process of change has begun. Improvements are being actively sought in agricultural productivity and the expansion of industrial output is underway. Many participate actively in international markets either as importers or exporters, or in some cases both. Import requirements among these countries tend to be dictated by a fundamental imbalance between agricultural output and population levels. Basic natural resources often are not in plentiful supply and much production is based on traditional agriculture with low productivity and static methods. Exporters among this group of countries tend to be centered around specialized crops whose principal markets are in the developed countries of the world.

Within this structural framework of world agricultural markets, the principal flows of trade are: (1) among the developed countries of the world and involve largely temperate zone agricultural products; (2) shipments, largely on a concessional basis, of temperate zone agricultural products from the developed to importing underdeveloped countries; and (3) exports of tropical and specialty commodities from the developing to the developed countries (table 4). It is within this frame of reference and in relation to the question of comparative advantage, economic efficiency, and the economic growth problems facing the developing countries that specific international trade problems in agriculture need to be defined.

PROBLEMS STEMMING FROM CHARACTERISTICS OF DEMAND

The market for agricultural products is inelastic both in respect to price and in respect to income. This means that a 1-percent increase in supply at a point in time results in a greater than 1-percent decrease in price; and, a 1-percent increase in disposable income is matched by a less than 1-percent increase in sales. These inelasticities of price and income, as they are called, vary among countries with the level of income and other socioeconomic characteristics, and among commodities. These fundamental characteristics of demand impose very real limitations on the economic growth potentials and policy alternatives for the agricultural sector.

In developed nations price elasticities tend to be low, which means that small changes in volume are matched by large changes in price. Experience with these conditions leads many farmers and farmer representatives to press for public action to limit the price changes for those important commodities subject to moderate to substantial changes in production from year to year. Grain, especially wheat, potatoes, and tobacco are likely to be at the low end of the scale of elasticities, and therefore more likely to be exposed to such pressures. Meat, dairy products, and fruits tend to be toward the upper end of the scale of elasticities (but still less than 1), and therefore somewhat less likely to become involved in such measures. These low price elasticities lead to price instability in world markets as well as in domestic markets. A number of crops, particularly tree crops, also are characterized by an inelastic supply, or a supply influenced mainly by weather. The combination of supply and demand inelasticities can lead to even wider price fluctuations, but can also be offsetting.

Similarly, income elasticities for farm products in developed countries tend to be low, with about the same range among commodities, so that rising levels of national income do not flow equally to the producers of agricultural and manufactured products. These characteristics often are exacerbated by the way in which prices are established in the several markets, since as technology advances, consumers are the likely beneficiaries of lower costs from agricultural advance, while workers, shareholders, and consumers share jointly in technical advances in industry. Another consequence of the low-income elasticity is to limit the growth potential for agriculture, both permitting and requiring a change in the structure of the economy away from agriculture. The evils, often exaggerated, of a one-crop economy derive mainly from these two points.

The instability of raw material prices has been documented by a series of studies over the past 30 years. A United Nations study in 1952,[9] covering the period 1901 to 1950 indicated an average year-to-year fluctuation in prices of 14 percent. The export volume varied by nearly 19 percent, while the combination of the two exaggerated rather than reduced the fluctuations, so that export earnings had a year-to-year fluctuation of 22.6 percent. This was a period of two major wars, a major depression, and several more limited cyclical changes. A more recent study,[10] for 1953–61 for a somewhat different list of commodities shows more modest fluctuations, volume 8.7 percent, unit value 8, while export value averaged 10.5 percent. With the greatly enhanced ability to deal with cyclical fluctuations during the past 20 years, the 10 percent of the latter study is far more appropriate than the 22 percent of the earlier study. An economic study by MacBean,[11] forming entirely on the period after 1947, concludes that the fluctuations in exchange earnings are no more severe for developing nations than for developed countries. However, there were individual countries which, for a variety of domestic and international reasons, suffered substantial instability in exchange earnings. We suggest that the widely accepted traditional view; namely, that specialization on a few export primary products exposes a nation to great economic instability, is likely to be overstated and overstressed. The traditional view depends too much on the experiences of 1925–45 and too little upon the period since 1947 when widespread sophisticated management and substantial economic stability of the major national economies has been the rule.

Turning to growth and development problems imposed by the low-income elasticities, here too the traditional view in the developing countries is to eschew investments in export agriculture. Only an exceptional nation, such as Taiwan, has deliberately invested broadly in agriculture for export. Others, such as Nigeria in oil palms and Parana State in Brazil in coffee, have invested in certain crops, in a few cases with deliberation, but in most cases as a consequence of private farmer decisions. Most nations have sought to save exchange through import substitution industries, or have sought new exchange revenues by developing a new export commodity as a means of diversifying their economy. In most cases, these procedures have been contrary to the concept of comparative advantage, assuming that added output of existing raw material exports would depress the price and therefore exchange earnings. The recent price facts support this view for certain commodities, such as coffee, rubber, coca, and cotton, and deny this view for other products such as meat, dairy products and

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[9] United Nations Department of Economic Affairs, "Instability in Export Markets of Under-developed Countries," New York, 1952.
[10] FAO, Trade in Agricultural Commodities, op. cit., p. I–17.
[11] Alasdar MacBean, "Export Instability and Economic Development," Harvard University Press, 1966.

feed grains. We shall see that factors other than demand have contributed to sluggish prices for some of these products. The point to be emphasized is that generalizations covering all primary products or all agricultural commodities need to be elaborated more carefully; price history of some major commodities confirm the traditional view, while for others the contrary is true.

PROBLEMS STEMMING FROM THE GROWTH OF SYNTHETICS

Through modern science, a wide range of synthetic substitutes for agricultural raw materials have been developed. The list includes rayon, nylon and a host of other fibers, synthetic rubber, atabrine and others for quinine, synthetic detergents, substitutes for leather, artificial sweeteners, along with certain more traditional substitutes such as paper for jute and other fibers. Presumably the general effect of such developments is to reduce the growth in demand for the natural materials. To the extent to which these new products derive from nationally produced raw materials, they also reduce the potential growth in international trade. However, the actual situation is more complex.

First, these new synthetics provide certain qualities which create new uses for the end product, carpeting in places not previously carpeted, a more extensive use of soft drinks, wider use of foam rubber cushions, pillows, etc. Thus, synthetics displace much less than the equivalent amounts of the natural commodity.

Second, in some cases, synthetics and natural products are being combined to create commodities more pleasing to consumers. Such joint products may enhance the sales opportunities, creating a larger demand for the final product, as has occurred recently for fibers.

Third, the price patterns are modified by the existence of a close substitute. The price elasticity of demand for the natural product is increased, thus reducing the probable range of price movements.

A 1964 study by the FAO of "Synthetics and their Effects on Agricultural Trade,"[12] states:

"One of the main threats to the exchange earnings of developing countries in recent years has come from competition of synthetics with agricultural raw materials, principally cotton, wool, jute and allied fibers, hard fibers (mainly abaca), and rubber. In the period 1959–61, world exports of these products were valued at about U.S. $5,600 million, equivalent to 24 percent of the total value of world agricultural trade. Moreover, more than half (55 percent) the total originated in developing countries, where they accounted for 30 percent of total exports of agricultural products.

"The overwhelming items in the developed countries' exports of agricultural raw materials are wool, the bulk of the trade in which originates from Australia, New Zealand, and South Africa, and United States cotton, valued at $779 million in the period mentioned. Otherwise the trade consists essentially of a flow from developing to developed countries.

"The world output of synthetic materials is heavily concentrated in developed countries (the United States, Western Europe and Japan) and centrally planned countries.

[12] FAO. "Synthetics and Their Effects on Agricultural Trade," Commodity Bulletin Series 38, FAO, Rome, 1964, p. 1.

"The location of synthetic industries in the main agricultural raw material importing countries is, of course, basically inimical to an expansion of the trade in the natural products. However, the establishment of such industries is usually inspired by technical, rather than autarchic, considerations except insofar as the synthetic products are competing among themselves. It is but one facet of the general process of technological evolution which is affecting the demand for agricultural raw materials in many different ways."

The origins of the natural materials much exposed to competition from synthetics are shown in table 6. Later this FAO report points out some rapid increases in demand: [13]

TABLE 6. DISTRIBUTION OF EXPORTS OF AGRICULTURAL RAW MATERIALS BY ECONOMIC GROUP OF ORIGIN AND DESTINATION, 1959–61

[In millions of U.S. dollars, f.o.b.]

	Origin				Destination			
	Developed regions	Developing regions	Centrally planned countries	World total	Developed regions	Developing regions	Centrally planned countries	World total
Rubber	[a] 68	1,392		1,460	[b] 1,061	93	306	1,460
Cotton	894	1,115	302	2,270	1,363	325	544	[c] 2,270
Wool	1,233	249	63	1,545	1,307	42	196	1,545
Jute, allied fibers		185		185	145	24	17	185
Hard fibers		134		134	124	4	5	134
Total	2,155	3,074	365	5,594	4,001	487	1,067	5,594

[a] Reexports.
[b] Includes imports of rubber subsequently reexported.
[c] Includes unallocable exports valued at $38,000,000.

Source: FAO, Trade in Agricultural Commodities in the United Nations Development Decade. Rome, 1964. FAO, "Synthetics and Their Effects on Agricultural Trade," Commodity Bulletin Series 38, FAO, 1964.

"When assessing the effects of these developments on the demand for agricultural raw materials it is necessary to keep in mind that the overall world market for apparel fibers and elastomers has been expanding at a rapid rate throughout the postwar period. Between 1952 and 1962, apparel fiber consumption increased by over 50 percent, while elastomer consumption nearly doubled. The markets shared by natural and synthetic products have, in fact, grown faster than those of some of the important food products."

In the United States, synthetic sweeteners have become of some importance as a substitute for sugar. A recent study examined five major food processing industries which normally use 60 percent of the sweeteners used in the United States; namely the beverage, baking, confectionary, canning, and dairy industries. After discussing competition among natural sweeteners in some of these industries, Hayenga [14] concludes:

"The soft drink industry has exhibited little caloric sweetener substitutability because of technical requirements for a high sweetness level per sweetener unit and purity, color, and sediment standards. Consequently, sucrose has historically supplied between 92 and 96 percent of the caloric sweetener requirements in the beverage industry. But the beverage industry recently began extensive use of the much

[13] *Ibid.*, p. 6.
[14] Marvin L. Hayenga, "Sweetener Competition and Sugar Policy," paper to be presented to the American Farm Economics Association, August 1967.

lower cost synthetic sweeteners. Low calorie soft drink sales have multiplied several times since 1960. In 1964, low calorie products represented approximately 10 percent of soft drink sales. Some industry sources believe this percentage may increase to 30 or 50 percent by 1975."

The general price patterns of natural and synethic commodities is indicated by the data in table 7. The stability in prices of the manmade materials is clearly evident; certainly they have reduced but not eliminated the fluctuations in the prices of the natural products. As to the level of the prices the FAO study [15] concludes:

"Since 1953, when the Korean boom had largely subsided, two features are immediately apparent: firstly, prices of most of the products were lower in 1962 than in 1953; secondly, reductions in prices of natural materials were generally greater than those of the synthetic products. The extent to which synthetic composition has contributed to this deterioration in agricultural raw material prices is indeterminate. If, at any time, the output of all synthetic materials had ceased, prices of their natural counterparts would certainly have risen in the short term. However, taking into account longer term supply responses, there is no similar assurance that prices would have been higher than they are today if manmade materials had never come into existence. Prices of some major agricultural products not subject to competition from manmade materials (e.g., coffee and cocoa) have declined more rapidly in the last decade than those of agricultural raw materials."

AGRICULTURAL PRICES IN INTERNATIONAL MARKETS

Much controversy has appeared about the level and the role of prices in the developing countries. Some of this stems from an argument about whether Public Law 480 shipments depress farm prices in the recipient countries. Some stem from the role which prices may play in stimulating an expansion in production in developing nations, where traditional agriculture is a dominant force. And, some arguments develop around the price trends for agricultural staples compared with manufactured goods, it being alleged that foreign exchange earnings are depressed by adverse terms of trade for major agricultural exports. Each of these points has an extensive literature; time and space do not permit an adequate coverage. We postpone the first issue to the final chapter when we review the policy implications of food aid. The second issue more properly belongs in a paper on agricultural development. The third price issue will be discussed briefly at this point.

Agricultural prices in world markets have lagged behind prices of other commodities. But the lags are uneven, and some commodities have price changes that substantially exceed those of manufactured exports. The prices of meat and dairy products rose 27 and 15 percent, respectively, for 1965 over the 1957-59 period. Beverages and agricultural raw materials' prices have actually declined during this period (table 8). Significantly, most of the latter products are mainly the products of developing countries, wool and cotton being exceptions in part.

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[15] FAO, "Synthetics and their Effects on Agricultural Trade," op. cit., p. 6.

TABLE 7.—PRICE INDEXES OF NATURAL AND MANMADE RAW MATERIALS

[1954=100]

	Apparel fibers				Rubber			Lauric acid oils [7]	Cattle hides	
						Synthetic				
	Cotton [1]	Wool [2]	Rayon [3]	Nylon [4]	Natural [5]	SBR [6]	Neoprene [6]		Argentine [8]	United States [9]
1953	97	97	95	100	63	98	105	99	102	100
1954	98	80	90	91	61	98	108	89	87	79
1955	89	73	90	87	101	98	108	77	74	83
1956	74	92	90	87	89	98	108	77	73	84
1957	75	70	90	87	81	98	108	77	79	74
1958	69	59	95	87	73	98	108	90	76	77
1959	65	65	86	87	95	98	108	109	112	128
1960	71	62	85	87	99	98	108	90	88	92
1961	74	65	85	87	76	98	108	72	81	100
1962	71	71	85	81	74	98	108	71	79	102

[1] Season average for American Texas, Middling 15/16 in., c.i.f. Liverpool.
[2] Season average for 64's, United Kingdom and Dominion auctions, adjusted to London costs.
[3] Viscose staple, 1.5 denier, United Kingdom.
[4] Staple, 3 denier, United Kingdom.
[5] RSS.1, spot, New York.
[6] United States.
[7] FAO index (original base 1952–54=100).
[8] Frigorifico, ox, cost, and freight, United Kingdom ports.
[9] Native steers, heavy, 58 lb. and upward, wholesale price, Chicago.

Source: FAO, "Synthetics and their Effects on Agricultural Trade," Commodity Bulletin Series 38, FAO, Rome, 1964, table 3, p. 6.

TABLE 8.—INDEXES OF WORLD AVERAGE EXPORT UNIT VALUES OF AGRICULTURAL PRODUCTS, BY MAIN COMMODITY GROUPS

[1957–59=100]

	Average, 1953–57	1958	1959	1960	1961	1962	1963	1964	1965 (preliminary)
Agricultural products	107	99	96	97	93	92	99	102	100
Food and feedstuffs	104	99	98	97	96	97	108	110	109
Cereals	112	100	98	98	97	103	103	106	104
Sugar	97	96	91	87	89	89	139	137	104
Oilseeds and vegetable oils	103	98	101	97	95	91	98	99	110
Fruit	95	105	89	90	93	93	100	94	97
Meat	96	101	105	108	106	102	107	121	127
Dairy products	109	92	104	103	96	96	102	106	115
Beverages and tobacco	111	105	92	89	83	81	84	92	91
Coffee	127	102	83	80	76	73	69	88	89
Cocoa	103	118	103	83	66	63	68	71	56
Agricultural raw materials	111	94	94	103	97	92	96	96	90
Wool	118	89	85	92	90	89	103	113	96
Cotton	116	101	88	94	96	92	91	88	89
Rubber (natural)	97	87	111	125	92	87	83	79	76
Average export unit value of manufactured products	96	100	99	101	102	102	103	104	107

Source: FAO, "The State of Food and Agriculture, 1966," table II-10, p. 40, Rome, 1966.

These trends have been interpreted as a worsening of the terms of trade for the developing nations, since they largely export farm products. But this trend also suggests that economic development is proceeding, that food requires a smaller part of the total family budget than formerly, leaving purchasing power to support a higher level of living. About 100 years ago, the typical U.S. family spent about two-thirds of its income on food and clothing; the decline in this percentage to a fourth or less is a major component of our economic development. The decline has been strongly influenced by a significant and continued increase in agricultural productivity. The fewer farmers of today are able to produce more food than their predecessors, and this process continues. True, this change required migration of millions of people from agriculture to industry and other urban occupations, a migration with many fits and starts. Farm prices and farm incomes lagged because of comparative overcommitments of resources in agriculture. The adjustment process brought anguish to many unable to understand and to accept the consequent inequities, and unable, also, to do much about them.

Is this same process operating in the agriculture of other nations? In most advanced countries, it is clear that evolving agricultural technology is leading to greater production per man and per acre, with substantial outmigration of rural manpower. Technical change also is affecting the conditions of production of some of the major exports of developing countries, e.g., coffee, cocoa, and cotton. The challenge is not to keep agriculture from becoming more productive; rather it is to devise procedures by which to take advantage of the changes that are occurring, and to assure that the gains are more equitably distributed. In the developing nations, rising population and income pressures lead to much concern that food production will not increase rapidly enough, despite substantial increases in food production. But, at present, another issue looms larger in politic-economic discussions coming from the developing to developed countries.

This is the argument that the longrun relative price movements of agriculture and manufactured goods—the terms of trade are adverse to the developing nations and leads to a deterioration of exchange earnings. Dr. Raul Prebisch, economist with the Economic Commission for Latin America, and Hans Singer, economist with the U.N., have developed this argument. More recently, as Director General of the UNCTAD Conference in Geneva, Dr. Prebisch has generalized these issues to all developing nations vis-a-vis the developed nations. The issues are sensitive and involve a wide range of economic and political relations between these two groups.

These views have been discussed by Harry G. Johnson [16] as follows:

"The alleged tendency, however, is not consistent with the empirical evidence. It is necessary in this connection to distinguish between two frequently confused but analytically distinct propositions: that there is a longrun tendency for the terms of trade between manufactures and primary products to turn against producers of the latter, and that there is a longrun tendency for the terms of trade between developed countries to turn against the latter."

Dr. Johnson cites a study by Robert Lipsey as evidence that the first proposition is not true, and that the second proposition is confirmed by one set of evidence and denied by two others, thus suggesting that a particular case but not a general case can be made.

Lipsey examines U.S. data and reviews previous studies,[17] concluding:

"Comparisons with exports of U.S. manufactures strongly contradict the belief in declining relative primary product prices; comparisons with manufactures imported into the United States mildly confirm it. On the whole, there seem to be more instances of primary products relatively gaining in price than losing. The scatter around these relationships among totals is large, and supports Kindleberger's view that the primary versus manufactured product distinction is not a particularly useful one for the analysis of changes in terms of trade."

In testing the second proposition Lipsey examines data for the United Kingdom (the basis for most of Prebisch's empirical evidence), the United States, and Kindleberger's data on continental industrial Europe. The proposition is supported by United Kingdom data but denied by the other two.

Moreover, when price fluctuations exist the selection of the base period can be crucial to the conclusions reached. Prebisch examines 1950 to 1961 price trends, thus starting with the Korean induced peak and ending with the post-Suez slump. The choice of 1950 is a U.N. statistical standard, not a Prebisch selection however.

FAO data, cited earlier, gives some support to the first proposition, but mainly suggests that the differences among commodities are far more important than the general trend. The data in Table 8 indicate a difficult trend situation for a nation exporting coffee or cocoa, but a favorable trend for nations exporting meat or dairy products.

A recent study by Goolsby in the Economic Research Service, USDA, examines prices and export earnings for Temperate and Tropical Zones commodities. This classification is only partially a developed versus developing nation comparison; cotton, for example, is excluded from either classification. Goolsby develops price trends for 11 commodities in each classification with a 10-year (1954–63) and

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[16] "Economic Policies Toward Less Developed Countries," the Brookings Institution, Washington, D.C., 1967, p. 269.

[17] Robert E. Lipsey, "Price and Quantity Trends in the Foreign Trade of the United States," National Bureau of Economic Research, Princeton University Press, 1963, p. 23.

a 17-year (1947–63) trend. The summary is shown in table 9. Again individual commodities do better or worse than the trend. He summarizes as follows:[18]

"Over the postwar era from 1947 to 1963, prices of farm exports from the Temperate Zone dropped an average of 2 percent a year, while prices of major tropical products as a whole declined 0.2 percent a year. But the variation in prices of Tropical Zone products was almost twice as much as the variation in prices of Temperate Zone products.

"Prices in 1947–54 were particularly unstable. Prices of tropical products increased aproximately 50 percent from 1947 to 1951. In 1954, they were still over 40 percent higher than their 1947 levels. Prices of Temperate Zone products fluctuated within a rather wide range in 1947–54, but in 1954 they were lower than they had been in 1947.

"From 1954 to 1963, prices of tropical products declined an average of 2.6 percent per year and those of Temperate Zone products declined 1.5 percent per year.

"Export earnings for both groups of commodities increased throughout the period studied. For the Tropical Zone commodities, the increase in earnings was 2.5 percent for the entire postwar period, but negligible over the last decade studied. Very significant declines in earnings for coffee and cocoa largely offset the increases for a number of other Tropical Zone commodities during this decade."

TABLE 9.—TRENDS IN PRICES AND EXPORT EARNINGS FOR SELECTED TEMPERATE AND TROPICAL ZONE COMMODITIES, 1954-63 AND 1947-63

Commodity group	Average annual change in unit value		Average annual change in export earnings	
	1954-63	1947-63	1954-63	1947-63
Temperate zone commodities [a]	−1.5	−2.0	4.7	3.4
Tropical zone commodities [b]	−2.6	−.2	.2	2.5

[a] Includes wheat, wheat flour, barley, corn, pork (bacon, ham, salt pork), powdered milk, butter, cheese, shell eggs, soybeans, and wool.
[b] Includes milled rice, bananas, copra, shelled peanuts, palm oil, coffee, tea, cocoa, raw sugar, natural rubber, and jute

Source: ERS–USDA, "Agricultura lExports from Temperate and Tropical Zones," "Foreign Agricultural Economic. Report No. 29," tables 2 and 4, pp. 7 and 14.

Our conclusions are that this is a very complicated matter. It is far more important to examine individual commodities and the individual countries degree of reliance on commodities adversely affected, than it is to make universal generalizations about developing nations, tropical commodities, or manufactured versus primary commodities. Fluctuations may be more critical than long-term trends for most commodities, though obviously some products are afflicted with surplus productive capacity.

The belief that the trends have been adverse, despite limited and contradictory evidence to support the claim, is a political fact of some magnitude in the developing-developed nations' relationships. The cord of truth in the argument is that the economic structure under which these products are produced and consumed frequently prevents

[18] Halbert Goolsby, "Agricultural Exports from Temperate and Tropical Zones." U.S. Department of Agriculture, March 1966.

them from being used as "engines of growth" and as the sources of rapidly expanding foreign exchange earnings that developing countries need if they are to purchase development tools and provide their people with the commodities needed for an improved level of living.

In both developed and developing nations, groups of producers, marketing, transportation, and export firms have developed production and distribution facilities geared to the continued export of certain commodities. They compete in world markets with other exporters, and in many cases with domestic producers in the importing nation. They seek policies which will enhance their ability to compete, and protest against measures which make exportation more difficult. Very frequently they are fairly specialized producers of the product or marketing services; alternatives are significantly less remunerative to the resources involved, and may require substantial costly and time consuming readjustments. Not infrequently their political influence is substantially based upon a variety of social, political, and economic strengths. In many cases a significant concentration occurs in a geographical area, so that an entire community, perhaps an entire state, perceives that its welfare is intimately related to a continued export flow. Thus, both leadership and a significant fraction of an electorate perceive their economic and political interests in common and seek to impose certain policies.

At the national level the perception of national problems may take on similar views, but with differences. Exports earn foreign exchange which translates to income for the producers and processors, but represents a source of development tools, imported consumer goods, and a base for international loans in the view of national policymakers. Or, expanded farm exports can help redress an adverse balance of payments and strengthen a nation's international financial position. Few nations are able to long ignore the problems of its exporters.

Developing nations, as indicated in the previous section, seek measures which counter instability and raise the level of prices received. Individually, they adopt devices which artificially enhance their competitive position (or offset discrimination imposed by importers). These devices include such items as favorable exchange rates for some or all exports, tied international sales and purchases, and the sale by semi-official agencies at losses for a period of time. Typically export taxes are major sources of government revenue; the rate of taxes may be reduced to stimulate or maintain exports.

Developed countries are subject to similar pressures, although export trade in farm products are critical to their international well-being. Internal agricultural policy may provide modern inputs at less than cost, as in a number of European countries, thus increasing domestic production of many products, some of which may be exported. More important, these stronger economies have sufficient resources to subsidize exports, if they deem it in their interest to do so. Although various arguments have been advanced to defend or condemn such measures, most nations tend to view them as a form of dumping adverse to the interests of other exporting nations. The United States engages in this activity, for some 15 commodities in 1965–66 with expenditures for nearly $600 million (table 10). Some progress has been made through changes in domestic farm policy in cutting the number of commodities receiving subsidies and reducing the amount of payment.

These pressures to export are the counterpart to the pressures not to import, that is, to depend more heavily upon domestic production as described elsewhere. Both types of measures interfere with the full functioning of comparative advantage, and often spawn countermeasures in other countries which lead to further interference with trade.

TABLE 10.—ESTIMATED EXPORT PAYMENTS ON U.S. AGRICULTURAL EXPORTS—AVERAGE PER UNIT AND TOTAL YEAR ENDING JUNE 30, 1966

Commodity	Unit	Average per unit (dollars)	Total (million dollars)
Wheat grain	Bushel	0.467	354.3
Wheat flour	Hundredweight	1.05	45.5
Grain sorghums	Bushels	.095	23.0
Rice, milled	Hundredweight	1.805	54.7
Cotton, upland	Bale	28.75	87.9
Cotton, extra-long staple domestically produced	do	50.00	.4
Tobacco, unmanufactured	Pound	.05	.3
Flaxseed	Bushel	.2325	1.2
Linseed oil	Pound	.01585	1.3
Peanuts	do	.07	12.4
Milk, nonfat dry	do	.036	9.8
Butter	do	.299	2.0
Milkfat (butteroil, anhydrous milkfat, ghee, etc.)	do	.368	3.7
Cheese	do	.087	.1
Chickens, whole	do	.056	.2
Total			596.8

Source: ERS–USDA, "Foreign Agricultural Trade of the United States," Economic Research Service, USDA, June 1967.

IV. Trade Problems and Policies Among Advanced Countries

The flow of trade in agricultural products that originates in or is absorbed by advanced countries constitutes approximately 73 percent of the world total. The dominant component among advanced countries consists of Temperate Zone agricultural products. The major net importing areas are West Europe and Japan, while the major net exporting areas are North America and Oceana. Trade within regions is important in Europe and in North America. The net recent position and changes in imports and exports since 1953–54 are indicated in table 11.

Despite rather substantial increases in the flow of trade among developed countries, major obstacles still exist; commercial conflict among developed countries has increasingly focused on agriculture. Rapidly expanding agricultural production based upon the technological revolution in agriculture and the stimulus of national support policies has led to a situation where the principal problem of exporters is to find outlets for excess production. Many of the policies that now influence trading relationships were developed for a purpose quite different from that which they now serve. The main impetus for the programs now in effect in most countries stems from the need for rapidly expanding food output during and following World War II. While the central objective in agricultural policy has shifted to income protection, other important objectives are sought. With the exception of a few small countries where agricultural exports represent a substantial share of gross national product, emphasis is placed on accommodation of agricultural policy to internal economic, political, and social requirements.

TABLE 11.—FOREIGN TRADE IN AGRICULTURAL PRODUCTS, BY SELECTED COUNTRIES AND MAJOR AREAS

[Values in millions of U.S. dollars]

Country	Imports				Exports				Net trade, average, 1963–64
	Average, 1953–54 [a]	Average, 1963–64 [b]	Index, 1953–54=100	Percent of total	Average, 1953–54 [a]	Average, 1963–64 [b]	Index, 1953–54=100	Percent of total	
Belgium-Luxembourg	514	758	147	3.1	130	365	281	2.1	−393
France	1,346	2,026	151	8.4	584	1,422	243	8.2	−604
West Germany	1,648	3,469	210	14.3	138	398	288	2.3	−3,071
Italy	465	1,588	342	6.5	402	757	188	4.4	−831
Netherlands	586	1,086	185	4.5	855	1,550	181	8.9	464
EEC countries	4,559	8,926	196	36.8	2,109	4,492	113	25.9	−4,434
Greece	66	126	191	0.5	109	203	186	1.2	77
Portugal	58	236	407	1.0	78	120	154	0.7	−116
Spain	106	563	531	2.3	265	455	172	2.6	−108
Turkey	16	67	419	0.3	242	244	101	1.4	178
Mediterranean countries	246	992	403	4.1	694	1,022	147	5.9	30
Austria	161	265	165	1.1	18	73	406	0.4	−193
Denmark	230	395	172	1.6	682	1,074	156	6.2	679
Iceland	9	15	166	0.1	46	100	217	0.6	85
Ireland	125	172	138	0.7	250	361	144	2.1	188
Norway	160	243	152	1.0	152	231	152	1.3	−12
Sweden	288	511	177	2.1	100	124	124	0.7	−388
Switzerland	336	600	179	2.5	81	147	181	0.8	−452
United Kingdom	4,161	5,239	126	21.6	480	784	163	4.5	−4,455
Other European countries	5,470	7,440	136	30.7	1,809	2,894	160	16.7	−4,546
Subtotal, Europe	10,275	17,358	169	71.6	4,612	8,408	182	48.4	−8,950
Canada	512	827	162	3.4	1,190	1,648	138	9.5	821
United States	3,665	4,217	115	17.4	2,282	5,333	234	30.8	1,116
North America	4,177	5,044	121	20.8	3,472	6,981	201	40.3	1,937
Subtotal, Europe and North America	14,452	22,402	155	92.4	8,084	15,389	190	88.7	−7,013
Australia	([c])	168	----	0.7	([c])	1,094	----	6.3	926
New Zealand	([c])	74	----	0.3	([c])	510	----	2.9	436
Japan	([c])	1,598	----	6.5	([c])	347	----	2.0	−1,251
Other developed nations	([c])	1,840	----	7.6	([c])	1,951	----	11.2	111
Total, developed nations	----	24,242	----	100.0	----	17,340	----	100.0	−6,902

[a] Source: OECD, Agriculture and Economic Growth, Paris, 1965 taken from OECD, Agriculture and Food Statistics, 1962, and OECD. Division of Statistics.

[b] Source: FAO, Trade Yearbook, 1965, table 124.

[c] Comparable data not available.

COMMERCIAL MARKETS FOR U.S. AGRICULTURAL PRODUCTS

The bulk of U.S. commercial agricultural exports go to Japan, Canada, and Western Europe. Exports to Canada largely consist of fruit and vegetable products that cannot be produced for year-round supply in northern climates. Comparative production advantage and demand expansion associated with population and income growth in Canada largely determine this flow of trade. Policy conflicts are minor and steady, though only gradual increases in exports to Canada can be anticipated.

Japan presents a unique situation in advanced country agricultural trade. Because of extremely limited land resources, postwar agricultural policy has been oriented toward expansion of output, first to provide self-sufficiency in cereal food requirements and, in more recent years, to provide increased quantities of livestock products, fruits, and vegetables. Approximate self-sufficiency has been achieved in rice but considerable quantities of wheat and barley are imported for food. With increasing incomes consumption of livestock products is expanding rapidly, requiring increasing imports of meat and milk products, as well as feed grains to support domestic production. These can be expected to continue despite restrictive import policies and domestic price programs.

Japanese farms average only about 1 hectare in size. Commodity price guarantees are required to maintain farm income and this, in turn, led to close regulation of competing imports. All cereals are subject to state trading; quantitative controls are used to regulate imports of livestock products, some oilseeds and oils, and processed foods. Thus, while Japan has been expanding imports rapidly, growth has been closely regulated and subsidiary to domestic agricultural programs.

Clearly the most complex issues surrounding trade relations in agriculture are those among individual and groups of European countries and those between other exporting countries and West Europe. This follows both from the economic and policy conditions surrounding European agriculture. Recent changes in food consumption and agricultural production have resulted in increasing pressures on some markets, yet in other instances output tends to be inadequate. While surplus stocks have generally not accumulated, increasing problems in some countries and some commodities have resulted in expansion of sales and export subsidies on international markets. In other cases, agricultural product prices have risen rapidly in response to short supply. In general, increases in both consumption and production have been rapid.

Recent expansion in consumption has been most marked in livestock products other than milk and in fruits, vegetables and sugar, with increases in the order of 2 to 3 percent per year for most of these products (table 12).

Consumption levels, however, vary widely within Europe and the potential for future expansion both in response to income and price variation differs greatly by regions. In northern Europe, consumption of some commodities is approaching North American levels and income elasticities of demand are relatively low and declining. In southern Europe considerable potential for expanded consumption with a strong response to both higher income and lower price appears to exist.

TABLE 12.—WESTERN EUROPE: LEVEL AND CHANGE IN PER CAPITA CONSUMPTION AND CHANGE IN OUTPUT OF SELECTED COMMODITIES

Consumption			Output	
Item	Quantity consumed per capita, 1962-63 (kilograms per person)	Index 1962-63 (1952-53=100)	Item	Index 1962-63 (1952-53=100)
Bread grain	97.7	89	Wheat	128
Rice	3.4	110	Coarse grain	137
Potatoes	90.8	88	Rice	92
Vegetables	85.8	111	Sugar beet	131
Fresh fruit	73.6	126	Meat	149
Total meat	50.0	135	Milk	121
Eggs	10.6	133	Eggs	145
Sugar	32.2	131	Fruit and vegetables	130
Fats and oils	16.8	121	Oilseeds	136
Liquid milk	98.5	96		
Cheese	6.6	132		
Butter	4.9	126		

Source: OECD Agricultural and Food Statistics, 1952-63, Paris, 1965.

Changes in consumption have been accompanied by relatively rapid rates of expansion in the output for most commodities. The index of total agricultural output increased during the same period to about 128 or an output expansion of nearly 3 percent per year. Coupled with the fact that per capita consumption levels are now relatively high for many food products and rates of increase appear to have declined somewhat, a question arises as to whether historical rates of output can be absorbed in the future.

The existing and developing market balance, however, varies considerably between commodities. In wheat, annual increases in output exceed the rate of increased in utilization. Imports are based primarily on the need for quality wheat with little change in the general level of imports since the early 1950's. On the other hand, subsidized exports from western Europe, primarily France, to eastern Europe and other areas have become an increasingly important safety valve in providing outlets.

An even more rapid rate of expansion, about 4 percent per year, has occurred in production of feed grains. However, because of a rapid expansion in production of livestock, self-sufficiency has declined and increasing imports have occurred. This can be expected to continue and represent an expanding market for U.S. products.

With the exception of Mediterranean countries, both the production and consumption of dairy products is relatively high and exporters are experiencing increasing difficulty on international trade flows. Dairy products trade is primarily intra-European with the United Kingdom, Germany, and Italy as the principal importers and with excess production in most other countries. Future expansion in European markets will depend primarily on income growth in countries with lower income levels and on general population growth. "Expanded consumption from these two sources, however, is not likely to keep pace with output. Increasing pressures on dairy markets and greater problems for exporters can be expected within the European markets." [19] A number of European countries would like to expand foreign outlets but short of liberalized trading relationships with

[19] OECD unpublished material.

North America, there is little prospect for major shipments, except on concessional terms.

Fruit and vegetable consumption per capita is relatively high throughout western Europe. The major trade flows are intra-European from the Netherlands and Mediterranean countries to other European countries. Shipments of canned products from North America are increasing, however. European production has increased at the relatively rapid rate of 3 percent per year. With consumption levels already high, it appears that this rate of expansion cannot be maintained in the future. While our exports to west Europe have increased, the expansion has not been rapid and cannot be expected in the future to represent large quantities.

Trade relations with western Europe are closely tied to agricultural income policy. With the exception of the United Kingdom and the Netherlands, incomes in agriculture lag, sometimes substantially, behind those in other sectors. The central focus of policy to maintain or increase incomes in agriculture continues to be implemented through variety of direct price supports and policies that directly interfere with agricultural trade. Further, as economic growth continues and incomes expand in nonfarm sectors, the scope and complexity of measures taken tend to increase coverage so that virtually all commodities receive some form of market protection in most countries.

Price support and supplementary measures have led to widely dispersed price levels and hence in the relationship to world price levels. These relationships for wheat are shown in table 13. A similar pattern exists for other grains and dairy products. Adequate data to indicate the overall effectiveness of support measures with consistent comparison between countries and change through time are not easily available but the general pattern is that prices have increased though sometimes not commensurate with general inflation; hence real prices have declined somewhat.

TABLE 13.—WHEAT: SELECTED PRICE DATA

Country	Price in United States dollars per bushel, 1963–64	Ratio of support prices to import value 1962
Denmark	1.58	92
United Kingdom	1.63	97
Ireland	1.83	105
France	1.94	111
Greece	2.01	118
Netherlands	2.09	112
Austria	2.12	124
Belgium	2.12	123
Italy	2.20	129
Sweden	2.30	129
Spain	2.30	121
Portugal	2.34	137
Germany	2.38	139
Norway	3.20	187
Switzerland	3.68	215
Finland	4.22	204

Source: FAO Developments in Agricultural Price Stabilization and Support Policies, 1959–64, CCP 65/5, Mar. 22, 1965.

The method of price determination and the political mix in European agriculture assures that price supports will continue to be important and that price levels will, in general, be maintained.[20] The agricultural population is relatively large in many countries and, unlike the United States, the relationship between agricultural interest groups and government is often relatively close and formalized. Farm organizations often either participate directly in the year to year price determination or in the basic formulation of agricultural legislation and price computation methods. In Sweden long-term contracts are negotiated directly between the government and the farm organization. In other countries, prices are subject to more frequent negotiation and to automatic renegotiation if general price levels change by more than a specified amount. Where direct negotiation is not required, government price fixing often occurs in direct consultation with farm organizations, or within closely specified rules and in some cases through the direct use of farm cost-return data. These methods tend to assure price such that relative incomes in agriculture, if not always prices, will be generally maintained irrespective of market pressures or general price level changes.

The scope of price supports historically has tended to be limited largely by export considerations and in less-developed countries by the sheer weight of agriculture in the total of the economy. Increasing adequacy of supplies and expanded treasury burdens more recently have led to some restriction on price supports in an effort to reduce the burden of treasury costs. In some cases, this has taken the form of shifting costs to consumers through higher prices. It has also taken the form of specific limitations on the proportion of a product eligible for price support or of declining scales of support with increased output. These limitations, while having some implication for adjusting production to market demand, have not generally been designed specifically for this purpose. With the exception of a few special commodities, direct supply regulation has not developed and probably cannot be expected.

Thus agricultural protectionism in Europe under national policies, had become very extensive and covered all major commodities in virtually all countries. The methods and instruments used for implementing policy include internal price support plus a large variety of trade controls including traditional import restrictions such as customs duties and quantitive restrictions as well as newer devices such as minimum prices and variable levies, import calendars, conditional imports and mixing-in regulations, state trading, equalization taxes on imports and preferential trading systems. Countries with export surpluses have adopted numerous measures to facilitate sales including direct export subsidies, transport subsidies, special tax exemptions, price equalization arrangement, and other measures to assist in sales. The intermix of domestic and trade policies thus is comprehensive and trade policy discussion becomes a discussion of national agricultural policy.

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[20] The following several pages are based in part on a previous article: V. Sorenson, "Trade Policies and Prospects in Western Europe," Journal of Farm Economics, December 1966.

IMPLICATIONS OF THE EEC AND UNITED KINGDOM POLICIES

Two major recent developments have occurred that change the setting but not necessarily the focus of European agricultural policy. These are the formation of the EEC and the EFTA. EEC agricultural policy is based on objectives and attitudes long embedded in national agricultural policies. Changes are aimed largely at arriving at a common market organization but not at reducing, or for that matter greatly increasing, the amount of protection to agriculture. To this point the EEC has not developed a broadly oriented agricultural policy. The principal focus has been on domestic price supports, protection against competitive imports and, where necessary, export subsidies. These policies have recently taken on concrete form and will apply to 85 percent or more of EEC production. While prices are relatively high as shown in table 14, the overall increase from preexisting levels does not appear to be great.[21] Price guarantees will apply to 85 percent or more of EEC agricultural output.

TABLE 14.—EEC: COMMON PRICES FOR SELECTED PRODUCTS

Product	Market[22] price in units of account (1 U.A.=$1 American)	Average U.S. price in Chicago markets, 1964
Soft wheat	2.90 bu	1.46
Barley	2.88 bu	1.01
Rye	2.56 bu	[a] 1.03
Corn	2.97 bu	[b] 1.26
Cattle (on the hoof)	31.11 unit[c]	22.86
Calves (on the hoof)	40.68 unit [c]	[d] 20.99
Hogs	32.66 unit	[e] 17.40
Milk	4.43 unit	[f] 3.37–5.35

[a] U.S. average price received by farmers.
[b] Beef steers, all grades.
[c] Medium quality.
[d] United States, average cost to slaughter, all grades.
[e] 1964–65 marketing year.
[f] Low price is U.S. price paid by condenseries; higher is U.S. average dealer price for fluid use. EEC price is for all milk.
[22] Market prices, while not precisely comparable, tend to more closely approximate U.S. terminal market prices than farm prices.

In evaluating EEC policy, the assumption is normally made that if prices are maintained at high levels this will protect high-cost production and import requirements will be lessened. While this may be true, it falls somewhat short of evaluating the total impact of the EEC. To the extent that the formation of the EEC increases the rate of the economic growth, an income demand effect will take place. If this occurs in the face of prices which are not in excess of the average that would exist in the absence of the EEC, there is a net stimulation to food requirements which increases import needs.

On the other hand, as indicated above, the formation of the EEC may have some stimulating effect on output through providing the basis for specialization and exchange within the community and thus reduce import requirements. The effect of EEC price policy on total production in agriculture, however, can easily be overestimated. Within the range of feasible price levels, it is unlikely that the total resource commitment to agriculture will shift measurably.

[21] For an evaluation of probable changes in prices to farmers due to implementation of EEC policy see D. EEP., "The Impact of Agricultural Policies on Regional Grain and Livestock Prices in the European Economic Community," mimeo, to be published.

A recent comprehensive study of the grain and livestock economy of the EEC suggests that overall price developments will likely stimulate the consumption of some livestock products and thus potentially increase feed grain requirements.[23] Relative prices between agricultural commodities will change somewhat but not enough to cause major shifts in the total output of grain or livestock products. Analysis of production conditions in all of the EEC countries indicate that technology and organization have had a great deal more influence than price change on the level and composition of output in recent years.[24] This will likely continue to be the case for some time to come.

A second major factor of European agricultural policy, the trade implications of which are not yet fully clear, are recent developments in the United Kingdom. Direct agreements regulating imports have been completed with the major suppliers of several important commodities. The trend began in 1962 with essentially unilateral action by the United Kingdom to place quotas on butter. In 1963, agreements were concluded with principal suppliers of bacon to regulate import quantities. Agreements concluded with four principal suppliers of grain in 1964 to allocate imports between suppliers and establish minimum import prices. Since 1964, 17 additional countries have signed similar agreements so that virtually all grain imports by the United Kingdom come from signatory countries. Import levies can be applied if a signatory country fails to comply with minimum prices.

All of these agreements (except butter) were entered into with the implicit or explicit understanding that market growth would be shared between domestic (United Kingdom) producers and exporters. Whether this will follow isn't yet clear. While United Kingdom support policies have been adjusted with a view toward balancing market requirements, the national economic plan developed in 1965 emphasizes the importance of food imports as an element in the balance of payments. Expansion in livestock output is visualized with increased feed grain requirements met largely from domestic sources. Market growth for outside suppliers will cease if this is accomplished.

PROBLEMS IN FUTURE POLICY CHANGE

The solution to problems of international adjustment in agriculture are complicated by domestic income policy. Income policy, in turn, is highly dependent on problems of production organization and resource use in agriculture. Central to the question of whether trade relations among advanced countries will improve is the extent to which production methods and particularly farm organization can be adapted to modern technological conditions in high cost producing countries. These changes will not depend solely on conditions and policies related to agriculture. General economic growth rates will

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[23] V. Sorenson and D. Hathaway, "Changes in the Grain-Livestock Economy of the EEC and Their Effects on Foreign Trade Patterns," mimeo, to be published.

[24] George E. Rossmiller, "Changes in the Grain and Livestock Economies of West Germany With Projections to 1970 and 1975," "Changes in the Grain and Livestock Economies of the Benelux Countries With Projections to 1970 and 1975," mimeos, to be published.
Fred A. Mangum, Jr., "Changes in the Grain and Livestock Economies of Italy With Projections to 1970 and 1975," mimeo, to be published.
Michel J. Petit and Jean-Baptiste Viallon, "French Grain and Livestock Production Projections to 1970 and 1975," mimeo, to be published.

improve the climate for change in agriculture through increased demand, particularly in lower income countries, but more directly and in all countries through the labor market.

Achieving structural transformation is important for two reasons. First, short of major structural reorganization in agriculture, the flexibility to adapt output to market requirements as between commodities will be difficult to achieve. Many small farms with excess family labor, limited capital, and very limited land resources must employ labor intensive techniques and maximize returns to land. This resource organization limits flexibility in responding to market and price conditions and leads to excess output of some products in the face of limited or inadequate output of other products. Second, the small farm is high cost and large numbers of high cost producers create conditions where governments have little flexibility in reducing price support levels and trade barriers.

A significant question is whether policies will be implemented to effectively support or encourage reorganization. Change could undoubtedly be facilitated by market pressures if permitted to operate, but this is difficult to achieve in the face of political pressures, and it is likely that achieving change will depend heavily on policies that are aimed directly at changing farm organization rather than through price pressures. Maintenance of income on small farms will become more and more difficult as time passes and increasing attention must be given to direct programs for structural improvement.

Legislation to improve farm organization in both Japan and Western Europe includes efforts to provide specifically for consolidation and amalgamation of land into larger units as well as broader programs aimed at promoting rural development and assisting rural people to prepare for and accept other employment. With few exceptions, however, these programs have not progressed far and in large part are aimed at gradually eliminating land parcelization and achieving a reduction in the number of very small farms. Programs are not aimed at encouraging the general structural reorganization that is required to provide an efficient commercial agriculture utilizing modern technology and with sufficient land and capital resources to provide an increasing level of income without relatively high prices and consequent trade restrictions.

Thus, it cannot be assumed that change will take place quickly to bring agriculture to a lower cost basis requiring less isolation from world markets. Political, social, and institutional restraints to change based on historical factors are numerous. In these areas, the EEC has taken only minor and cautious steps and there is little evidence that leadership for this kind of change will develop under the common agricultural policy. Further, agricultural policies are sometimes strongly influenced by other factors. In Japan, achieving self-sufficiency in food cereal production has an important bearing on agricultural policy. Sweden and some other European countries, seek to maintain a given level of self-sufficiency in food production even at an economic cost. In most European countries the maintenance of a desirable rural social structure, again at an economic cost, is a strong motivating factor in policy development.

While conditions vary among countries both exporters and importers engage in widespread intervention in domestic agricultural markets and protectionism in international markets. Subsidies and other aids serve the same purpose for exporters as trade restrictions for importers—namely to maintain domestic prices above free market levels. It is clear, therefore, as recently indicated by the FAO,[23] that in international agricultural markets "palliatives which have no influence on domestic support policies cannot be expected to effect any significant improvement to the trade situation for this group of commodities. However, the social pressures which led to the need for agricultural support continue to exist. Farm incomes in the developed temperate-zone countries continue to trail behind those in the rest of the economy, and as a consequence it will be by no means easy to gain agreement on the ways in which domestic policies are to be changed."

Change in the concept of income policy for agriculture will be required. Price supports alone, without supporting programs to adjust agriculture to modern conditions, will achieve little for many farmers and will perpetuate the conflict between domestic policy and a more liberal trading policy. Progress in reducing the level of direct income supports, especially in high cost countries, can be accelerated through programs that seek to: (1) create structural reforms through consolidation and amalgamation of holdings, inheritance laws, ecetera; (2) provide help to the low-income or marginal farmer by creating the conditions for the transfer of his labor elsewhere in the economy and by financial aid; by accelerating farm improvement programs; by creation of supplementary income sources through vocational training; employment information; decentralization of industry, ecetera; (3) strengthen the commercial farmer's economic position through agricultural education and advisory services, marketing aid, income as against price supports, ecetera.

This will entail far-reaching changes in the approach to agricultural income protection. The full recognition in agricultural policy of what is basically a very simple concept, namely that income is a function of both price and quantity, and its full incorporation into Government programs, is fundamental to achieving the kind of change in domestic policy that will ultimately be needed to reduce agricultural protectionism and achieve improved trading relations.

V. Trade Problems and Policies of Special Relevance for Developing Nations

The developing nations' contribution to world trade is small in relation to their population. Among themselves, despite constituting the majority of the world's population, they contribute only 6 to 7 percent of the total trade. Most of their international trade is with developed nations, exporting to them primary products of agriculture, forest, fishery, or mineral origin, while importing a wide range of commodities, including food. The priority given to development usually is high, usually requires substantial imports of capital goods, and generally leads to foreign exchange deficits. These deficits in turn limit the potential exports of the developed nations. Thus, both economic and humanitarian goals of the United States could be more fully met if the value of developing countries' exports could be expanded. But since most developing countries project limited export expansion,

[23] FAO, Commodity Policy Studies, No. 2, op. cit.

and because certain desired connotations of modernity attach to industrialization and a declining dependence on agriculture, import substitution (manufacturing) has become a major element of policy. Hence, behind the specific problems, discussed below, lie this need to increase the volume of exchange earnings (the preferred position), and to use the exchange earned for high priority imports.

AGRICULTURAL SELF-SUFFICIENCY EFFORTS

The agricultural leadership in many developing nations, especially in Latin America, often have a background of experience with large-scale agriculture. Their farm management decisions often place substantial emphasis on holding cash expenditures down, to make the farm nearly self-sufficient, even when additional purchased inputs would increase production by several times their costs. The concept of specialization and comparative advantage is not applied to individual firms to the extent that is applicable. Price instability, variation in Government policy, institutional rigidities, and fear of war or depression induced input shortages, provide a general economic setting hindering the full application of comparative advantage among farms. Moreover, the inflationary pressures common to many developing nations, and consequent rising costs and uncertain supplies of inputs, also reinforce the drift into self-sufficiency.

The same approach carries into national policies for agriculture, reinforced by the desire to save foreign exchange. Thus, import substitution policies also operate within the agricultural sector. Not infrequently, more enthusiasm attaches to production policies and research developments which will make production possible or larger for a new farm commodity than to programs which increase the production and efficiency of a present major export product.

In the short term, foreign exchange may be saved (though usually less than anticipated), and nationalistic pride is swelled. But, for the longer run, scarce scientific manpower has been diverted and spread too thinly, while production efficiency and comparative advantage has lagged in the important export products.

These approaches to agricultural policy reduce the degree of specialization and extent of comparative advantage. A wider range of products are produced for domestic use than would be provided with specialization and exchange. And exports of the product with greatest advantage often are not pressed as far as recent economic conditions warrant because secondary products are stimulated in efforts to diversify.

INTERNATIONAL COMMODITY AGREEMENTS

The agricultural price experience of many export countries since 1925 has been interpreted as a signal to avoid one crop economies, to intervene in the international marketplace where possible in order to raise prices, and to seek means beyond price of products and volume of export which assure a stable or preferably a rising volume of foreign exchange earnings. International Commodity Agreements have been sought as a commodity-oriented program with beneficial price imports. The merits of the twin problems of price and earnings instability and chronic deterioration in the terms of trade were reviewed in chapter III. But whatever the merits of these debates, producers of certain commodities do consider price trends unfavorable and do seek public and international efforts to counter price adversities.

Despite the many discussions and efforts to formulate programs, Blau notes: [26]

"Yet in the 17 years since the end of the war, international agreements have been concluded for only five commodities—wheat, sugar, coffee, tin, and olive oil. Of these, the only two functioning at present as agreements which qualify as producer-consumer agreements and contain some operative provisions designed to influence world trade, are those for wheat and tin. The total value of world trade in the five commodities for which agreements have been concluded in one form or another accounts for about 10 percent of world trade in primary products. The proportion of trade actually covered by agreement provisions is considerably less.

"In recent years, there has been a growing sense of disappointment, particularly on the part of the primary producing countries, with the limited results attained so far. Increasing attention has been paid to other techniques which could serve either as a substitute for, or as a complement to, the working of International Commodity Agreements."

Since this was written the series of 1-year arrangements on coffee have been replaced by a more comprehensive 5-year quota agreement. Some of the discussions with the EEC, particularly France, have urged the expanded use of commodity agreements. Conceptually, International Commodity Agreements impose limitations on trade. Though operating internationally, they are close kin to domestic price supports and storage operations such as the CCC wheat and cotton programs. They pose new problems while dealing to some degree with the older problem of low prices. The lack of control of surplus productive capacity and the handling of the produced excess are crucial limitations; in fact stable prices, if attained, may actually attract new excess capacity. Stabilization programs often "stabilize prices upward" and are very difficult to readjust once established, as indicated by some domestic U.S. experience with price supported commodities. Quotas imposed under such programs usually reflect past production history and operate as if comparative advantage were static and equal for all producers. Economic logic would call for a reduction in production for high cost producers and for those whose comparative advantage was declining, but little success has been attained, partly because international reallocations of quotas are even more difficult to apply than regional allocations within a nation.

Another approach to this same problem of controlling world prices functions through national marketing boards, as in West Africa for cocoa and palm oil. Such agencies have attempted to average payments to farmers over a series of years, while selling in a fluctuating world market. To some degree their decisions to sell or to hold also influenced the level of prices. More recently, a priority purpose has become agencies through which to collect the equivalent of an export tax, thus accumulating funds for development.

Both of these approaches to improving the price situation have a number of other economic, administrative, and political limitations. In an effort to deal with the basic development problem—namely, the

[26] Gerda Blau. "International Commodity Arrangements," reprinted in C. Eicher and L. Witt, *Agriculture in Economic Development*, McGraw-Hill, 1964, pp. 322–339.

instability of export earnings—and to avoid the limitations of a single-commodity approach, several combinations of measures to guarantee exporting earnings have been discussed. A report by a U.N. committee[27] suggests the costs and returns of several levels of guarantees. More recently the World Bank and International Monetary Fund have been asked to evaluate alternative approaches.

Each of the approaches discussed so far in this chapter implies a continued emphasis on agricultural and raw material exports and ways to make this dependency supportive of stability and development. But most developing nations place substantial emphasis on industrialization and measures which increase exchange earnings. For this we turn to another area.

DISCRIMINATION AGAINST THE EXPORT OF PROCESSED AGRICULTURAL PRODUCTS

Developed nations often have tariffs in the following pattern: Unprocessed raw material, 5 percent of value; partially processed, 10 percent of value; fully processed, 15 percent of value.

A tariff at this level does not appear to be a serious hindrance to trade. And it is not for the unprocessed raw material. However, the second and third 5 percents become rather large tariffs in relation to value added by processing. Assume that processing adds 50 percent to value, so that the following values apply:

	Value	Tariff rate (percent)	Tariff charged	Marginal increment
Raw material (hundredweight)	10.00	5	0.50	5 percent.
Partially processed	11.50	10	1.15	43 percent (0.65÷1.50).
Fully processed	15.00	15	2.25	31 percent (1.10÷3.50).
Raw material to fully processed				35 percent (1.75÷5.00).

In this example the rate of protection against the raw material is a low 5 percent, but the rate of protection against processing is 43 and 31 percent. Against such tariff rates the developing nations have no choice; they export the raw material.

Yet, the natural and logical first steps toward industrializing a developing country would be factories to process the nation's major raw materials. While the labor costs of processing are likely to be smaller in a developing country, the capital costs are usually larger, so that the cost differentials normally would not counterbalance the differences in tariffs. For a plant to process their own raw materials the economies of scale are likely to be advantageous compared with a plant for an important substitution industry, since the size of the plant is limited only by the volume of raw materials, rather than by the size of the internal market. This statement is especially relevant for small economies.

The question now becomes, "How important is this type of discrimination?" Harry Johnson cites some unpublished computations by Padma Mallampally, as shown in table 15.

[27] United Nations, "International Compensation for Flucuations in Commodity Trade," E/3447, E/CN. 13/40, New York, 1961.

TABLE 15.—NOMINAL AND EFFECTIVE PROTECTION OF PROCESSING OF AGRICULTURAL PRODUCTS, UNITED STATES AND EUROPEAN ECONOMIC COMMUNITY

[In percent]

Processing industry	U.S. protection rates		EEC protection rates	
	Nominal	Effective	Nominal	Effective
Coconut oil (refined)	5.7	57.5	15.0	150.0
Jute fabrics	3.1	5.3	23.0	39.6
Cigarettes	47.2	89.0	([a])	([a])
Hard fiber manufactures (cordage)	15.1	38.0	([a])	([a])

[a] Not available.

Source: Unpublished computations by Padma Mallampally from scattered data on processing costs. Harry G. Johnson, Economic Policies Toward Less Developed Countries, The Brookings Institution, Washington, D.C., page 91.

An aggregative analysis is provided for five developed nations in a study by Balassa. See table 16. For both sets of data, clearly the effective tariff is substantially above the nominal tariff. Note also that advanced processing enjoys greater tariff protection, for the U.K. rising from 7.6 to 17.8 percent.

TABLE 16.—AVERAGES OF EFFECTIVE AND NOMINAL RATES OF DUTIES FOR FOUR COMMODITY CATEGORIES,19

[In percent]

Category	United States		United Kingdom		Common Market		Sweden		Japan	
	Nominal	Effective	Nominal	Effective	Nominal	Effective	Nominal	Effective	Nominal	Effective
Intermediate products I[a]	8.8	17.6	11.1	23.1	7.6	12.0	3.0	5.3	11.4	23.8
Intermediate products II[b]	15.2	28.6	17.2	34.3	13.3	28.3	8.5	20.8	16.6	34.5
Consumer goods	17.5	25.9	23.8	40.4	17.8	30.9	12.4	23.9	27.5	50.5
Investment goods	10.3	13.9	17.0	23.0	11.7	15.0	8.5	12.1	17.1	22.0
All commodities	11.6	20.0	15.5	27.8	11.9	18.6	6.8	12.5	16.2	29.5

[a] Manufactures whose main inputs are natural raw materials.
[b] Intermediate goods at higher levels of fabrication.

Source: Bela Balassa, "Tariff Protection in Industrial Countries: An Evolution," Journal of Political Economy, vol. 73 December 1965), p. 591.

The final line of table 16 indicates that for 1962 the nominal U.S. tariff rate of 11.6 percent becomes an effective tariff rate of 20 percent. Little information is available to the authors to calculate the rates application when the Kennedy Round rates go into effect. But it seems clear from the preliminary information that this problem will continue to be significant and to represent an important area for future discussions between the developed and the developing nations.

INTERNAL GROWTH IN DEMAND IN DEVELOPING NATIONS

Exports develop when the volume of production is sufficiently large to more than satisfy internal demand. If price differentials between internal and international markets offset the costs of exporting then the exportable surplus is sold. If price differentials are too small or nonexistent, then internal prices must decline, production must shift to other products, or a public agency must intervene to purchase and hold the commodites pending future world price increases, or to arrange for exports at a loss.

The increases in per capita income, modest though they may be, gradually increase the level of domestic demand. In developing nations the income elasticity of demand is higher than in developed nations, 0.5 or 0.6 compared with 0.2 or 0.3; thus, a given increase in income converts to a larger demand than in developed countries. High rates of population increase, stemming from high birth rates and sharp decreases in death rates, also add substantially to the increase in effective demand.

Thus, over time, the internal consumption of agricultural products increases. A number of developing nations, once exporters of rice or beef and certain other food products, have become less significant in world markets or have disappeared entirely. This set of circumstances ensues when the expansion of production lags behind the dynamics of income and population. This tendency toward a larger internal consumption pervades all countries. Continued and expanded exports requires a significant internal effort to increase production. Thus, a static or relatively static situation with respect to agriculture will lead to a gradual reduction in exportable surpluses, a decline in the volume of exports, and a reduction in exchange earnings, unless increases in world prices compensate for the decreases in volume. A present concern is that a significant number of developing countries are becoming less capable of feeding their own population.

PRODUCTION, POPULATION AND FOOD AID

The rate of agricultural expansion in developing nations has been substantial. "During the period 1948–63, the rate of increase in crop production . . . exceeded 5 percent a year in seven countries . . . Israel, Sudan, Mexico, Costa Rica, the Philippines, Tanganyika and Yugoslavia. It varied from 4 to 5 percent a year in five other countries . . . Taiwan, Turkey, Venezuela, Thailand and Brazil." [28]

Food production is expanding in the developing countries of the world. During this century, at least, the United States only occasionally has attained increases of 3 percent; the usual figure is smaller and occasionally negative. However, these substantial improvements in agricultural production are matched with high rates of increase in population and by increasing per capita incomes, part of which goes to increase per capita consumption of food products. Nonetheless, most of the countries listed above have been able to improve their consumption export balance. However, among the nations whose agricultural progress has been less dramatic, many face actual or potential shortages of food at current prices; with possible combinations of alternative consequences of (1) increasing prices to consumers, (2) rationing of existing supplies, (3) increased investment in agriculture designed to expand domestic production more rapidly, (4) expanding imports, (5) population control as a long-term solution.

Popular discussions of world food problems have been confused by the mixing of two concepts, the need for food and the demand for food. The need for food derives from estimates of the kinds and amounts of food required to feed the world's population a nutrition-

[28] ERS/USDA, "Changes in Agriculture in 26 Developing Nations, 1948 to 1963," Foreign Agricultural Economic Report No. 27, November 1965, pp. 6–7.

ally balanced diet. It begs the questions of: (1) who will pay for this food? (2) how will those now consuming poor diets be induced to consume a better diet? and (3) how can the requisite foods be distributed to those people and geographical areas where deficits exist? The demand for food, on the other hand, reflects consumers' desire backed up with money which they are spending. The need for food increases as population increases. The demand for food increases as incomes expand. The major interest in these discussions of trade problems is with the demand for food and other agricultural products, the commerial trade that caters to this demand, and the international trade that helps adjust national supply to demand.

However, a substantial portion of the U.S. Public Law 480 exports fall in between these two concepts. Reviewing past shipments, grants under former titles II and III (present title II) represent donations to attend to food needs which otherwise would be met only with great difficulty. Long-term loans under former title IV (present title I) represent food sold on a dollar repayment basis, thus bridging a current foreign exchange gap. Sales for local currency under former title I (and still possible, though restricted, under present title I) represent a combination of grants and sales depending upon the uses to which the local currency is put in the specific case. The shipments under the world food program, and certain bilateral programs as for Canada, fall into a food aid or development aid category; i.e., development grants for specified purposes. Most sales of wheat by France probably should be classified as concessional sales or export dumping since the principal concession is in the price. The new multilateral program developing out of the Kennedy Round negotiations on grains will provide a substantial amount of food aid from present importing countries. Present reports on the agreement do not make clear whether these shipments should be classified as grants or as concessional sales.

Any discussion of food aid in the future rests heavily upon the likely trend in world population and the prospects for a great acceleration in family planning. If current projections are realized, the pressures for accelerated food aid will be well nigh insatiable, especially if coupled with a growth in commercial trade stemming from larger per capita incomes in Japan and Western Europe, and from concessions made in the Kennedy Round negotiations. If family planning is accelerating rapidly, as argued by a few population specialists, then modest and feasible levels of concessional and grant shipments will continue, with a gradual improvement in the average levels of human nutrition.

To complete this section we turn to a recent research report on Public Law 480, [29] selecting from the summary chapter. This material discusses the impact upon development and prices of past Public Law 480 shipments.

"An examination of the program's impact in several countries indicates that farm products can provide useful economic assistance, but they do not do so automatically. The internal policies of the recipient nations can do much to compensate for or override the possible adverse price effects of additional imports * * * within the framework of the individual Public Law 480 agreement, a recipient nation may find

[29] Witt, Lawrence, and Carl Eicher, "The Effects of U.S. Agricultural Surplus Disposal Programs on Recipient Countries," Research Bulletin 2, Agricultural Experiment Station, Michigan State University, 1964, pp. 69–72.

it possible to reduce commercial imports, thereby reducing the volume of additional imports and increasing the amount of industrial goods and non-surplus farm products imported * * *

"The economic events which led the United States to inaugurate this program in 1954 and to expand it in ensuing years are not necessarily limited to a desire for economic development among the poorer nations. In fact, the program became one of the ways in which the structural weakness of the national economy (not of agricultural policy alone) could be made less onerous. These events are likely to be repeated in other advanced nations. Several western European countries, and the European Common Market, look upon overseas disposal as a convenient tool of policy. Subscriptions to the world food program reflect the same forces as those underlying the Public Law 480 program. Advances in agricultural productivity similar to those of the United States are well underway in the advanced nations—based upon reduced price uncertainty, improved technology, better management, more capital, more nonfarm produced inputs, and farm consolidation. These additional supplies move to markets where price and income elasticities are moderate and declining as economic growth pushes up individual incomes. The combination of low price elasticities and low downward supply response threaten to provide lower farm prices and incomes. In many countries of Western Europe there is good reason to expect a political response which supports and continues price policies which bring "surpluses" into being; in some commodities, they already exist."

"These countries too, have economic and humanitarian reasons to send surpluses overseas, to aid development and improve nutrition * * *

"The convenient marriage which Public Law 480 represents stems from the substantial resources which developed countries must commit in order not to produce certain commodities, while the less-developed world hesitates to commit substantial resources to expand production of the same or similar commodities. If the world is short of food and prepared to insure that adequate supplies are made available, then the resource cost of producing additional supplies may well be less, in the shortrun, if produced in presently developed nations and distributed at low or zero prices where needed.

"Whatever the merits of a temporary program, it does have both short-term and long-term difficulties. First, the possibility of Public Law 480 supplies at low cost may postpone making fundamental structural adjustments both in sending and in receiving countries. The economy of each is less strong than it might be. Second, the commodities in surplus may not be the commodities most needed for development or for better nutrition. Public Law 480 has done little to reduce the apparent substantial protein deficiencies especially prevalent in South Asia. Third, for the developed countries at least, the process of structural adjustment is in operation, and, there is no assurance that surplus commodities will be available for an indefinite period. Fourth, with the high rate of population increase in underdeveloped nations, it seems unlikely that the developed nations alone can continuously expand food production to feed them. The local country almost certainly must supply the majority of the necessary increased food needs * * *

"Finally, attention must be given to the question of whether Public Law 480 inhibits development through adverse effects upon agriculture. The evidence here is equivocal. Additional imported farm products have helped prevent consumer protests and permitted an expansion of industry without necessarily a concomitant, supporting expansion in internal agriculture and marketed supplies. This is development, even if it is one-sided, and may contain a fatal weakness. (Development theory is not sufficiently advanced to permit a final judgment.) In some countries agricultural development appears to have been discouraged as a consequence of Public Law 480 imports. In other countries, Public Law 480 imports have either become an agricultural development resource, or have been neutralized through internal policy adjustments—thus encouraging or not discouraging the simultaneous development of local agriculture."

VI. The U.S. Interests in Agricultural Trade

Annual reviews and day-by-day decisionmaking by Congress and the executive agencies deal mainly with the immediate and direct interests of the United States. Papers such as these emphasize the long-term and the broad, sometimes less, direct aspects of U.S. interests in one or another public issue. Neither approach should ignore the other; but the pressure of events and administration emphasizes the short run. The attainment of short-term goals can be a step toward improved long-term relations, but, not infrequently, the short term is at least partially in conflict with the long term. With these thoughts we turn to an examination of U.S. interests in agricultural trade.

U.S. INTERESTS

Agricultural trade relates to a number of economic, social, political, and humanitarian interests of the United States. Those that seem to be most important are listed below; it is presumptuous to suggest the relative importance of each to Members of Congress. In fact, one of the purposes of this set of hearings, is for your Committee to recommend on the importance of this topic to the United States. We will try, on the basis of the past, to suggest some of the interests that seem to be important. Briefly, the United States has the following interest in agricultural trade:

1. Agricultural exports provide about 20 percent of U.S. export earnings.
2. The export market represents a large outlet, 35 to 50 percent, for certain commodities, notably wheat, feed grains, cotton, tobacco, soy beans, and certain other fats and oils.
3. International agricultural trade brings to U.S. consumers a wide range of tropical and semitropical products at reasonable cost, which contributes to a higher level of living.
4. Agricultural product exports make a significant contribution to the network of world trade, which increases the economic interdependence between the United States and the major world trading nations. Such interrelationships have many important, though subtle, influences toward reducing the likelihood of conflict among these nations.

5. Trade, including agricultural trade, provides for specialization and makes use of comparative advantage, so that the participating economies become more productive, thus, enabling their citizens to enjoy higher levels of living.

6. Improved international political relations often are associated with an expanding volume of trade. It is not always clear which is the primary cause and which is the effect, but once well started, expanding trade usually improves the general tone of international relations.

7. Agricultural trade is one means for improving the level of human nutrition and well-being in nations whose agricultural productivity and resource base is limited.

8. Concessional or grant exports of farm products help satisfy our humanitarian concern and sense of responsibility for undernourished individuals and groups in other parts of the world. Our aspirations that such assistance will enable these people to become more productive, have not been realized as fully as desired.

9. Concessional agricultural trade programs can have desirable political effects. Despite the protests of some Congressmen, we believe that food exports to Yugoslavia provided that country with an opportunity to pursue a more independent course than would otherwise have been possible, and that this stance contributed, through time, to U.S. international political interests. The Egyptian experience argues a contrary view.

10. An increasing volume of agricultural (and other exports) from developing countries can increase their level of economic activity. As these nations increase their sense of economic and political well-being, the number of individuals with goals and values consistent with our own are likely to increase, with gradual changes in their international position. While there is no assurance that they will aline themselves with the United States, it is likely that they will pursue independent policies with which the United States can live.

11. Moreover, as these nations strengthen their economies they are more likely to become expanding markets for our commodities, and to require smaller amounts of foreign aid.

These interests are both conflicting and overlapping. Programs to serve these interests are not always well designed to attain their objectives, and differ significantly among countries and regions. We turn first to United States and the developing nations.

One conflict needs to be given special attention here, particularly since it has arisen and will arise again in UNCTAD and other conferences. The U.S. interest in maintaining or expanding trade in its own subtropical agricultural products, in certain other raw materials and in simple manufactures conflicts with the U.S. interests in the developing nations' expansion of their exports and improvement in their economies. Many other developed nations face the same conflict. Protection against the import of such products, so as to maintain domestic production and processing has the same effect.

Expanding agricultural exports increase foreign exchange earnings and thereby reduce the U.S. balance-of-payments gap. The increased outflow of farm products strengthens the internal U.S. market for such products, provides opportunities to reallocate agricultural resources, and to utilize a larger proportion of the productive capacity of U.S. agriculture. The economic welfare of farm people is enhanced. An expansion in agricultural trade, like total trade, increases the interdependence of the trading nations, and, as they exploit comparative advantage more fully, contributes to higher incomes, greater welfare, and stronger economies.

For the less developed nations trade expansion is even more vital. An expansion in agricultural and other raw material exports increases their foreign exchange earnings, and thereby makes it possible for them to reduce a balance-of-payments gap or to increase their purchases of tools for development. An increased outflow of farm products also benefits the level of economic activity within the economy and leads to an increase in aggregate and in per capita income. Moreover, developing countries depend far more heavily upon raw material exports as the "engine of growth," typically 70 to 80 percent of their exports being so derived compared with 5 to 25 percent for most of the developed nations. The one-sidedness of their economy can represent a solid exploitation of comparative advantage, but it is also a source of uncertainty and inflexibility. A recent UNCTAD document comments on the lack of diversification as follows:

"Many factors have contributed to this situation. Ecology, topography, climate and soil often limit the scope for agricultural diversification. There are also many economic benefits to be derived in some cases from specialization. These include comparative cost benefits, economies of scale and of estate cultivation, greater standardization, etc. However, specialized economies are excessively vulnerable to instability in international commodity markets and to the adverse effects of policies adopted in competing and in importing countries. They are liable to be faced with difficult adjustments if demand should contract. Moreover, the long-term growth of demand in international markets for most agricultural commodities may be too slow to permit the adequate growth of imports required by rapid economic development." [30]

The United States has economic strength to subsidize exports at the expense of the developing nations, if it so desires, but also has multiple alternatives for many of its resources, so that it could, at some cost, eschew such a rise in exports. Such action could strengthen the export sectors of relevant developing countries and help them attain a rising level of income and larger foreign exchange earnings. Such developments would contribute to two other U.S. objectives, the direct interest in larger exports of industrial goods, and the longer run, less direct interest in stronger, more self-reliant economies in the developing world. The choice is a very difficult one to make in the United States and in other developed countries, mainly because of the adverse internal income effects on farmers and manufacturers presently producing such products and prepared to protest politically. A choice must be made, if the United States is to deal effectively with the discussions between developing and developed countries begun at the first UNCTAD Conference in Geneva and continuing in the forthcoming second UNCTAD Conference in India.

Thus, one of the important issues is the competition in available consumer markets between the developed and developing countries for those commodities exported by the latter.

A second issue is the reduction of trade barriers, perhaps on a differential basis, to ease the entry of agricultural imports from developing areas. The United States does not have high tariffs against most

[30] UNCTAD, "Role and Financing of Diversification Programmes," Trade and Development Board, Committee on Commodities, TD/B/C.1/36, Jan. 9, 1967, p. 3.

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of these products—Western Europe is more open to criticism—but for a few commodities the United States has a combination of quotas and tariffs that are significant barriers. Sugar, wool, and dairy products are noteworthy.

The problem of synthetic competition—rubber, fibers, plastics—has some similarities, but the technological considerations make this more a question of adapting to dynamic changes in comparative advantage.

Another area of concern to the developing areas is the discrimination against processing of raw materials in the producing country. Here the United States and most other developed countries need to review the situation after the Kennedy Round, and consider possible actions. Economic logic in comparative advantage and longrun interests in fostering efficient industrialization indicate that additional tariff and other concessions are appropriate.

We turn now to trade and policy issues among developed countries. In volume this trade is far larger. Policy issues recently have been dominated by relations between the United States and the presently constituted EEC. In the future this may change to an expanded EEC and include important questions of relationship with non-EEC free world countries as well as socialist countries. Whatever the specific composition of issues at any particular point in time, U.S. interests will simultaneously lie in increasing the competitive structure of world agricultural markets while at the same time improving cooperation among advanced countries in dealing with problems of food aid and policy vis-a-vis developing countries.

In trading relations vis-a-vis advanced countries, U.S. interests lie primarily in seeking reduced restrictions in importing countries and expanded sales of U.S. farm products. Obtaining concessions on trade, however, will depend on the extent to which international negotiations can be instrumental in reorienting domestic agricultural policies to reduce the conflict with trade policies. "As long as price supports at relatively high levels are used as the principal means of protecting income, these must be accompanied by tariffs or controls of international trade." [31] The obligation for leadership in reducing these kinds of conflicts necessarily lies with any country seeking reduced trade barriers. Yet, it is fair to say that our use of trade restrictions to facilitate domestic support programs has been relatively comprehensive.

Some of these inconsistencies have recently been reduced, especially for cotton and grains, by changes in domestic price support legislation, and the trade expansion act has limited the use of the escape clause. Nonetheless, many recent specific actions have emphasized our sensitivity to protection and expansion of the American market for domestic producer groups. These include the import limitations on dairy products from Australia, New Zealand, and Ireland in 1963; agreements on the limitation of beef imports; the continuous use of section 22 restrictions to restrict imports of supported commodities. These specific actions along with such longer term policy positions as that in sugar and the fact of a two-price system which provide a differential in returns to producers from the domestic and international market, create difficulties in bargaining for reduced trade barriers by other countries. While all of these conditions cannot be eliminated, a wise policy would attempt to minimize them and they must be subject to reciprocal international negotiation.

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[31] OECD, "Agriculture and Economic Growth," Paris 1964.

Second, restraint in pursuing export programs is also needed. Market promotion in developed countries if inappropriately handled can lead to inconsistencies to serious consequences for competing countries as well in those countries whose market is at stake. Market promotion further often leads to forceful representation of commodity interests in international discussions and often does little to sell more farm products; rather it contributes to tensions which make international negotiations difficult.

This is not to say that all efforts at expanding foreign outlets should be avoided, e.g., those that inform and attempt to discover market requirements. Market expansion based on economic forces should be welcome as should expansion based on overall and mutually acceptable reduction in trade barriers both on industrial and agricultural products. Trade expansion through vigorous pressures for reduction of barriers on specific commodities sometimes contrary to the welfare of an always smaller country or through special commodity arrangements are more questionable.

The pursuit of reduced interference with trade among advanced countries must continue to represent an important part of our international policy. Meaningful negotiation, however, normally requires that each country to the negotiation have something to gain from agreement or to lose if it fails to bargain. Meaningful reciprocity therefore must be sought or by implication some parties to the bargain must be willing to forego full reciprocity. Given the conditions in agricultural production, with wide disparities in production costs among countries plus our own willingness to place commodities on world markets below production cost it is not surprising that major agricultural price concessions were not achieved in the Kennedy Round.

Progress in the future will depend on the reciprocal willingness of both exporters and importers to reduce protection of domestic agriculture and this in turn depends on accelerating the process of change in countries with an inefficient agriculture and in adjusting the level of total resources in agriculture to fit the needs of domestic and world markets. While immediate and sharp reductions in agricultural trade barriers among advanced countries are probably not feasible meaningful improvement should be possible through time. As suggested recently:

"Considerable gains could be achieved by adopting changes in agriculture and food policies that over a period of years will permit expansion to occur most rapidly in areas with the greatest comparative advantage. Policies should be implemented in such a way that they encourage desirable international specialization and should not seek to maintain traditional commodity relations where this interferes with shifts in line with comparative advantage. With reduction in artificial stimuli for all high cost production, wherever it exists, the general balance of international resource use would be gradually improved. This allocation must be secured within the framework of total resource commitment that is in line with potential rates of expansion of domestic and world markets and the potential rates of diffusion of economic growth among regions and areas." [32]

The second major issue among advanced countries is achieving the basis for cooperation in meeting the trade and aid needs of developing

[32] OECD, "Agriculture and Economic Growth," op. cit.

countries. Some progress was made in the grains agreement of the Kennedy Round. This calls for a joint allocation of food aid among both importing and exporting countries. The issues, however, are broader than providing coordinated food aid. Developed countries in exploring the possibilities of coordinated action to improve the trading relations and to accelerate growth in developing countries should explore a number of questions. These include:

1. The degree to which international cooperation is useful in providing and financing aid, including food aid.
2. The extent to which preferential trading relations and reduction in barriers on imports from developing countries is feasible.
3. The extent to which financial arrangement and positive marketing aids to encourage exports from developing countries can be instituted.
4. The role that international commodity arrangements could play and the form they should take to be politically acceptable and economically useful to developed and developing countries.

International commodity agreements, in particular, have been viewed as one approach to improvement in the trading position of less-developed countries. Their adoption, however, has been limited. Some efforts have been instituted by the International Monetary Fund to provide compensatory financing of export fluctuations that tend to equalize earnings from export over time. The problem of the extent of use of commodity and financial measures and possibilities for international cooperation in developing programs are important issues in trade policy toward developed countries.

Other measures to guarantee export earnings have recently been discussed by the U.N. that need to be considered jointly. Over time most developed countries have instituted a set of nationalistic policies that pay little regard to its impact on less-developed countries. Import restrictions on tropical products with differentials related to degree of processing have already been noted as a case in point. Trade restrictions and subsidies on trade in commodites such as oils and oilseeds reduce the earning from competing exports in less-developed countries. Through this process, international prices are driven to unrealistically low levels with major consequences for competing third countries. These market disruptions are essentially discriminatory against developing countries and cannot be reduced without direct cooperation of all advanced countries.

But, eliminating discrimination against developing countries is not the end point of needed policy coordination. The call has recently been sounded for trade preferences on a general basis for developing countries. Present international arrangements, including the EEC arrangements with overseas territories and the British preferential system in particular, provide certain trade preferences. On the whole, however, these arrangements provide preferences for certain countries over others in the markets in question and do not deal with the question of preferential trading relations between developed and developing countries. This more general question cannot be handled short of major policy coordination among all advanced countries. In the face of preexisting biases toward regionalization among continental European countries and toward more general most-favored-nation treatment in the United States, this may represent the No. 1 immediate challenge in international policy confronting the United States.

UNITED STATES TRADE WITH LESS DEVELOPED COUNTRIES*

BY JOHN PINCUS

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I. INTRODUCTION

CURRENT TRENDS IN THE UNDER-DEVELOPED COUNTRIES—TRADE INTERESTS

The discussion of this paper is taken from a recent study [1] on the economic relations between rich and poor countries. The rich countries (Western Europe, United States, Canada, Australia, New Zealand, and Japan) are often referred to herein as "the North." The poor countries (Latin America, Africa, and the rest of Asia) are often referred to in the text as "the South."

We can begin the analysis of North-South trade policies by pointing out the advantages derived from international trade for all participants. There are two aspects to the gains from trade: those deriving from specialization according to comparative advantage, and those deriving from and contributing to the process of economic development over time. Today, economists discussing development emphasize the latter set. They are not necessarily inconsistent with the former, and modern versions of neoclassical theory emphasize the view

*Reprinted by permission of McGraw-Hill Book Co., from "Trade, Aid and Development" by John Pincus, RAND Corporation. Copyright 1967 by Council on Foreign Relations, Inc.

[1] John Pincus, "Trade, Aid, and Development," New York, McGraw-Hill, 1967.

that specialization according to comparative advantage will be likely to promote rapid growth.

The principle of comparative advantage states in effect that to maximize world output at any point in time, each country should export those goods it produces relatively cheaply and import those it produces relatively dearly. The total world output from a fixed quantity of resources is thereby increased compared with production without trade.

The static gains from trade are presumably greater as the differences between trading partners' resource endowments and production and demand conditions are greater. It is difficult to measure the actual value of these gains, however; in the absence of data on prices and costs, we must resort to gross measures. The combined national products of the Northern countries were about $1,165 billion U.S. dollars at official exchange rates (1964 estimates). Their total exports in 1964 were about $118 billion, of which one-fifth went to underdeveloped countries. In other words, exports to underdeveloped countries are equivalent to only 2 percent of Atlantic Community production. Therefore, gains from trade with the South are less than vital to Northern prosperity. For the South, trade with rich countries accounts for at least one-tenth of total output. Small wonder, therefore, that the future of North-South trade is a perpetual concern of developing countries, while the North tends to look upon such issues as somewhat secondary. Table 1 shows the relevant trade and income estimates for 1964.

Table 1 probably gives a slightly misleading impression of the North's trade stake in the South. Although North-North trade is much larger, the gains per dollar of trade are probably greater in North-South trade. Gains from trade are presumably greater when countries differ widely in resource endowments and demand patterns.

TABLE 1.—FREE WORLD EXPORTS AND PRODUCT, 1964

A. TOTAL TRADE, 1964[a]

[Dollars in billions]

Region	1964 combined GNP	1964 exports (f.o.b.)	1964 imports (c.i.f.)	Exports, as percent of GNP
Industrial countries	$1,165	$118	$125	10
Underdeveloped countries	240	35	35	[b]15
Total	1,405	153	160	11

B. NORTH-SOUTH TRADE, 1964

Exports	Amount	Percent of 1964 GNP
From industrial countries to industrial countries	$85	7
From industrial countries to underdeveloped countries	25	2
From underdeveloped countries to industrial countries	25	10
From underdeveloped countries to underdeveloped countries	7	3

[a] Includes free world imports from and exports to Communist countries; excludes trade between Communist countries.
[b] The United Nations has estimated LDC exports as amounting to 18 percent of combined domestic product in 1961. "The Growth of World Industry 1938–61: International Analyses and Tables," New York, 1965, p. 33. The estimate in the table may therefore be too low.

Source: United Nations, Monthly Bulletin of Statistics, March 1966.

This conclusion that the North has a relatively minor interest in trade with the South applies a fortiori to some of the dynamic aspects of gains from trade. The transmission of technology and skills through trade and investment is predominantly from North to South. The economic reorganization and market expansion the South seeks will utilize the experience, products, and markets of industrial countries. In general, the industrial countries' dynamic gains from trade—those that result in expanding markets and in lowering costs by increasing scale or output or introducing new techniques, thereby raising productivity—stem primarily from trade with each other. However, their dynamic gains are probably relatively smaller per unit value of trade anyway, because the state of the arts varies less among them than between them and LDC's. New technique (more specifically, embedding technological progress and productivity growth in the economy) is probably a central element in the dynamic gains from trade, although it is evidently linked in practice to cost reductions stemming from economies of scale.

INVESTMENT INTERESTS

Turning from trade to investment, the relative stakes change somewhat. Northern annual net private investment, including portfolio investment, in underdeveloped countries averaged about $2.5 billion during the decade ending in 1964, and showed no particular trend. In 1964, the value of U.S. private capital invested in the South was estimated at about $13 billion. LDC investment in industrial countries is small, although much of it is presumably unrecorded and no reliable figures exist. Of course, Northern and Southern stakes in private foreign investment are not adequately measured by the value of sunk capital. In the long run the dominant issue is the potential returns on investment, both to private individuals and to society as a whole.

It is commonly stated that private investment benefits the host country by providing capital, transferring technology, increasing the productivity of labor and thereby allowing increases in domestic savings and investment, further stimulating growth. No a priori judgment is possible, however, as to whether the rich countries or the poorer ones have a greater economic stake in protecting existing investments and promoting new ones. As an extreme example, some poor countries might gain more from confiscating existing Northern investments than from encouraging new ones. It is rather difficult to speak in quantitative terms of Northern or Southern stakes in liberalizing or restricting investment, because each country is sui generis.

The issue, moreover, is primarily not economic but political. The economic loss of new investment arising from restrictions is largely the host country's because the investing country's capital can go elsewhere. For existing investment, restriction generally takes the form of control over repatriation of capital and profits, and of requirements for domestic participation. The net effect on capital availability depends on whether discouragement of new investment exceeds gains resulting from controls.

Obviously, the decision to invest or not is ultimately a question of profit. From the viewpoint of the foreign investor, his return (including discounts for unusual risks arising from investment in LDC's) is the primary criterion. In that light, restriction is simply one aspect. It affects the degree of risk or the expected profit. Profitable foreign investment in the South has been largely limited to mining and refining, although in recent years there has been some investment in manufacturing.

In any event, looking at both trade and investment from the static viewpoint, the industrial countries taken together have a rather modest interest—although there are significant exceptions, such as Japan, which does half of its export trade with LDC's and could not readily shift these exports to markets in the North. The specter of a North deprived of vital raw materials by a hostile South owes more to imagination than to analysis. At most, if raw materials exporters insisted for political motives on denying themselves export earnings—an unlikely event—there would be an increase in raw material costs. This in turn would presumably be offset, at least in part, by induced technological changes in industrial countries.

DYNAMIC FACTORS IN TRADE AND INVESTMENT

Similar conclusions apply to the process of economic growth over time. Some economic theories of trade and development tend to support the view that trade is an agent of economic growth. Historically there is no doubt that it has operated to promote the interests of both advanced and underdeveloped countries. To the extent that trade now operates as an agent of growth for the Atlantic countries, however, the developing countries play a minor role in the process. Only one-fifth of Northern trade is with LDC's, and the proportion to total trade has been falling in the post-World War II period. It is the intra-Northern trade that has grown most rapidly among the market economies, particularly intra-European trade. Again, as in the case of static gains, there are exceptions. The remarkably rapid post-war growth of Japan must reflect in part the increased specialization and economies of scale made possible by the expansion of its exports to the South, and by the development of new raw material sources in underdeveloped countries.

Although the North's interest is less vital than the South's it is far from negligible. Furthermore, the process of growth in North and South alike may intensify the Northern interest. Northern growth will increase the demand for imported raw materials, including some in which it is now largely self-sufficient. Southern growth will increase its demand for Northern products. The South's population, even excluding China, is more than 1.5 billion, 2½ times that of the North, so that the increase in demand could be substantial. At the same time, cost conditions in the two areas will change, and each may export goods it now imports. Each can benefit from trade under situations where comparative costs change. But this is far ahead, because the South's demand is now sharply constrained by the interacting effects of low income levels and foreign exchange restrictions. However, as the next section points out, taking a long view, we can foresee vast increases in LDC trade and income by the end of this century. In the past 150 years the United States has risen from an insignificant role in world trade to a major one. Over the generations to come, the underdeveloped regions may also play an increasingly important part.

AGGREGATE GROWTH

It is generally believed that economic growth in the underdeveloped countries has been slower than that in developed countries in recent years. If we define growth as a percentage of increase in national product, this belief is not so—the two areas' incomes grew at an average compound rate of about 4.5 percent annually from 1950 to 1962 with the LDC rate if anything slightly higher than that of the Atlantic countries. Growth of per capita income, however, has been faster in the Atlantic countries, the amount of the spread from year to year being influenced not only by faster population growth in LDC's, but also by changes in U.S. income growth, because the United States accounts for more than half of Atlantic income.

If it were not for rapid population growth in the South, economic growth rates in the two regions would be about the same (other things being equal). With annual growth in per capita incomes of 3 percent then entirely feasible, incomes per head would double every 23 years.

It is largely on the basis of this concern for small differences in growth rates and on the alleged limitations of growth caused by lack of foreign exchange that underdeveloped countries in economic rationality can justify their preoccupation with trade and aid concessions from the North. It is possible to argue one or both of two cases to support the need for faster export growth as a condition of faster output growth: (1) Foreign exchange limitations create a barrier to output growth; (2) domestic savings or domestic markets for goods cannot be increased readily, so that increased imports are the only way to increase investment; or increased exports the only way to find markets (because domestic demand is small, or domestic productive factors are immobile as among industries). Both arguments are made by underdeveloped countries.

Industrial countries, on the other hand, generally do not argue so strongly for trade expansion on these grounds. Their case for more trade is to a greater degree on the comparative cost arguments and, in the case of smaller countries, the desire to benefit from economies of scale.

In any event, there is clearly no unique relation between trade and economic development. The percentage growth of Atlantic Community exports was nearly twice as great as its income growth during the past decade; underdeveloped countries' exports rose a little slower than income. Yet income in the two areas grew at nearly the same rate. Table 2 compares industrial and underdeveloped countries' trade growth from 1950 through 1965.

These data underline the error inherent in equating income growth and trade growth uniquely for all countries. The industrial countries' prosperity has been marked by rapid increases in trade, probably reflecting: (1) Dismantling of the trade restrictions created during the depression of the 1930's, and maintained until after World War II—in effect a sort of catching up to normal trade patterns after a long period of restriction; (2) increasing specialization in production of manufactures, made possible by increases in demand, and encouraged by preferences for widely advertised products; (3) the internationalization of tastes made possible by modern communications, and encouraged by the growth of international corporations, which are also often their own customers in world trade; (4) the marked and continuing decline in transportation costs in this century.

TABLE 2.—GROWTH AND SHARES OF EXPORTS, 1950–65

	Average export growth rates (percent per year)		Shares of total exports [a] (percent)		
	1950–60	1960–65	1950	1960	1965
Industrial countries	8.6	8.4	66	76	78
Underdeveloped countries	3.6	5.8	34	24	22

[a] Excludes trade between Communist countries; includes free world exports to Communist countries.

Source: UNCTAD, Handbook of International Trade Statistics, Doc. E/Conf. 46/12/add. 1, Feb. 28, 1964; United Nations, Monthly Bulletin of Statistics, May 1966.

Growth of the underdeveloped countries has taken place under a variety of trade conditions. They have benefited, either as exporters or importers, from the factors listed above, but the results for trade have been generally modest. The situation varies greatly among countries. The basic points accounting for the difference seem to be: (1) the buoyancy of world demand for manufactures has allowed all Northern countries to share, albeit unevenly, in the rapid growth of trade: (2) often lacking that opportunity, some Southern countries, usually the larger ones, were able to expand rapidly by maintaining the traditional but slow-growing exports, substituting domestic industrial production for imports, and using the foreign exchange savings for importing capital goods; while others grew either by outpacing the average LDC export performance or else failed to grow. The data of table 2 offer some evidence of changes in this pattern since 1960. Southern exports have increased faster than in the preceding decade, and their exports of manufactured products have continued to rise at a faster rate than all exports combined. It is still too early to say whether this trend marks a shift in the forces that propel Southern economic growth, or portends a rise in aggregate growth rates. It could be largely the reflection of short-run fluctuations in commodity price levels.

The UNCTAD resolutions and the report of its Secretary-General stressed inadequate command over imports as the major factor in slow growth. While there is evidence to support this claim, an examination of all the facts supports a somewhat more complex interpretation.

First, sustained economic growth is almost always associated with at least some growth of imports, often financed in part by foreign capital. There have been a few exceptions in modern times, necessarily associated with major efforts at import substitution. But to cite the exceptions, such as Brazil, the Soviet Union, and possibly Australia in recent years, only stresses the special conditions required—a large domestic market and a varied natural resource base.

Second, the smaller the country, the greater the need for trade growth as a condition of income growth. Small countries (less than 10 million population) that grow fast always have a rapid growth of imports.

In most cases, import growth is somewhat faster than income growth for small countries. The principal exceptions are Venezuela, where changes in oil company imports of capital equipment have been an important source of variation; and Israel, faced with serious trade deficits and aided by capital inflows and a rapidly growing home market for import-substituting industry and agriculture.

Third, rapid import growth is not a necessary condition for rapid income growth, where the market is large enough to allow domestic industrialization, or substitution of domestic for imported commodities. Thus, between 1950–52 and 1961–64, Mexico's income grew at the annual rate of 5.6 percent, while imports increased at the rate of 4.7 percent. For the Philippines the comparable figures are 5.4 percent and 3.8 percent. In Brazil and Burma, imports actually declined over the period.

In sum, rapid peacetime growth of imports has been a sufficient condition for the growth of income in the South, but not a necessary one. The reasons for the association are clear. Steady growth of imports is financed either by an equivalent export growth or a capital transfer. In the latter case, the recipient benefits from increased investment without the immediate need for corresponding savings. The continuation of such a transfer normally means that private or public investors in the North are confident of the capital importer's economic potential.[2] If the import increase is largely export financed, as is the case for most of the fast-growing small countries, then it implies that the country is able to compete effectively in world markets, and is presumably in a favorable growth situation.

If, on the other hand, a developing country finds itself unable or unwilling to finance steady import increases by exports or borrowing, the record shows that rapid growth may still be possible if the domestic market is large enough and the resources and organization are present to permit large-scale import substituting investment. In such cases, the close relationship between trade and growth recently observed in the North no longer holds, and import substitution becomes the leading sector in growth.

TABLE 2A.—GNP GROWTH AND TRADE GROWTH, FAST-GROWING LDC'S, 1950–52 TO 1961–64

(Annual increases; countries listed in decreasing order of GNP growth)

Country	GNP growth rate (percent)	Trade growth [a] (percent)	
		Imports	Exports
Populations under 10 million:			
Israel	10.0	6.0	17.0
Jordan	[b] 9.8	10.5	13.1
Iraq	8.4	9.7	11.7
Trinidad	[b] 7.6	9.2	9.6
Jamaica	7.0	9.4	12.3
Venezuela	6.7	1.4	4.2
Puerto Rico	5.6	9.1	10.0
Nicaragua	5.3	8.1	7.2
Ghana	5.3	7.6	3.0
Populations over 20 million:			
Mexico	5.6	4.7	3.7
Brazil	5.6	1.6	−2.1
Thailand	5.4	12.6	4.9
Philippines	5.4	3.8	3.7
Burma	5.2	−1.1	3.5
Turkey	4.9	2.9	3.6

[a] Corrected for terms of trade changes, 1962 equal 100.
[b] 1955–57 to 1961–64.
Source: Computed from U.N. data.

[2] Of course, the motive for the transfer may be political. In extreme cases (Vietnam, Korea), long-term potential is virtually irrelevant.

Some economic writing insists that the trade development relationship is essential to growth. In fact, the world allows a variety of sources of growth; a high and fast growing level of trade is perhaps indispensable only for small nations or those with a particularly uneven distribution of resources. The combined populations of 70 developing nations with less than 10 million inhabitants each do not equal half the population of India, but they exercise together a disproportionate political weight in international forums. This fact has shaped the nature of the UNCTAD recommendations, particularly its insistence on the international element in growth.

II. Present Situation and Prospects—Commodity Trade

About 85 percent of LDC exports are primary commodities—food, tropical beverages, agricultural raw materials, fuels, and mineral ores, some domestically refined for further processing after export. Table 3 shows the trends, by category, in recent years.

No matter what the long-range hopes for LDC manufactured exports may be, most underdeveloped countries today must rely primarily on commodity trade. Prospects for trade in commodities vary greatly, both by product and by country.

World demand for LDC commodities in the aggregate rose slowly during the decade 1952–62. The principal factors were probably slow growth of demand for food in rich countries; substitution of synthetics for natural raw materials (rubber, plastics, synthetic fibers, detergents); a tendency for industrial buyers to use smaller amounts of raw materials per unit of final output; agricultural protectionism in the Atlantic Community; low elasticity of demand for commodities in the aggregate with respect to price changes (although the actual market situation product by product is complex). During the 1950's, these tendencies were reinforced by the decline in prices, following the speculative effects of the Korean war.

TABLE 3.—LDC EXPORTS BY CATEGORY, 1956–64

[In billions of dollars]

Year	Food and beverages	Agricultural raw materials and mineral ores (not refined)	Petroleum and other fuels	Manufactures (including refined ores) *	Total
1956	8.0	7.0	6.5	3.3	24.8
1958	8.2	6.2	7.4	2.8	24.6
1960	8.1	7.6	7.7	3.8	27.4
1962	8.5	7.3	8.9	4.2	28.9
1963	9.4	7.6	9.6	4.8	31.5
1964	10.3	7.7	10.8	5.5	34.4

* In recent years, refined ores have accounted for $1,000,000,000 to $11,700,000,000 of the LDC exports under this category. The estimated figures for 1960 through 1964 are, in billions of dollars: 1960, $1.4; 1961, $1.4; 1962, $1.4; 1963, $1.5; 1964, $1.7. (Cf. United Nations, Monthly Bulletin of Statistics, May 1966.) Rows may not add to totals shown because of rounding.

Source: United Nations, Monthly Bulletin of Statistics, March 1962 and March 1966.

There were several factors at work tending to maintain and increase LDC export supplies despite the slow growth of demand. The principal ones were immobility of resources in LDC's, leading to continued production of traditional export crops even when demand was unfavorable; high prices during the Korean crisis bringing expansion of supply for many products, notably minerals and tree crops; new countries, seeking additional foreign exchange sources, turning to expanded commodity production as the easiest way to compete in world markets. In the past 15 years, regions that previously exported little coffee, tea, or petroleum have entered the world market as significant producers.

The net effect of LDC export supply growth outpacing demand growth for their products was a general reduction in commodity export prices during the period. The UN index of LDC export prices declined from 113 in the 1951 boom to 100 in 1952, and drifted down to 84 in 1962. Subsequently, agricultural commodity prices rose and LDC export unit values were about 5 percent above 1962 levels at the end of 1964. Atlantic Community export prices meanwhile remained relatively stable, so that terms of trade (export price index divided by import price index) of LDC's declined by about 8 percent over the 1952/53–1962 decade, and by about 5 percent for the period 1952/53–1964.

Although the quantity of LDC exports rose more slowly than the Atlantic Community's, there was a substantial increase in total LDC export quantity and value during the decade following the conflict. LDC commodity export values rose from about $18 billion equivalent in 1952 to about $28 billion in 1964.[3] If these figures are corrected for terms-of-trade declines during the interval, purchasing power of LDC commodity exports apparently rose by about $7 billion equivalent during the 13-year period, or at the compound rate of 2¾ percent annually. This is much slower than the real growth rate of Atlantic Community exports or of LDC manufactured exports, but it is by no means negligible, compared with LDC export growth over the past 50 years. A continuation of this trend would result in a doubling of 1952 commodity export value by 1977.

In discussing the commodity trade situation of some 70 countries, there is a great deal of variation, perhaps too much to allow any all-inclusive statement. However, a few points seem clear:

1. Many Latin American and Asian countries will be able to rely less and less on commodity trade for financing import growth.

2. The Middle East and Africa are better off, thanks largely to petroleum in the former region and favorable supply conditions for a number of products in the latter.

3. Two conditions will tend to favor the growth of any country's commodity export trade:

   Low-cost productive potential, even if the particular commodity faces sluggish world demand (as in the postwar expansion of African tea and sisal exports).

   Specialization in products with good demand prospects (as in Peruvian fishmeal trade, African copper exports, Middle East oil, or Malayan tin).

4. For most countries, this last condition does not apply. Those that are semi-industrial (India, Brazil, Argentina, Mexico, Taiwan) can hope to shift increasingly from commodities to manufactured exports, although this is no easy task. Those whose industry is not yet established have even fewer trade alternatives. For them, unless tourism or other service industries can be developed, the foreign ex-

[3] UNCTAD. "Handbook of International Trade Statistics" (E/Conf. 46/12 Add. 1), Feb. 28, 1964; "Monthly Bulletin of Statistics," April 1965.

change limitation is likely to loom as a major obstacle to desired rates of growth.

International action in the sphere of commodity policy has been concerned with three kinds of measures: (1) trade liberalization; (2) transfer of income from commodity importers to exporters; (3) stabilization of commodity prices and export earnings.

TRADE LIBERALIZATION

In theory improved market access is the most efficient way to increase LDC export earnings, because it increases the flow of trade and raises the earnings of exporters, with no corresponding income transfer from rich to poor countries. A liberal trade policy benefits both exporting and importing countries by raising the real incomes of both, but it may create adjustment problems for high-cost producers or revenue problems for governments who benefit from customs duties and fiscal changes. Because agriculture in the North is a relatively declining industry, which resists such adjustments, there is little likelihood that barriers to imports of competing crops (Southern commodities that compete with domestic production in the North) will be reduced. Some progress might be made, with relatively limited effects on trade, for such noncompeting products as tea, coffee, cocoa, and tropical hardwoods.[4] Thus, although LDC exports to the North might well increase by anywhere from $3 to $5 billion annually as a result of free trade in commodities, the immediate prospects for change are slim in the short run. For the time, agricultural protectionism seems to be on the increase.

COMMODITY AGREEMENTS

If the prospects are modest for increasing world income through freer trade in commodities, they are perhaps slightly greater for transferring income from rich to poor countries by commodity price fixing. The persistent international interest in "stabilization" of commodity prices is largely an effort to make importers pay more than they would in a free market. Discussion of such agreements is usually confined to noncompeting exports (coffee, tea, cocoa, sugar, bananas, spices, tin) and price-fixing agreements for these products could be used to transfer an average of perhaps $1 billion annually from North to South over the decade 1965–75. If extended to competing products, as proposed by the French Government, price fixing could result in a far larger transfer. For example, if price fixing could increase the south's $17–$18 billion annual revenue from commodity exports to the North by 20 percent, the total annual transfer would be of the order of $3.5 billion initially. However, a generalized price-fixing policy not only invites substitution of synthetics, but also encourages import substituting domestic production in the North. The common agricultural policy of the EEC is aimed in part at this latter goal. Therefore, the longrun effects of price fixing for competing products may be harmful to LDC's, unless import quantities are also guaranteed. Furthermore, there is no good reason for importers of competing

[4] In fact, the North, through the GATT, has suspended its duties on tea and tropical hardwoods. This modest accomplishment seems to have been the major result of the GATT action program in its first 3 years.

products to accept the principle of such transfers to other rich countries unless it is simply incidental to a policy of reaching domestic self-sufficiency, a la EEC.

The commodity approach to capital transfers suffers from many disadvantages in terms of administrative difficulties, economic inefficiency, promotion of substitute production, and encouragement of over-production. Its advantages are (1) it disguises the income transfer, thus apparently easing the recipient's conscience and relieving the donor of the burden of aid administration, a seemingly inescapable adjunct of official aid transfers; (2) it seems, within limits, to be more acceptable to importing countries than free trade in commodities, perhaps because the system is analogous to domestic commodity support programs. For these reasons, it seems likely that international discussion of policies for tropical exports will continue to revolve around price-fixing schemes. However, the increasing interest in supplementary finance (payments to underdeveloped countries whose export earnings over a period of time fail to meet reasonable expectations, because of circumstances beyond their own control—such as a long-term decline in world commodity prices, for example), arising from the United Nations experts' report and the UNCTAD resolution on the subject, may presage a gradual turning away from a single commodity approach.

PRICE STABILITY

The issue of price and earnings stabilization has become thoroughly confused with that of income transfer. Price stability and earnings stability are not the same for the individual exporter even if aggregate demand remains constant. If Colombian coffee output rises or falls 20 percent, constant world prices destabilize earnings. Stable earnings are sometimes asserted to be the goal, but it is not worth much to either importer or exporter simply to reduce short-term fluctuations around a trend by borrowing now and paying back later. The South wants to have greater price certainty but is not willing to reduce its freedom of action substantially in exchange for those benefits. It seeks much more strenuously to avoid low prices for products in inelastic demand, but that is not a question of stability.

If the objective were price stability, it would be possible to do something toward this goal by better price forecasting, use of buffer stocks, export controls, or price compensation schemes. The case for price stability is stronger than that for earnings stability because the prices of many commodities fluctuate so widely that they offer a poor set of signals for investment planning. They may also lead buyers to seek substitutes with more stable price levels. Providing that the system chosen to stabilize prices is a reasonably good forecaster of the market, it should help promote more rational investment. The extent to which this is desirable—and therefore also the price worth paying for it—depends on relevant opportunity costs. The amount of these costs is not an appropriate subject for aggregative analysis; and the detailed research that could offer some guidelines remains, as yet, largely prospective. The inference from existing work is that price stability isn't worth much as a guide to investment in terms of effects on GNP growth. However, we are still far from a definitive judgment on this subject.

CONCLUSIONS

The dominant conclusion that emerges from investigating all these aspects of international commodity trends and policies is that the South as a whole must look primarily to Northern prosperity as a source of export growth, and not to the UNCTAD policies. Should the effects of these policies be substantial, they are unlikely to be adopted; measures that are likely to be adopted are also likely to be unimportant as sources of increased capital or trade. Policies to increase or stabilize commodity earnings cannot proceed much faster than Northern willingness to act on the broader problem of LDC growth. This forecast offers scant encouragement to those who seek to promote Southern prosperity. But the issue here is prediction, not preference; and I find only faint grounds for Southern optimism about the course of international commodity policy in the decade ahead.

III. Trade in Manufactures

The predominant economic element in the South's desire to industrialize as a means of becoming prosperous stems from differences in the income elasticities of demand for manufactures and commodities. World output of manufactures grew at the rate of 4.2 percent annually from 1937 to 1957 and at 8 percent annually from 1958 to 1964. Output of commodities, including petroleum, grew less than half as fast. The world economy has changed, therefore, and the South seeks to change with it. Domestic industrialization normally affects world trade in two ways: It increases the demand for manufactured imports in the industrializing countries and it leads eventually to the development of manufactured exports by countries that formerly exported only commodities.[5]

At UNCTAD, the South produced a formula and a rationale for increased trade and aid, in which industrialization was perhaps the most important element. The formula consisted of six principal elements: (1) higher prices for commodities; (2) greater trade access in Northern markets; (3) payments by the North to developing countries whose export earnings are persistently below some reference level; (4) preferential treatment in Northern markets for southern manufactured products; (5) creation of preferential regional trading systems in the South; (6) creation of a permanent UNCTAD as the forum for LDC trade and aid demands. This chapter deals primarily with trade access and trade preferences for manufactured products.

Both the Secretary-General's report, Towards a New Trade Policy for Development, and the Final Act of UNCTAD stressed that industralization is the key to economic development and that increases in manufactured exports could act as the catalyst promoting that industrialization. In the words of the Final Act:

> The Conference recognizes the urgent need for the diversification and expansion of the export trade of developing in manufactures and semimanufactures as a means of accelerating their economic development and raising their standards of living. It considers that individual and joint action by developed and developing countries is necessary to enable the latter to obtain increased participation,

[5] A. Maizels, "Industrial Growth and World Trade," Cambridge University Press, 1963, ch. 1.

commensurate with the needs of their development, in the growth of international trade in manufactured and semimanufactured products.[6]

This view that industry is the key is commonly expressed by LDC spokesmen. The novelty in the UNCTAD approach lies in the assertion that industrial development can be fostered by export of manufactures, before a broad industrial base exists. Normally, the export of manufactured products on a large scale follows the long-term build-up of domestic industry.[7]

The South is making rapid strides in industrial development. From 1950 to 1962, its manufacturing output increased by nearly 8 percent a year; at the end of the period, volume of industrial production was 120 percent greater than in 1950. During the same period Northern industrial output grew by 80 percent. The powerful desire to industrialize quickly stems both from the close relation between industrialization and economic development cited above and from the foreign exchange problem that dominated discussions at UNCTAD. During the period 1955–63, value of world exports of manufactures increased at the rate of 8.1 percent annually, compared with a rate of 3.1 percent for commodities. Countries seeking rapid increases in export earnings are therefore naturally enticed by the prospects of trade in manufactured goods. Furthermore, Southern trade in manufactured products (excluding processed foods and refined metals), although still very small, grew at the rapid rate of 7.4 percent annually for the 8-year period. The contrast with the relative stagnation in commodity trade is not lost in the South.

Table 4 gives a regional summary of LDC exports of manufactured products for the years 1955, 1959, and 1963–64. Asia is by far the most important exporter, accounting for half of the total, and is also increasing its manufactured exports faster than other areas, thanks largely to the Hong Kong trade.

TABLE 4.—GROWTH OF WORLD EXPORTS OF MANUFACTURED GOODS,[a] BY REGION, 1955–64

[Dollar amounts in billions]

Region	1955	1959	1963	1964	Percent increase, 1955–64
World	45.5	61.1	86.3	98.7	117
Industrial countries	37.8	49.9	70.2	80.8	114
Eastern Europe	4.4	7.2	10.3	11.5	161
LDC's	3.0	3.2	4.8	5.5	83
Latin America	0.7	0.7	1.0	1.1	57
Middle East	0.1	0.2	1.8	1.8	100
Africa	0.8	0.9			
Asia	1.3	1.5	2.4	2.7	108

[a] Includes refined metals.

Source: UNCTAD, Handbook of International Trade Statistics, Doc. E/Conf. 46/12/Add. 1, February 28, 1964; United Nations, Monthly Bulletin of Statistics, various years.

Several points emerge from the study of the manufactured exports of LDC's.

[6] Final Act, par. 62, reprinted UNCTAD, Proceedings, vol. 1, p. 13. There was also a special principle favoring trade preference for the South in the draft Final Act, but it was not voted on.

[7] The exceptions are of two kinds: (a) Materials-oriented industries, of which minerals refining (Chile, Mexico), pressing vegetable oils (Nigeria, Senegal), and refining sugar (Taiwan) or petroleum (Iran) are typical; and (b) industries that benefit from low-cost labor, notably textiles and certain other light manufactures (Hong Kong, India, Mexico).

1. LDC exports of manufactures are small compared with both total LDC exports (about 10 percent) and with world exports of manufactures (about 4 percent). On the other hand, the South buys nearly one-fourth of the manufactured products entering world trade.

2. This Southern export trade is very specialized. The handful of developing countries that export manufactures in quantity have so far concentrated either on light manufactures with a high labor content (carpets, textiles, footwear, clothing) or on processing local raw materials, with a rather small value added by manufacture (metals, plywood, jute products). The degree of this concentration is great by country, region, and product: nearly half of LDC manufactured exports come from two countries; one-third of LDC manufactured exports are textiles; two-thirds of all LDC manufactured exports are from Asia.

3. The export concentration is matched by import concentration. The United States and the United Kingdom account for nearly half of all Northern imports of manufactured products; both countries take more than 10 percent of their manufactured imports (including metals) from the South.

4. The rapid growth of world trade in manufactured products shows no signs of slowing down; this tends to reinforce the preference of the foreign exchange-starved South for industrialization as the high road to development.

This sounds obvious and innocuous enough. But on consideration, it turns out to imply some intractable problems. The fact that the South is a large importer and a small exporter of manufactured products means that it has a comparative disadvantage, or that money costs do not reflects real costs (as, for example, where industrial wages are maintained at higher levels than required to call forth a given labor supply).

Almost all underdeveloped countries will have to change their economic structures and, often, their economic policies before they can export these products. The North does tend to erect high tariff barriers against labor-intensive manufactures as demonstrated below. The effect is to discriminate somewhat against LDC's. In terms of today's realities, that discrimination is confined to the semiindustrial countries; and elsewhere, to the rather limited prospects for materials processing and refining.

Therefore, the UNCTAD contention that preferential access (and to a lesser extent, nonpreferential reduction of Northern trade barriers) will be the catalyst for industrial development implies one or more of the following beliefs: (1) Northern protection is so high that tariff preferences will allow today's inefficient industry to compete; (2) access to the vast Northern market will encourage new domestic and foreign investment on a scale that will permit preference-aided Southern industries to reduce costs through economies of production by large scale firms; (3) preferences will encourage those more widely diffused economies, arising from the growth of industries in general, that ultimately transform economic and social structures; (4) the preferential system will benefit only the semiindustrial countries directly, but the repercussions will ultimately influence the most backward countries, by increasing world demand for their commodities, by concentrating the flow of foreign aid toward them, or by a gradual shift of labor-intensive industries toward the countries that are today least developed.

Each of these points can also be used to justify the demand for nonpreferential reduction of Northern trade barriers, although the advantages to the South would be diluted. Let us start our discussion of policy choices by looking at these issues in terms of reductions of trade barriers and going from there to see how preferential systems might alter the results.

NONDISCRIMINATORY REDUCTIONS OF TARIFFS AND OTHER TRADE BARRIERS

Since the end of World War II, reduction of barriers to trade—tariffs, quantitative restrictions, exchange controls—has been a significant causal factor in the rapid growth of Northern trade. As yet, it has not shown the same catalytic effects on the South, despite the fact that under the GATT procedures the benefits of reductions have generally been available to all nations. The major reason is that the South exports commodities, raw or processed, for which effective trade liberalization has been much more modest. Another reason, of less immediate importance, is that the North has often failed to reduce its tariff on the labor-intensive manufactures for which the South presumably has a longrun comparative advantage.

In the domain of processed products and manufactured goods, Southern exports have grown more rapidly—at the rate of 5 percent annually from 1953 to 1963, and at nearly twice that rate in recent years (1958–64). It is not clear how much of this recent advance is attributable to cost reduction or to increases in demand induced by income growth and by tariff reduction abroad and how much to improved statistics; all statistics about underdeveloped countries are legitimate objects of suspicion. If Prebisch is correct in asserting that easy lines of import-substitution have been exhausted in many LDC's, then increases in export supply of these products may be a dominant reason. The argument for dominance of supply factors is reinforced by the fact that Northern incomes have not risen faster since 1958 than they did before, nor have tariff reductions proceeded faster.

The GATT negotiations for general tariff reductions that began in 1963 under the title of the Kennedy Round were aimed partly at counteracting the discrimination against outside suppliers created by the two European trade blocs, particularly EEC.

However, some Northern governments also claimed that the Kennedy Round, if it achieved its goal of a 50-percent reduction in Northern tariffs without requiring reciprocity from the South, would also greatly benefit Southern exports. Thus, in the words of the U.S. delegate to UNCTAD:

> The industrial countries have done much in recent years to reduce these barriers. More can be achieved by deep, across-the-board tariff cuts in the "Kennedy Round"—and we are prepared to have these benefits accorded to the developing countries without asking reciprocity. Such tariff cuts can be of immediate help to the developing countries. But even more important they can provide an environment that will make it possible for them to build productive export industries. It is at this point that UNCTAD and the GATT Conference, which is to follow, so strongly complement each other.[8]

[8] UNCTAD, Proceedings, vol. II, p. 396. Statement of George Ball, U.S. delegate.

Such viewpoints as this find their rationale in the case for free trade. The merits of free trade as a vent for surplus, source of new methods, and incentive to economic efficiency have been opposed by the protectionist rejoinder, based on infant industry and infant economy arguments, as well as on skepticism about the North's interest in actually allowing "low wage" manufactures to enter its markets. What are the facts? Will nondiscriminatory removal of trade restrictions have a great effect, a small one, or none at all on the growth of Southern trade and income?

First, what would be the result of northern adoption of "free trade" removal of all restrictions on trade in manufactured products? There are two kinds of short-run effects to consider: (1) substitution effects resulting from replacement of domestic products by imports, and (2) income effects resulting from the growth of world income as a consequence of free trade. The income effects, it can be confidently predicted, would be negligible.

The substitution effects would be far greater. It is impossible to estimate anything more than orders of magnitude, because we know so little about cost levels or about price elasticities of demand and supply. Johnson has made a valiant effort to estimate the effects, and emerged with a minimum figure of a 40-percent increase in LDC manufactured exports, resulting from abolition of Northern duties on manufactures.[9] In 1963, this would have amounted to $800 million if only manufactured articles are included, or to about $1.3 billion if other processed products are included.

Johnson's estimate of a 40-percent increase is, as he recognizes, very conservative. It assumes that imports from LDC's would increase at the same rate as imports from the world. But both nominal and effective protection of manufactured products that LDC's are likely to export is greater than that on manufactured goods in general.

It has been long recognized that effective rates of protection are often higher than the nominal tariff rates imply. If copper ore, for example, bears no import duty, and refined copper is dutiable at 10 percent, then the effective protection is much higher than the duty implies. If ore accounts for 75 percent of the costs of refined copper production, then a domestic manufacturer of refined copper who purchases domestic or imported ore benefits from a 10-percent duty on the full value of output, not just on the 25 percent of its total value that the manufacturing cost represents. Thus, the height of the tariff on value added is not 10 percent, but 40 percent (10 percent tariff on total value, divided by 25 percent value added by manufacture). This means that the copper exporting nations seeking to build up a refining industry for export effectively faces a 40 percent tariff barrier in the importing country. The difference between nominal and effective tariff rates results from the fact that some goods are imported, not for immediate consumption, but as inputs into production. Normally, calculations of effective tariffs show that nominal tariff rates understate the real degree of protection, because tariffs on raw materials are usually lower than those on finished products.

Industrial countries' effective protection for all goods combined is roughly double the nominal rate for all products combined. It is gen-

[9] Harry Johnson, "Economic Policies Toward Less-Developed Countries," Washington, D.C., The Brookings Institution, 1966, ch. 3.

erally highest on consumer goods, and is significantly higher in Japan and the United Kingdom than elsewhere in the North.

Effective protection is not only greater than nominal; it is also particularly high on manufactured products of interest to developing countries.

The effects of free trade are not only static, as discussed above, but also dynamic, leading to changes in economic growth and structures. The dynamic consequences of free trade might include changes in the location of investment leading to development of new skills and of product lines that, with the assurance of export markets, can operate at low unit cost; and the association of this cost-reducing pattern with growth of supply and demand in the pattern of increasing returns. These consequences of free access to Northern markets are more important than static effects, particularly if reciprocal tariff concessions are not required from the South.

It is impossible to estimate the extent of these dynamic effects, except by historical examples; these are always open to the objection that they reflect special circumstances. In recent years Puerto Rico and Hong Kong, by selling manufactures largely into zero-tariff or low-tariff areas, have experienced a vast growth of industrial output which has fed upon itself, bringing rapid improvement in living standards, providing capital and skills for new investments, and improving the relative cost position of the economy. In essence these cases seem to validate the classical economists' case for free trade as an agent of growth.

But both territories benefited from special circumstances: preferential access to U.S. markets and tax advantages for foreign investors in the case of Puerto Rico; and Commonwealth preference, plentiful local capital, and a huge, low-cost, adaptable labor supply in Hong Kong. The dynamic gains from free trade are much less striking in other Southern countries that have benefited from preference—notably France's former colonies and British Commonwealth members. In the French case, industrial exports, except for metals, are nil. In the British Commonwealth, the textile exports of India, Pakistan, and Honk Kong have been the principal beneficiaries of preferences for manufactures. As a general proposition, each case is sui generis, so the conclusions must remain agnostic. Some beneficiaries of Commonwealth preference seem to have grown no faster than the South as a whole. Trade liberalization seems to be a necessary condition of industrialization only for small nations and is never a sufficient condition of itself.

The GATT aim of reducing tariffs on manufactured goods without requiring reciprocity from the South, nevertheless, remains a goal worth striving for, by the criterion of Southern self-interest. Any such reductions are overwhelmingly likely to benefit the South rather than hurt it; the only practical qualification arises from the operation of preferential systems, as discussed below. If tariffs are reduced on labor-intensive manufactures, LDC exports of such products are likely to rise dramatically.

But the race is generally to the swift, at least in the short run; and liberalization, to the extent that it does materialize, will obviously most favor countries that are initially prepared to export. This means above all the North; and next, Hong Kong, India, Israel, Mexico, Philippines, Pakistan, Taiwan, Argentina, and Brazil, perhaps roughly in the order of their current exports. For most of the rest of the South, there is little or no short-run capacity to supply the world market for manufactured products. The advantages, for their trade and industrial development, of a nondiscriminatory system of one-way tariff cuts for manufacturers are long run, except where tariff reductions facilitate simple raw material processing.

PREFERENTIAL SYSTEMS

The South, in the name of economic justice, seeks preferential treatment, not free trade. The call for preferences is the clarion of UNCTAD's own Great Society and must be understood, as any such rallying cry, less for its content than for the aspirations it embodies. Prebisch's economic theories and policy proposals are the rationalizations for a profound sense of injustice. Therefore, the economics of preferences are only a minor aspect. Nonetheless, we will begin our discussion of the subject with a review of the economic issues.

There are two kinds of preferential systems for manufactured products in effect today: (1) customs unions and free trade areas, which, in principle, offer duty-free entry to members only on all products (EEC, EFTA) and (2) preferences for all or some products, offered by rich countries to poor ones on a reciprocal or nonreciprocal basis (EEC preferences to associated overseas states, U.S. free trade with Puerto Rico and preferences to the Philippines; Commonwealth preference offered by the United Kingdom). The two are similar in many respects. In this study, I will deal only with the second, particularly with its world wide application.

A preference system in its simplest form allows free entry to the exports of the preference-receiving countries in the markets of preference-granting countries, while the exports of countries not receiving preferences continue to be dutiable. The principle proposed, but not voted on, at UNCTAD in 1964 would have been such a one-way preference. The South would receive preferences in Northern markets, but not grant them to the North in return. An infinite number of variations of one-way discriminatory free trade is possible and we will discuss some of them, after examining the basic theme.

The arguments for a worldwide system of preferences from north to South are all based on the judgment that it is desirable or expedient for the North to promote the industrialization of the South; or, from other motives, at least to give the impression of promoting it. The economic case is based on the belief, reinforced by the effective tariff argument, that preferential treatment will hasten industrialization by offering the LDC's the near equivalent of a protected infant-industry market in the North, as well as the possibility of economies of scale in production, arising from the size of that market. Underlying that belief is the tacit assumption that income elasticities of demand virtually dictate industrialization as the route to prosperity and trade growth. Given these beliefs, the principal arguments favoring preferences are as follows: (1) the future gains accruing to the South from further trade liberalization are uncertain, both because of doubts surrounding the results for the South of the GATT negotiations concluded in June 1967 in light of exemption lists, which drop many products of interest to the South from the tariff-cutting procedure; (2) even if those gains were forthcoming and large, infant-industry and equity grounds conspire to warrant further concessions to the South; (3) the income transfer involved in making price concessions to the South is small but is more acceptable politically to donor and recipient than the equivalent foreign aid subsidy; (4) many LDC's have gone as far as—and often farther than—they should in import substitution, so that any device to encourage export-promotion is desirable; (5) the South wants preferences, and the North's costs would be negligible, whether or not the alleged gains materialize.

The arguments against preferences are: (1) they tend to promote and perpetuate economic inefficiency—even the valid infant-industry and scale-economy arguments are grounds for subsidy rather than preference; (2) rather than improving North-South relations, preferential systems would exacerbate them for a variety of reasons—they inevitably discriminate in effect against some LDC's and some Atlantic countries, they would create an automatic obstacle toward further efforts to liberalize world trade (because reduction of tariffs also reduces the preference margin), and they would, if successful, create a type of economic dependence on northern concessions that is inconsistent with the South's struggle for independence; (3) preferential systems are strikingly complicated to administer in any event, and impossible to manage without inequity to some parties; (4) preferences are likely to bring with them the reverse of the effects intended, because the introduction of preferences gives Northern producer interests a chance to legislate restrictive "safeguards," that would be impossible under a nondiscriminatory tariff policy (known technically as "most-favored-nation" or MFN system); (5) the gains from preferential systems would be small, because tariffs, even effective tariffs, are generally low now in light of the South's cost disadvantage, and would be still lower after GATT negotiations are completed; (6) preferences are an inferior way to give aid and lead to an inequitable distribution of aid costs.

It must be obvious by now that the differences in assumptions, goals, and estimates of the fact are so great that there can be no final answer. I favor extension of preferences to the South, whether or not on a worldwide basis, providing they are temporary with fixed expiration dates (preferably set by reduction of MFN tariffs to the preferential rate), or, failing that, are limited by quota or other device. My reasons for supporting preferences are based on the beliefs that the North should do more than it now is to help improve Southern living standards, and that preferences will make some contribution in that direction. They would create both administrative problems and incentives to inefficiency but would also provide positive incentives to domestic and foreign investment that could make a big difference to the rate of economic and social development of some countries. The stress on efficiency overlooks material issues: (a) short-run efficiency and long-run growth are not necessarily achieved by the same methods; (b) there may be a conflict between efficiency and equity; (c) preference-induced increases in Northern investment abroad will strengthen the Southern lobby in the North, and may therefore be a risk worth taking, at least for those who generally support Southern claims. In practice, the best way to reconcile the conflicts between the gains and losses from preferences is to tie the adoption of temporary preferences into a general system of progressive reduction of MFN tariff rates, as discussed below.

SOME PROPOSALS FOR PREFERENTIAL SYSTEMS

The French Plan.—The Brasseur plan, as advanced by France in 1963, provides for negotiations of separate bilateral agreements in a system of selective, temporary, and decreasing preferences. Each preference-granting country decides in each case to whom it will accord preferences, for what products, with what tariff quotas, with what preference margin, and with what duration.

The application of this system by 20 northern countries to 70 LDC's for 1,000 products would require the equivalent of 1½ million bilateral negotiations. Furthermore, each preference-granting country would not operate in a vacuum. Its decisions about each bilateral preferential offer would be made in light of the decisions made by other Northern countries, so that de facto multilateral negotiations would be superimposed on the system. These are virtually certain to be crippling obstacles to a large-scale system. The French Government has tacitly recognized the defects and its current proposals for preferences no longer stress the merits of the Brasseur plan.

The French system, however, offers some decided advantages in theory. It assures one or a few preference-receiving countries of exclusive preference. Therefore, domestic or foreign investors in the preference-receiving country are able to rely on a relatively sure export market, once they are able to meet the preference-granting country's domestic price for the product. Worldwide extension of preference offers no such guarantee. A second advantage, for governments, of the French system is its flexibility. Internationally, it can be used as a device to help friends or punish the recalcitrant; at home, it can be used to protect domestic industries, or to threaten those who fail to agree to government price, investments, or employment guidelines. Finally, in theory, it is the most equitable system, in terms of equalizing benefits received, because it allows the preferences to be adapted to provide for the circumstances of each country. In practice, of course, the political pressures for foreign and domestic interests would prevent the attainment of such a goal, even if the preference-granting country were inclined to aim at it. LDC's have shown little enthusiasm for the Brasseur plan, because of its complexity and the evident colonialist connotations.

The LDC Plan.—The administrative headaches are by no means dispelled if the South's most recent proposals are accepted instead. At UNCTAD meetings in 1965, the LDC's asked for general one-way preference, with larger margins for the least-developed countries than for those that are already semi-industrial. This plea for equity requires the very difficult determination of which preference category each LDC falls into. The LDC proposal also specifies a quota-free preference, with no products exempted. This is a blow in favor of administrative simplicity, but if insisted upon as a condition, it would foreclose the possibility of general preferences. The prospects for Northern acceptance of a system that allows unlimited preferential access to all comers can best be judged by reference to the recent history of textile imports on MFN basis.

Furthermore, the graduation of preference margins is a plea for equity in Southern eyes, although its short-term effectiveness in promoting, for example, African exports of manufactures may be doubted. But it implies an inequity in the North. High-tariff countries in the North would bear a greater adjustment burden than low-tariff countries. Equity in this sense requires equal tariff reductions among preference-granting countries.

But in practice, this kind of "damage-limiting" equality can be achieved only by setting preferential rate import quotas by product and, thereby, creating considerable administrative problems. If, as has been suggested in the name of equity, portions of each product quota were assigned to each LDC, effective administration would become a real challenge.[10] Furthermore, if, as Johnson proposes, exporters' quotas were made negotiable to allow nonexporting LDC's to sell their rights to those that can benefit from the preference, the claim to equity would be increased at the expense of still greater administrative novelty.

One-way Free Trade.—The optimum system, to combine ease of administration, Northern political imperatives, and genuine impact on development, requires: (1) quota-free preferences; (2) a list of excepted products—those that now compete effectively in the North; (3) an escape clause that allows tariffs to be reimposed if imports exceed some stated proportion of domestic demand; (4) and, most important politically, establishment of general preferences as a step on the road to a worldwide MFN system.

This system, like most income-redistributing policies, is rife with inequity. It also leaves unanswered such knotty questions as which countries should be eligible for preferences, what the escape clause criteria should be, and whether the preference should be permanent or temporary, worldwide, or selective. But it has the sovereign advantage of being workable, and of encouraging the industrial development of those countries that are actually ready to industrialize.

It is generally believed that preferences should be temporary to avoid setting up a permanent vested interest in discrimination. Prebisch has suggested that no LDC be allowed to benefit from preferences for a specific product for more than 10 or 15 years, for example. This device would allow new producers to enter the market over time and submit established LDC producers to the test of world competition. However, this approach introduces substantial complexity because of the large numbers of countries and products. Furthermore, established LDC suppliers will be reluctant to surrender their "temporary" preferential advantages. They may well band together under the banner of "la justice exige que seul le provisoire dure."

The politics of the situation therefore dictate a somewhat different approach. If preferences are to be temporary, they should be established on the principle of according advance reductions to LDC's in a general program of worldwide MFN reductions. For example, if the North accords LDC's a 50 percent tariff reduction on manufactured products for 10 years, the preference would end not by raising the preferential rate back to the preexisting MFN rate, but by lowering the MFN rate to the preferential rate. This method presents dual

[10] How to distribute country quotas to exporters offers no fewer difficulties than how to set the size of the quotas initially.

advantages. First, it increases the pressure on Northern countries to reduce their trade barriers. Failure to reduce their tariffs simply perpetuates LDC's competitive advantage. School, and for similar reasons, it reduces the ability of LDC's to perpetuate the preferential margin.

If preferences are integrated into a system of staged MFN reductions in this manner, no major recasting of the existing trade system would be required (although GATT rules would have to be amended). Furthermore, it even offers some prospect of mutual advantage. Countries that seek liberal trade can then look upon preferences as a way station toward that goal. Countries that seek to help LDC's can harness free trade efforts to their wagon.

On the other hand, a system of this kind is likely to meet opposition on several counts: from countries that are not interested in general tariff reductions, from LDC's seeking perpetual preference, and particularly from LDC's that are still at very early stages of development. The latter group might fear that progressive MFN reductions would in fact leave them with no significant preference margin by the time they were ready to export manufactured products.

No system of preference administration can avoid the problems raised by the fact that some people will be hurt more than others and some helped more than others. But the remedy for this does not lie along the lines sought by France and the LDC's. It requires instead adjustment assistance for Northern firms that suffer damage and shifts in the distribution of foreign aid for those LDC's that fail to benefit.

THE EFFECTS OF PREFERENCES

The attack and defense of preferences seems to become more intense as our ignorance of its effects becomes more apparent. Instead of responding by trying to clarify the facts about trade, development, and industrialization, policymakers all too often seem to take ideological refuge in one or another version of whatever theory happens to be congenial.

Unfortunately, we know rather little about the effects of preferences. Sometimes, when other incentives or prerequisites were present, they have apparently had a marked effect on trade (Puerto Rico). In other cases, the results have not been striking.

Commonwealth Preference.—Only one preferential system, that of the British Commonwealth, has been studied in detail.[11] The studies review the effects of preferences from the time they were introduced (1932) until 1962. During that period, United Kingdom imports from the Commonwealth increased relatively by nearly one-third, accounting for 30 percent of all British imports by value before preferences were introduced and rising to an average of 40 percent during the period 1960–64. During the early postwar period this increase was even more marked, but both GATT tariff cuts and the easing of the dollar shortage have had their effects. In the period 1959–65, for example, Commonwealth imports fell from 44 percent to 36 percent of the United Kingdom import total.

The preference is highest for manufactures, averaging about 20 percent, ad valorem, in 1962, compared with an average of 11.8 percent

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[11] Political and Economic Planning, "Commonwealth Preference in the United Kingdom," London. 1961; R. W. Green, "Commonwealth Preference," Board of Trade Journal, June 11, 1965, pp. iv–xix, and Dec. 31, 1965, pp. 1551–58.

for all imports enjoying preferences in that year. If nondutiable imports are included, the figure is much lower, because most foodstuffs and raw materials are duty-free from any source. The average duty on Commonwealth imports has fluctuated considerably over the years.

The areas that export manufactured products to the United Kingdom therefore benefit from higher margins than the 7.2 percent Commonwealth-wide average.

Manufactured products accounted for 9 percent of United Kingdom imports from the Commonwealth in 1957, 14.5 percent in 1962, and 16 percent by 1964. The principal beneficiaries in respect to manufactured imports were Hong Kong, India, and Pakistan, benefiting respectively in 1962 from average preference margins of 19, 11, and 14 percent.

The pattern of United Kingdom trade was significantly affected by the preferential system. The United Kingdom took 14 percent of its total imports of manufactured products from LDC's in 1964, a higher proportion than any other industrial country. Three-fourths of this amount came from preferential suppliers.

Although the effects were significant, they were hardly revolutionary. The principal factors in mitigating preferential effects were: the gradual erosion of preferential margins resulting from MFN tariff reductions; the United Kingdom had a comparative advantage in manufactures and received reciprocal preferences in Commonwealth markets in some cases; Asian members best able by virtue of economic structure to profit from preferences were remote from the United Kingdom, so that transport costs and unfamiliarity of the market may have loomed large; after independence, these countries generally turned to import-substitution as the easiest form of industrialization.

There is no evidence that Commonwealth countries, or other preference-receiving LDC's, have had a more rapid growth of manufactured exports than nonpreferred suppliers. In fact for the period 1960-65, for a group of 65 LDC's including all the major exporters, manufactured exports of those not receiving preferences increased by 100 percent, while those of preference-receiving nations rose by only 67 percent. Part of this difference reflects a statistical factor. Hong Kong, India, Pakistan, and the Philippines, all receiving preferences, accounted for half of the 65 countries' manufactured exports. All preference-receiving LDC's combined accounted for two-thirds of the South's manufactured exports in 1964. Therefore, the more rapid relative growth of exports to the North from nonpreferred suppliers largely reflects the fact that they started from a small base, about $320 million in 1960, compared with $914 million in that year for preference-receiving countries. These data for the 1960-64 period illustrate both the gains from preferences and their limitations. The grant of preferences undoubtedly makes some contribution to the dominant role of preference-receiving nations in world markets for LDC manufactures. But the data also illustrate that preferences are not essential to the development of LDC trade in manufactured products, as witness the very rapid growth of exports from Mexico, Israel, Taiwan, and South Korea since 1960.

The results of Commonwealth preferences offer an example of the primacy of preconception over analysis in these matters. The preference system demonstrated modest but helpful effects for the beneficiaries. These presumably would have been greater if the preferential market was larger and less remote, and the exporting nations' independence longer established. The steady growth of United Kingdom-manufactured imports from the preferential area since 1957 supports this latter opinion. Yet much contemporary public discussion ignores this, by stating either that the results would be negligible for the South or difficult for the North.

BALANCE-OF-PAYMENTS EFFECTS

A second point at which the scanty observed results differ from the evidence is in the estimate of what preferences would do to balance of payments. It is claimed that the United States cannot given preferences because they would lead to increased imports, thereby worsening the balance of payments. The problem is analytically quite complex, because increases in U.S. imports from LDC's have a series of effects on the balance of payments.

If the new imports from LDC's substitute for goods previously imported from the North, then the balance-of-payments results will depend on the relative extent to which North and South spend additional foreign exchange earnings in the United States. Obviously, if Northern countries use dollar earnings to build up reserves, while LDC's use them to finance imports, then a switch in the source of supply from North to South benefits the U.S. balance of payments. But the full effects depend not only on the initial disposition of the dollars earned by foreigners, but also on subsequent rounds of spending.

Some research has been carried out in order to measure the balance-of-payments effects of tied aid compared with untied aid. This research indicates that there are sharp differences among LDC's in their marginal propensities to spend additional dollars, tied or untied, in the United States, but that these intercountry differences narrow when additional rounds of respending are taken into consideration.

Two points stand out: (1) during 1960–64, LDC's increased their imports from the United States one-third faster than the growth of LDC exports, while their imports from the rest of the North increased only half as fast as LDC exports; (2) although U.S. exports to the North increased at the same rate as to the South, these increases were smaller than either the rate of Northern trade growth or the growth of Northern exports to the United States.

These data offer some implication therefore, that diversion of U.S. imports from North to South results in an improvement of the U.S. trade balance. Naturally, these aggregative computations offer only an indication. The data for the 1960–64 period also reflect an accentuated U.S. emphasis on tied aid, as introduced under pressure of America's balance-of-payments concerns. For the period under review, this may have been a dominant element in the rapid growth of U.S. exports to LDC's.

Countries that face substantial trade diversion from preferences (such as Japan) are unlikely to recoup fully through these respending effects. But those whose exports are not highly competitive with potential LDC exports may well gain on balance. If, as seems likely, LDC's spend all their additional foreign exchange earnings, the effect for all industrial countries, as a group, is neutral. The question at issue, however, is the country-by-country incidence of that effect. Some industrial countries would benefit, in balance-of-payments terms, while others would lose. The analysis that would help to answer the questions "who?" and "how much?" remains to be performed.

PREDICTING THE TRADE EFFECTS OF GENERAL PREFERENCES

Whatever the likely balance-of-payments effects, or the record of existing preferential systems, they give us no sure guide to the trade effects of the proposed general system. The estimates that have been made so far are not very helpful, because they are based on static analysis, and are defective, even in those terms, because of our ignorance of the relevant supply and demand elasticities. However, they serve some purpose in indicating whether short-run effects are large or small.

One such estimate has been made by Grant L. Reuber.[12] He has made various assumptions about trade effects for LDC's of: (1) reducing MFN tariffs to zero; (2) reducing MFN rates only enough to maintain existing preference margins; (3) maintaining MFN rates for the north and reducing LDC rates to zero. Not surprisingly, he concludes that the South would benefit most from the last alternative. With an average tariff of 12 percent and a demand elasticity of minus 2, he estimates that LDC exports of manufactured products subject to significant tariffs, but not now subject to quantitative controls, would increase by 25 percent (or $250 million), and exports of noncompeting unmanufactured products by 2.4 percent (or $350 million), for a total effect, at 1961 trade levels, of $600 million. If quantitative restrictions were removed from competing goods, he estimates an additional $1.1 billion of imports would result under "optimistic" assumptions. Reuber points out that these effects are negligible compared with current levels of trade and aid.

Johnson has said that Reuber's is too low an estimate because it neglects effective protection. He offers an estimate for increases in manufactured exports alone under free trade of $600 million. Preferential trade results would be correspondingly greater. But if a figure of $600 million is used to adjust Reuber's estimates, the short-run trade effect of preferences becomes about $1 billion, even if existing quantitative restrictions are retained.

As an alternative to this approach, I have estimated the effects on a different set of assumptions, and emerged with a result that is not significantly different. My method was to assume that the developed countries would allow a preferential duty-free tariff quota to the South on a product-by-product basis. There were three additional assumptions: (1) Preferences would not be extended products for which the South is now competitive; (2) tariff quotas would not be effective in stimulating imports of manufactured products either when existing tariffs are below 5 percent ad valorem, or when, no matter what the tariff level, technology and scale problems seem insurmountable; (3) preferential quotas would be set at 5 percent of last year's imports of all products. Using 1962 data for Western Europe, Japan,

[12] "Canada's Interest in the Trade Problems of the Less-Developed Countries," Private Planning Association of Canada, Montreal, 1964, pp. 23–29.

Canada, and the United States, this exercise produced the following results:

I. Manufactured products with average tariff below 5 percent

A. 1962 Northern imports from—All sources, \$4.1 billion; LDC's, \$30 million.

B. Potential preferential imports under 5 percent tariff quota,[a] \$175 million.

II. Manufactured products with average northern tariffs greater than 5 percent[b]

A. 1962 Southern imports from—All sources, \$31.8 billion; LDC's, \$277 million.

B. Potential preferential imports under 5 percent tariff quota,[a] \$1.3 billion.

At the May 1965 meeting of the UNCTAD special committee on preferences, the South asked for a preferential system that would allow duty-free entry under a global quota of 10 percent of all Northern imports. The effect if each of the Northern countries took 10 percent of their manufactured imports from the South compared with 1963 trade levels would be equivalent to \$5.1 billion. The total increase in imports under these assumptions would have been \$2.5 billion, because 1963 Northern imports from the South, including metals, were worth \$3.1 billion.[13] If, on the other hand, we assume that the global duty-free quota would result in a 10-percent increase in imports, then the value of the trade increase would be \$5.2 billion, a sum far in excess of any current estimates. In practice, the entire range of aspirations represented by the \$2.5 billion "minimum" and the \$5.2 billion "maximum" lies above what can reasonably be expected from preferences in the short run.

Halting as these initial estimates are, they can be considered solid compared with estimates of the full effects, allowing for all the dynamic considerations discussed earlier. The best we can say now is that the evidence supports neither LDC hopes nor Atlantic countries' fears of "market disruption." Obviously, if under a 5-percent tariff quota, or similar limiting device, the initial (2 to 5 year) trade effect is of the order of \$1 to \$2 billion, the aggregate damage to Northern producers is negligible.

CONCLUSIONS

For many Southern countries, sharply increased production and exports of processed materials and manufactured goods are probably one condition of rapid economic growth. In some cases, the possibilities are fairly good under a liberal nondiscriminating trading system. Some countries would really not benefit much unless they could get preferred treatment. Others are now too underdeveloped to export manufactures (except refined ores and foodstuffs), even with preferences. They will need considerable time and assistance before they can look even to domestic industrial markets.

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[a] If all quotas are used by LDC's. Tariffs weighted by trade.

[b] Excluding products for which LDC's are now major suppliers.

[13] This increase of \$2.5 billion, added to the \$3.1 billion existing level, gives a total of \$5.6 billion, not \$5.1 billion. The discrepancy arises from the fact that the United States and the United Kingdom now take more than 10 percent of their manufactured imports from the South.

In theory, preferences in Northern markets benefit the South more than free trade, because they confer a price advantage over competitors. This advantage could be offset if the grant of preferences were tied to restrictions on entry. In any event, the benefits of preferential systems are likely to be important only to the semiindustrial countries in the short run. These short-run increases in LDC exports might be of the general order of $1 billion annually under a system of one-way free trade, if existing quantitative restrictions are maintained.

In the long run, preferences should help shift world location of processing industries toward the raw material sources, encourage greater domestic and foreign investment in industry, and promote a greater awareness of trade opportunities. Not even the roughest guess of the size of these effects is possible.

The case for preferences is in large part political, because they involve, among other elements, a transfer of resources and adjustment costs to Northern producers. If the North wants to be associated with the South and influence its policies, encouragement of trade ties can have its uses, at modest cost. Conversely, the refusal to grant preferences, unless it is accompanied by some other form of aid, does nothing to reduce North-South tensions. This is an important consideration for the United States, which is still saddled with its somewhat negative UNCTAD record. Unfortunately, its stand on preferences remained unaltered, despite strong pressures from other OECD countries and LDC's at the 1966 meetings of the UNCTAD preferences committee. Ultimately, U.S. policy will be forced to change, as already foreshadowed by President Johnson's statement at Punta del Este in April 1967. However the prolonged delay probably benefits neither North nor South. The system proposed by other OECD countries was objectionable because it was based on tariff quotas, which are all too likely to be used as tokens of preferential treatment with little real effect. Nonetheless, the U.S. refusal to agree to any scheme can hardly be viewed as a constructive alternative.

It is one thing to affirm, as I have, that political and economic advantages could stem from preferences, and quite another to claim either that the benefits would be vast, or the pitfalls negligible. There is no evidence to support the view that the economic transformation of the South awaits only the infant industry effects of preferences. Nor can the view be dismissed that the use of preferences is likely to be either as an instrument of trade restriction, somewhat in the manner of U.S. sugar legislation, or as a token gesture that will arouse more resentment than support in the South. But new policies normally have their risks, and these are no different. In this case, the political risks seem more modest than the gains.

Finally, each underdeveloped country is a special case, and each will develop differently. Whether Northern policies are enlightened or not, some of today's poor nations will inevitably prosper, while others, by comparison, will seem to stagnate. In a century-long perspective there will be countries that will far surpass a tenfold growth of per capita income, and others that will not even be close. This in turn will raise new questions of international equity and perpetuate old ones. Arbitration of these discords will be the task of another era. The success of contemporary generations in attacking poverty will be measured by how much or how little its descendants need be concerned with the issues I have analyzed here.

IMPORTS OF MANUFACTURES FROM LESS DEVELOPED COUNTRIES

BY HAL B. LARY

The following analysis is condensed from a comprehensive study being prepared for publication by the National Bureau of Economic Research. The study is subject to revision in the light of comments by the board of directors of the National Bureau and other readers, and the present abridged version is submitted on the author's own responsibility. *July 1967.*

CHAPTER I. THE PROBLEM AND A SUMMARY OF FINDINGS

INTRODUCTION

It seems to be generally agreed that newly developing countries will need to achieve a rapid and sustained rise in export earnings to cover their growing imports of capital goods and other essentials and to service their foreign borrowings. Failure to attain such an increase, or to receive ever larger foreign aid, would impose a foreign exchange constraint on their growth, even though the major transformation required is in their internal economic and social structures and in their capacity to save and invest.

Looked at from this point of view, the figures in table I–1 are not reassuring with respect to the export performance of the less developed countries.[1] Over the period 1950 to 1965 these countries, exclusive of the major oil producers among them, increased the current dollar value of their exports to the developed countries by 4.2 percent annually on the average. Their exports to each other, again omitting the major oil producers, were only slightly larger in 1965 than in 1950. Over the same period the dollar value of trade among the developed countries rose at an average annual rate of about 9.4 percent, or perhaps a percentage point less if figured at constant prices. Total exports of developed countries to the destinations covered by table I–1 were about 2½ times those of the non-oil-producing less developed countries in 1950 and were five times as great in 1965.

The need for a faster increase in exports of the less developed countries will not be elaborated here, since it has been studied at length by the United Nations and others. One may question alternative projections of the likely "foreign exchange gap," or the validity of the gap approach. But there seems to be little room for doubt that exports of the less developed countries will need to rise faster than heretofore as one of the conditions for their economic development.

The contrasting performance of exports of developed and less developed countries reflects, in addition to factors on the supply side, the faster growth of world demand for manufactures than for most of

[1] Throughout this study the less developed countries are taken as comprising all of the Western Hemisphere except the United States and Canada; all of Africa except the Union of South Africa; the Middle East except Turkey; the rest of Asia and the Far East except Japan, mainland China, and North Korea; and Oceania except Australia and New Zealand.

TABLE I-1.—EXPORTS OF DEVELOPED AND LESS DEVELOPED COUNTRIES, 1950 AND 1965 [a]

	Value (billions of dollars at current prices)		Compound annual rate of growth, 1950–65 (percent)
	1950	1965	
World exports (total)	53.5	156.3	7.4
Exports of developed countries (total)	35.9	122.5	8.5
To each other	25.0	95.5	9.4
To less developed countries	10.9	27.0	6.2
Exports of less developed countries (total)	17.6	33.8	4.5
To developed countries	12.4	26.2	5.2
To each other	5.2	7.6	2.5
Exports of less developed countries, excluding major petroleum producers [b] (total)	14.1	23.7	3.6
To developed countries	10.0	18.5	4.2
To each other	4.1	5.2	1.7

[a] All figures exclude exports to and exports of Eastern Europe, the U.S.S.R., and mainland China.
[b] Countries excluded are Algeria, Iran, Kuwait, Libya, Netherlands Antilles, Saudi Arabia, Trinidad and Tobago, and Venezuela.

Note: Figures may not add to totals shown because of rounding.

Source: Various statistical publications of the United Nations.

the primary products which make up the bulk of the exports of the less developed countries. Reasons for the relative lag in trade in primary products include economies in their use, the continuing development of synthetic substitutes, and the growing complexity and sophistication of final products, all of which tend to reduce the input of raw materials per unit of output.

It will therefore be accepted as a starting point for the present analysis that the increase in exports of the less developed countries will have to be largely in manufactured goods. Some countries exceptionally well endowed with natural resources may be able to meet their growing foreign exchange needs through sales of primary products in crude or processed form. The oil-exporting countries form a small and privileged group in this regard. Broadly viewed, however, there is little reason to suppose that the influences tending to retard the growth of trade in primary products have run their course. If this is a correct judgment, a solution commensurate with the growth needs of the less developed countries will presumably entail a rapid increase in their exports of manufactures to the advanced countries.

LABOR-INTENSIVE MANUFACTURES

This study seeks to identify the kinds of manufactures best suited to the growth of exports and to examine the pattern and prospects of trade in these items. By definition, the less developed countries have little accumulated capital or technical skill. Any comparative advantage which they may hold or attain in manufacturing for export, apart from strongly resource-based industries, is therefore likely to be in industries which are intensive in the use of relatively unskilled labor and sparing in the use of both physical and human capital.

Such a course encounters obvious problems and resistances on the side of the developed countries. But it also offers them the possibility of shifting scarce manpower from traditional lines of production to other industries where labor can be more productively combined with their capital resources.

Such a course may also be unwelcome to some of the less developed countries, implying concentration on relatively simple types of manufacturing and perhaps excessive exposure to the risks of international trade. These disadvantages are scarcely greater, however, than those entailed in their present heavy reliance on exports of primary products. And, if the analysis given here points in the right direction, a willingness to focus initially on labor-intensive lines of manufacturing may be a necessary condition for evolving toward the production of goods with, as Fei and Ranis say, "an increasing skill and ingenuity component over time." [2]

It may be further objected that, apart from qualifications such as that just given, the approach taken here makes no specific allowance for the possibility that comparative advantage may shift as development proceeds, thanks to internal and external economies of scale and other dynamic influences associated with growth. How much weight should be attached to this possibility in the present context is difficult to say.

One factual observation deriving from this study is that, if the argument is deemed to be relevant to, or consistent with, the need to increase export earnings of less developed countries, there is little indication that any of these countries have so far become competitive in the more capital-intensive lines of manufacturing (except, of course, those based on the exploitation of natural resources). Usually, however, dynamic considerations have not been related to problems of export promotion but have been invoked rather to favor a strategy of import substitution and may be subject to the same need of cautious reappraisal as that seen below.

Still another possible objection to the present approach is that, even within a comparative cost framework, the emphasis may be too much on labor intensity to the neglect of other conditions affecting the ability of less developed countries to sell manufactures in the markets of the more advanced countries. Some industries are more strongly market-oriented than others, and ease of communication between producer and customer may bear importantly on their location.

Even in such cases, the increasing speed of international communications and growing experience in procuring abroad may open up new possibilities of siting production where costs are lowest. This is illustrated by the evolution of the garment industry in Hong Kong toward high-fashion goods and also by the encouragement given by American companies to the production of electronic and other components in low-wage countries.

THE OVERSPILL VIEW OF EXPORTS

The usual approach to the problem of increasing exports of manufactures by the less developed countries has been along the lines of what Winston Churchill once called the overspill view of exports in Britain. That is, concentrate first on developing the home market, and this will create the conditions needed for an efficient and rising export trade.

[2] John C. H. Fei and Gustav Ranis, "Development of the Labor Surplus Economy." Homewood, Ill., 1964, p. 303.

W. W. Rostow has put the point in the following way, with more specific reference to the problems of the less developed countries: "What I am asserting, then, is that the expansion of the domestic market which is required to produce a modernization of rural life and an ample market for domestic industry is also the proper base for the development of diversified exports." [3]

A similar conception seems to infuse programs of financial assistance to the less developed countries. The International Bank's loans and feasibility studies have mainly focused on the infrastructure and the home markets of the less developed countries and have rarely served more directly to develop their exports. Our AID programs have also been chiefly concerned with strengthening the internal conditions for development, though some of the studies of investment opportunities which it has helped to finance point toward export possibilities. The Export-Import Bank has well merited the first half of its name by granting credits to finance sales of capital equipment and other goods to the less developed countries. But little of its financing has been aimed at stimulating imports from them.

The power and transportation facilities, machinery, and technology made available through these loans and grants do, of course, help to build up the economies of the less developed countries and may ultimately serve to diversify and strengthen their exports. Moreover, these public agencies no doubt consider, with some reason, that investment opportunities offering attractive export prospects are particularly suited to private initiative and financing and do not require public development aid.

It seems fair to observe that the advanced countries have accepted restrictive import policies by the less developed countries as a necessary accompaniment of industrial development, and also have so far made little adjustment in their own policies to facilitate the growth of imports of manufactures from the less developed countries.

Under these conditions, it is remarkable that this trade, at least in some products, has grown as fast as it has in recent years. The growth has, however, been very unevenly distributed by exporting as well as by importing countries—a fact that underlies the trade demands put forward with increasing vigor by the less developed countries during and since the United Nations Conference on Trade and Development (UNCTAD) in 1964. The need to find better ways of expanding their exports is evident. The means proposed to this end—on either side—are more debatable, sometimes seeming primarily designed to shift responsibility for action to other countries while avoiding commitments that might entail awkward adjustments on one's own part.

LIMITATIONS OF MARKET SIZE IN THE LESS DEVELOPED COUNTRIES

However persuasive the argument may seem, it rather begs the question to say, with Rostow, that the most effective base for the export of manufactures is a large domestic market. According to one estimate, only five of the less developed countries have national incomes (converted to dollars at prevailing rates of exchange) larger than Connecticut. These are India, Pakistan, Brazil, Mexico, and Argen-

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[3] W. W. Rostow, "Economic Development in Asia," Department of State Bulletin, May 31, 1965, p. 850.

tina, to which perhaps Indonesia (with poor statistics but a population of 100 million) should be added. Though the beginnings of industry go back rather far in some of these countries, none of them has yet done sufficiently well in exporting manufactures to vindicate the overspill view.

The six countries just mentioned account for more than half of the total population of the less developed countries, but that still leaves a host of people and problems outside as well as inside. Close to 100 of the less developed countries have a population smaller than 15 million, and in two-thirds of them it is less than 5 million.

On the whole very poor, they are smaller still in size of market compared with most developed countries. More such countries are being born as Malta, Gambia, the Mauritius Islands, and the few other remaining European possessions move toward and achieve independence. This proliferation of small and minuscule nations is largely a product of the swift unraveling of colonialism after World War II, though in Central America it goes far back into the last century.

Uncertain Prospects for Regional Integration

In principle, one way of meeting this dilemma is by integration of these splinter economies into larger and more viable regional groupings following, at a great distance, the example of the European Common Market. There are excellent reasons favoring this course and commending it to outside support—even apart from any hope which harried officials in developed countries may hold of being thereby relieved in some measure of the problem of increasing imports from the less developed countries.

So far, efforts to combine into larger regional entities have brought little specific result. In some areas, the trend is rather the other way, as indicated by the strains and disruptions experienced in the West Indies, Malaysia, East Africa, and Nigeria. Little progress is evident in the Maghreb, which was supposed to embrace the Arab States of North Africa. The most promising of these regional endeavors, the Central American Common Market, illustrates the limitations more than the potentialities of such arrangements. It brings together a fairly homogeneous group of countries, compared with most others, and even so adds up to only 12 million people with a combined purchasing power less than that of any one of a number of European and American cities. Now a far larger, more difficult, and more distant objective has been set with the commitment by the heads of the Latin American States in April 1967 at Punta del Este, "Beginning in 1970, to establish progressively the Latin American Common Market, which should be substantially in operation within a period of no more than fifteen years." [4] The length of the period set for achievement of the objective attests to the difficulties to be overcome.

In some regions political and social frictions may well be the major obstacle to regional integration. The economic difficulties include disparities in the levels of development attained by different countries of the same region, since laggard countries tend to fear competition by their more advanced neighbors. Even more awkward problems may be presented by disparities among countries in the levels and

[4] From the "Declaration of the Presidents of America," Department of State Bulletin, May 8, 1967, pp. 712–721.

structures of production costs and prices. Barriers of the latter nature are, in turn, largely the result of the exaggerated pursuit of "import substitution" as a means of promoting industrial development.

COSTS OF EXCESSIVE IMPORT SUBSTITUTION

A developing country has some room for choice in orienting its new industries toward replacing imports rather than expanding exports. Initially, the emphasis is likely to be on the former course, since imports attest to a market already in being at home and susceptible of being reserved against foreign competition. Most and perhaps all developed countries have followed this course in the early stages of their growth and, indeed, still cling to protection even though with little basis any more for invoking the "infant industry" argument. Within limits, this course is consistent with the "overspill" view of exports, since, if the industries chosen for protection are well suited to a country's potentials, substitution for imports in its home market may set the stage for competition in export markets later on.

These limits, however, can be quickly exceeded. A less developed country's imports typically embrace a far greater variety of goods than its exports. The difference is all the more striking if one considers not merely final goods but also the materials, parts, and capital equipment entering into their production. Import substitution may therefore soon spread a country's resources too thin over numerous small and insufficient enterprises, and extend to types of production ill suited to its conditions, with the unfortunate result of raising costs even in industries in which it should otherwise be able to compete. A further consequence is to deny the economy the stimulus to efficiency and innovation which exposure to competition in domestic and foreign markets can provide.

In other words, "backward and forward linkages" with other industries may prove to be a burden rather than a blessing if the industries selected for promotion are not well suited to a country's capabilities and size. This may happen even in the largest of the less developed countries.

Considerable caution would therefore seem to be warranted with respect to the various internal and external economies which have frequently been invoked in favor of capital-intensive industries at early stages of economic development.

The frustrations of import substitution were the subject of an urgent warning by Raúl Prebisch in his advance message, as Secretary General, to the United Nations Conference on Trade and Development. Based largely on his close observation of the Latin American countries, he found that the "easy phase" of import substitution had about reached its limit in the countries which had followed that course, and that it could not go farther without considerable waste. He also found that high tariffs to protect narrow national markets had "encouraged the establishment of small uneconomical plants, weakened the incentive to introduce modern techniques, and slowed down the rise in productivity."

"Thus," Prebisch continued, "a real vicious circle has been created as regards exports of manufactured goods. These exports encounter great difficulties because internal costs are high, and internal costs are high because, among other reasons, the exports which would enlarge the markets are lacking. Had it been possible to develop industrial exports, the process of industrialization would have been more economical, for it would have made possible the international division of labour in manufacturing."

Responsibility for exaggerated import substitution does not fall only on the governments of the less developed countries and their advisers. Two World Wars and the great depression in between were reason enough for many countries to try to produce at home what, in those circumstances, they were no longer able to buy abroad. But the least to be said in criticism of the less developed countries is that so far they have shown little tendency to reverse course and expose their small monopolies to outside competition.

REGIONAL OR INTERNATIONAL INTEGRATION

Under the conditions described, negotiations for regional integration by various groups of less developed countries are likely to mean hard bargaining for mutual support, and reciprocal sacrifice, of high-cost industries. With each participant concerned lest it lose more than it gains, the difficulties of arriving at agreement and successful implementation are apparent.

Considered in this light, it may be significant that the one regional grouping which has been showing signs of progress toward integration—the Central American Common Market—is one whose member states had previously remained relatively open to the outside world and consequently did not differ widely from each other in their cost and price structures. Nor, it must be added, did the members differ much in the relatively low state of their industrial development. There may be, in fact, some risk that the progress now being registered in their manufacturing output and in their trade with each other could prove to be another example of what Prebisch called the "easy phase" of import substitution. The outcome is likely to depend on how successful they are in diversifying and expanding their exports to other countries at the same time they increase their trade within the area.

Political conditions permitting, other countries with relatively simple and open economies may be able to form local economic unions on the Central American model. That experience also suggests the paradoxical thought that countries whose import substitution has gone much further, such as most of the other Latin American countries, may be able to move toward regional integration only by first reintegrating with the world economy and bringing their cost and price structures more in line with those outside. A different, and perhaps more realistic, strategy is evidently reflected in the renewed effort toward economic union undertaken at Punta del Este; namely, as Joseph Grunwald has expressed it, that integration is a "means of lifting the Latin American countries to a level of economic maturity where, without the aid of inefficient protection, they will eventually be able to compete as equal partners with the developed nations."

The expectation underlying this strategy, as expounded by Grunwald, is that integration would expand market perspectives, allow a more rational allocation of resources, permit economies of scale, spur competition, and stimulate private investment. Also, a "protected regionwide market" would provide the catalyst needed to break down economic, political, and social rigidities and restore economic viability.

This may be a correct appraisal of the Latin American problem and the most promising way of accelerating growth in the region. It seems unlikely, however, that this approach will significantly alleviate the need for a rapid increase in exports to other areas, particularly in view of the extended period—1970–85—over which the common market is to be achieved. In the worst case, regional integration could hinder such an increase in exports if it were to mean the spread of cost-raising import substitution to countries in the region which, otherwise, would set their policies toward becoming more competitive in world markets.

To recapitulate, this study accepts as its point of departure that if the less developed countries are to earn foreign exchange in amounts commensurate with their needs, they will have to achieve a rapid increase in their exports of manufactures to the developed countries. This is where the world's buying power is concentrated, as long as levels of economic development remain so far apart, and it is also where the less developed countries will have to obtain most of the capital equipment and much of the materials and even some of the food needed by their growing economies and population.

FACTOR INTENSITIES IN THE UNITED STATES AND ABROAD

The next question is to try to identify the kinds of manufactures in which the less developed countries are most likely to hold or to be able to achieve a comparative advantage in international trade. The "factor-proportions" theorem identified with Heckscher and Ohlin provides a persuasive, but much disputed, answer to this question. According to that theorem, countries may be expected to have a comparative advantage in goods requiring relatively large inputs of the particular factors of production—whether labor, capital, or natural resources—with which they are most liberally endowed and, correspondingly, a comparative disadvantage in the production of goods embodying their scarce factors. A given country would therefore export goods of the first type and import goods of the second type—on the assumption that there are no hindrances to the flow of trade. In the context of the present study this would mean that, apart from industries based on such natural resources as they might have, the less developed countries would tend to specialize in labor-intensive goods and to import capital-intensive goods. More developed countries with greater capital resources and a highly skilled labor force would show the opposite pattern, at least in their trade with less developed countries.

The criterion used here for measuring, or at least approximating, inputs of both human capital and physical capital on a common basis will be value added by manufacture per employee. Put very loosely, "value added by manufacture" is what remains after subtracting the value of materials consumed from the gross value of output in any given industry or industry group. Differences from industry to industry in value added per employee are assumed to measure differences in the aggregate flows of services from the factors of production employed in the manufacturing process (and exclude therefore indirect factor inputs such as materials used). It is further assumed that these services may be ascribed either to human capital or to physical capital, and that, in interindustry comparisons, the wage and salary part of value added is a good proxy for the first and the remainder of value added a good proxy for the second.

Though affected by various market imperfections, value added per employee has significant advantages as a measure of factor intensity in manufacturing. One is that this measure may be taken to reflect the flows of services into the manufacturing process from both human capital and physical capital, and permits their treatment on a common basis. Another advantage is that value added per employee is available in considerable industrial detail for the United States and a number of other countries from their censuses of manufactures. The use of this measure contasts with the usual reliance on more infrequent statistics of stocks of physical capital as a measure of capital intensity, sometimes supplemented by verbal qualifications with regard to skill requirements.

To test the validity of this approach, value added per employee is broken down into its wage-and-salary component and the rest, and significant relations are found across industries between the first and other measures of skill and between the second and stocks of physical capital. It appears that value added per employee is a reasonably good, though not infallible, guide to the capital intensity of different industries.

By this criterion, the labor-intensive industries include such major industry groups in the census of manufactures as textiles, clothing, lumber and wood products, furniture, leather and leather products, and the broad group of miscellaneous manufactures. These main industry groups are relatively homogeneous in that very few of their component industries exceed the national average for wage and nonwage value added.

Industries which are extremely capital-intensive by both criteria employed here include chemical products and petroleum refining. Another industry which would fit into this category is the tobacco industry, ranking very high in nonwage value added though low on the wage scale. Here again there is a high degree of homogeneity in the component industries of these major groups.

The remaining major industry groups fall closer to the overall averages of wage and nonwage value added for all U.S. manufacturing. They are also much more diverse in composition by these criteria. Some of the latter fall well within the capital-intensive sector—for example, blast furnaces and steel mills, primary nonferrous metals, automobiles, tires and tubes, paper and paperboard mills, hydraulic cement, flat glass, alcoholic beverages, flour mills, sugar refining, and some other food processing industries. Other components fall well within the labor-intensive sector, including a number of items of interest in the present analysis—rubber shoes, motorcycles and bicycles, cutlery and various other metal products, pleasure craft and other small boats, glass containers, chinaware and pottery, ceramic tiles, canned seafood, canned fruit and vegetables, paper and paperboard containers, and various kinds of printed matter and printing services.

This allocation leaves a number of other industries and products near, or beyond, one or the other of the margins of the labor-intensive sector, among them being metal castings and stampings; hardware and tools; plumbing and heating equipment; household fans, automotive electrical equipment, radio and television sets, and other light electrical goods; sewing machines and typewriters; various types of machinery; surgical and medical instruments; some measuring or scientific instruments; and watches and clocks.

As will be noted later, most of the items just enumerated are marginal also in the sense that exports by less developed countries form only a very small part of international trade in these goods. They are nevertheless of particular interest, since these products could be regarded as next in line for the achievement of an export potential by some of the less developed countries as the growth of their experience and capacity in manufacturing permits them to move beyond the more strongly labor-intensive types of production. And one may further observe that the development of labor skills (including managerial experience and technical abilities) seems no less important than the growth of physical capital, if this kind of evolution is to occur.

It may be asked, however, whether any pattern of industries by factor intensity discerned for the United States would hold true for other countries. Doubt on this score is natural, given the lower wage rates and higher capital costs generally prevailing in other countries, especially the less-developed ones. All industries will no doubt tend to use more labor in relation to capital in poor low-wage countries than in richer ones, at least in auxiliary services if not in basic production processes. But if this substitution were stronger in some industries than in others, the ranking of industries by factor intensity would also differ from country to country. And if the tendency were widespread, it would means that—contrary to the "strong factor intensity" hypothesis underlying the factor proportions theorem—one could not confidently rank industries according to their requirements of labor and capital nor look at the relative factor endowments of different countries for clues to the likely composition and direction of their foreign trade.

Despite problems of comparability, the analysis of value added per employee in the United States and other countries developed at various levels of industrial aggregation gives little evidence of factor-intensity reversals. The comparisons tend rather to support the strong-factor-intensity hypothesis underlying the factor-proportions theorem and, more specifically, the relevance of the U.S. pattern of factor intensities to other countries at very different levels of economic development and with very different factor-price ratios. The selection of labor-intensive manufactures based on value added per employee in the United States stands up well on the basis of similar data for other countries, including detailed comparisons with the United Kingdom, Japan, and India.

Apart from any influence which may be exerted by differences in factor-price ratios, the interindustry pattern of factor intensities may change because the rate of technological advance is faster in some industries than in others, leading to new combinations of the factors of production. And these changes may be registered sooner in some countries than in others, depending on technological leadership, entrepreneurial initiative, and the conditions of competition.

In recent years a good deal of attention has been given to the rate of technological progress and changing factor proportions in textiles, especially cotton textiles. Thus, A Study on Cotton Textiles prepared by the GATT Secretariat,[5] states that "the industry is continually improving its performance through a shift to new types of equipment embodying technical advances and innovations at every stage of production," and that "the cotton industry in the industrialized countries and some of the less developed exporting countries is undergoing fundamental changes." "Use is being made of huge investments for this new equipment," the GATT study reports, and it adds: "A modern cotton industry is regarded as being among the most highly capital-intensive of the manufacturing industries."

How far this and other similar assessments are correct is important for reasons that transcend the identification of labor-intensive manufactures for analytical purposes. For one thing, technological advance in textiles is thought to have been stimulated by the rapid growth of exports by some of the less developed and other low-wage countries. Developments in the industry could therefore be regarded as illustrative of the kind of competitive response which, in still other products, could slow down or even thwart the growth of exports by less developed countries. Secondly, the prospect of a highly capital-intensive cotton textile industry is sometimes invoked as a reason why, in the meantime, imports from less developed countries should be curbed.[6] Commercial policy is thus summoned to the support of economic projections.

While the rate of technological innovation in cotton textiles is impressive, it may be exaggerated to suppose that the process is significantly faster than in manufacturing as a whole and to conclude that the industry is becoming strongly capital-intensive. The evidence for the United States is consistent with the view that there has been heavy investment in modernization in the last few years in cotton textiles, but it gives little reason to think that the industry is becoming capital-intensive compared with manufacturing in general and ceasing to be appropriate to the factor endowments of the less-developed countries. According to the criteria applied in this study, cotton textiles and the textile industry in general still rank among the most labor-intensive of the manufacturing industries, and they will be so treated in the analysis of trade.

The contrary view that a fundamental change in textiles is under way may rely unduly on comparisons with the industry's own past characteristics and performance and fail to allow for the progress made by manufacturing in general. The illustrations frequently given of developments in the industry also suggest a tendency to confuse the technological optimum with average practice at any one time.

Chapter II. Trade in Labor-Intensive Manufactures

CHARACTERISTICS OF THE TRADE

Probably the most important generalizations that can be made about imports of labor-intensive manufactures by developed from less developed countries are, first, that these imports are small and, second, that they have been growing rapidly in recent years.

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[5] General Agreement on Tariffs and Trade, Geneva, July 1966. The passages cited are from p. 55.

[6] For further discussion of the responses of developed countries to increased imports of textiles from the less-developed countries see p. 237.

Another broad generalization is that the trade is rather uneven in its composition by products and in its distribution by both exporting and importing countries. By product, textiles and clothing make up a particularly large share of the total, though some other light manufactures have recently been rising more rapidly. Among the countries of origin, Hong Kong holds an extraordinary position, and, all together, the less developed countries of the Far East are paramount over other areas as suppliers of labor-intensive manufactures to developed countries. Among the latter, the United States, the United Kingdom, and West Germany account for by far the greater part of these imports, and they also take the greater part of imports of labor-intensive manufactures from Japan and other low-wage countries.

Relative Size of Imports

A noteworthy feature of this trade is the small size of U.S. imports of labor-intensive manufactures from the less developed countries in relation to U.S. production of similar goods. The value of U.S. output (or "value of shipments") in 1965 of the items selected as labor-intensive was $138 billion. Imports of these items from all sources in 1965 were equal to only about 4.1 percent, and those from less developed countries only 0.7 percent, of that amount. These ratios were particularly low for certain items which may be described as "marginally labor-intensive." Exclusive of these items, total imports were about 4.2 percent, and import from the less developed countries about 1.1 percent, of domestic output. A similar comparison, if it could be made, would probably yield a slightly higher ratio of imports from the less developed countries to the domestic production of other developed countries considered as an entity, but with sharp contrasts among the members of the group.

Looked at in relation to total imports of labor-intensive manufactures, the share supplied by the less developed countries is much larger in this country than in other developed countries—about 18 percent for the United States in 1965 versus 6 percent for other developed countries taken as a whole, or 25.8 and 10.5 percent, respectively, exclusive of the "marginal" items. This observation has to be set against the much more limited role which imports in general play in the U.S. economy than in most other countries. Even so, the ratios (again exclusive of the marginal items) seem very small in most cases—between 3 and 8 percent in all of the smaller European countries and Canada. In France, despite its longstanding economic ties with African countries and the tariff preferences extended to them, the 1965 ratio is only 12.3 percent, or slightly larger than in West Germany with 11.1 percent and much less than in the United Kingdom with 19.2 percent.

As a final comparison, on the basis of the 1965 trade returns, labor-intensive manufactures make up less than one-tenth of total imports of the developed countries from less developed countries. Coffee, cocoa, and tea alone bulk larger in the total, and crude petroleum 2.7 times larger. Labor-intensive manufactures are less than half as large as other products classed as "manufactures," the latter being more capital-intensive and generally having an evident natural-resource orientation (major examples being petroleum products and nonferrous metals). The only items of which the latter is not true are of negligible consequence in the trade.

It is noteworthy, however, that developed countries' imports of labor-intensive manufactures from the less developed countries rose by almost 11 percent from 1964 to 1965 in contrast to an increase of less than 4 percent in all other products. This relative gain was achieved despite the fact that the defensive balance-of-payments measures taken by the United Kingdom toward the end of 1964 and, more particularly, the tightening of restrictions on textiles seem to have fallen with special severity on its imports of labor-intensive manufactures from some of the Commonwealth countries. Developed countries other than the United Kingdom raised their imports of labor-intensive manufactures from less developed countries by 17.5 percent in 1965.

Product Composition of the Trade

Textiles, clothing, and accessories made up about one-third of 1965 imports of labor-intensive manufactures by developed from less-developed countries. (If burlap and other coarse fiber products are also counted in the textile group, the latter accounted for some 44 percent of the total.) The concentration of the trade by product is therefore pronounced, but it is perhaps less extreme than sometimes suggested by the attention given to textile imports from low-wage countries. Comparison of the 1965 results with those for 1964 indicates, moreover, that the concentration may be diminishing, the textile items having increased by 10.4 percent compared with an overall increase close to 27 percent by a wide assortment of miscellaneous light manufactures (excluding food items and industrial materials). Both figures are strongly influenced by the British measures noted above. Developed countries other than the United Kingdom increased their imports of textiles, clothing, and accessories by about 25 percent and those of miscellaneous light manufactures by 37 percent from 1964 to 1965. The corresponding increases for the United States alone were 34 and 44 percent, respectively.

Distribution by Importing Countries

Of total imports of labor-intensive manufactures by developed from less-developed countries in 1965, the United States accounted for 41.4 percent. The United Kingdom was next with 17.6 percent, and West Germany third with 12.7 percent. Together, these three countries took almost 72 percent of the total. The United Kingdom's share had been as high as 22 percent in 1964, but was reduced in 1965 with the absolute decline in its imports from the less-developed countries, while those of the United States and West Germany continued to rise.

Rapid increases are also found for several countries—Sweden, Austria, Japan, Australia, and New Zealand—whose imports are relatively small. Others, including the European Common Market members except West Germany, show small shares in total imports of labor-intensive manufactures from the less-developed countries, small ratios to their own imports of like products from all sources, and low rates of increase.

There are considerable differences in the distribution of the main product groups among importing countries. The share of the United States is particularly high—more than half of the total—in the rapid-growth miscellaneous light manufactures. The Common Market countries take a relatively large part—twice as much as the United States—of the labor-intensive food products. The United States, the United Kingdom, and West Germany account for three-quarters of total imports of textiles, clothing, and accessories from the less-developed countries. All three show considerable variety in the product composition of their imports from the less-developed countries. The United Kingdom's imports are, however, more concentrated on Commonwealth countries, which enjoy preferential entry to the British market, than those of the United States and West Germany. The much smaller total of French imports of labor-intensive manufacturers from the less-developed countries is composed to the extent of two-thirds of food products, leather, and lumber, chiefly from Africa. Japan's imports of labor-intensive manufactures from the less-developed countries are extraordinarily small by almost any standard. In these products Japan's role vis-à-vis the less-developed countries is, at least for the time being, far more that of a competitor than that of a customer.

Distribution by Exporting Countries

Hong Kong alone supplied 28 percent of total imports of labor-intensive manufactures by developed from less-developed countries in 1965, outranking India and the whole of Latin America with less than one-fifth each. The extraordinary role of Hong Kong is not sufficiently indicated by the overall percentage just cited: Its share in labor-intensive food products and industrial materials was negligible, reflecting its lack of land and other natural resources, but it supplied half of the textile group and more than half of miscellaneous light manufactures.

Other less-developed countries of the Far East brought the combined share of that area to two-thirds of the total. Extraordinarily rapid rates of increase from 1964 to 1965 were shown by several of these countries, notably South Korea and Taiwan. It may be noted that their highest rates of increase were in miscellaneous light manufactures, and this was generally true of the less-developed countries in other regions as well.

No less remarkable than the vigor shown by the exports of some of the small Far Eastern countries is the failure of some of the larger less-developed countries, with an earlier beginning of industry, to compete on a significant scale in the markets of the developed countries for labor-intensive manufactures. These countries include Argentina, Brazil, Chile, Mexico, the Philippines, Egypt, Algeria, and Morocco. With the exception of Brazil, whose exports in 1965 gave some promise of renewed growth, these countries also failed to share in the general rise in exports of labor-intensive manufactures from the less-developed countries in 1965. Their participation is especially weak in miscellaneous light manufactures, which include some of the more rapidly growing items. Nor should it be supposed that the minor role played by these countries as exporters of labor-intensive manufactures to the developed countries is to be explained by a more impressive performance in capital-intensive manufactures. Exports of such manufactures by the less-developed countries, apart from strongly resource-based products, are exceptional. Some of the exceptions are, however, of possible interest in the present connection. They include $15,758,000 of iron and steel exported by Mexico to the United States; $1,002,000 of tires and tubes exported by Israel to Western European countries as well as smaller amounts from Morocco, India, and the Philippines; $363,000 of trucks from Morocco to France; and $90,000 of insulated wire and cable exported by Argentina to the United States.

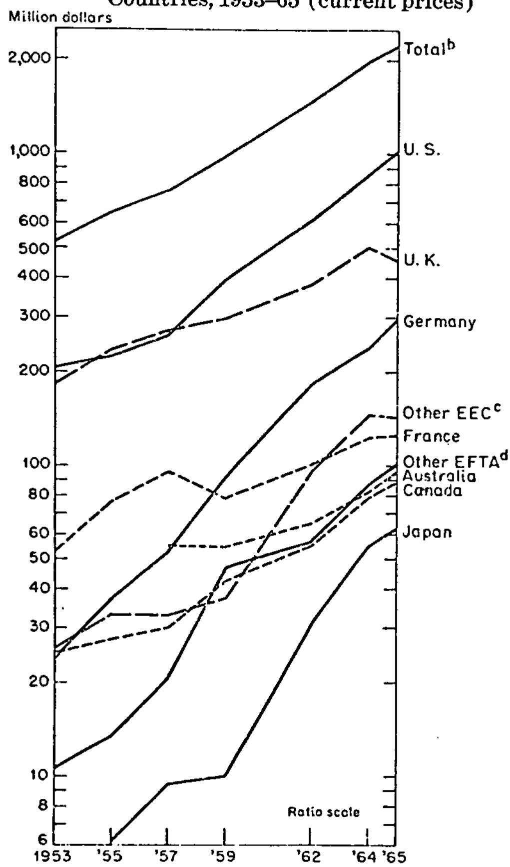
MARKET POTENTIALS

Past Growth, 1953–65

The rate of growth in imports of labor-intensive manufactures by developed from less developed countries in recent years has probably been much faster than had been expected. For instance, in a study published in 1964, Bela Balassa projected an annual rate of increase of 5.5 percent in exports of manufactures by less developed to developed countries over the period from 1960 to 1975, prices being assumed to remain constant.[7] By contrast, the total of the labor-intensive items plotted in chart II–1 shows imports in 1965 4⅓ times as

CHART II–1

Imports of Labor-Intensive Manufactures by Developed from Less Developed Countries, 1953–65 (current prices)



Source: Compiled from publications of U.N. Statistical Office.

[a]Imports of countries reporting on a c.i.f. basis have been adjusted to an approximate f.o.b. basis.

[b]Excluding Australia, Japan and Switzerland.

[c]Belgium-Luxembourg, Italy and the Netherlands.

[d]Austria, Denmark, Norway and Sweden (Switzerland and Portugal not included).

[7] Bela Balassa, "Trade Prospects for Developing Countries," Homewood, Ill., 1964, p. 66 and tables A3.1.1 and A12.

large as in 1953, an increase of about 13 percent per annum compounded. This is at current prices, and the annual rate of increase might be 1 or 2 percentage points less at constant prices.

In other words, the increase foreseen for 15 years was approximately realized in 5 years. As table II–1 shows, the strength of actual performance in relation to the projections was pervasive, extending to most product groups and geographic areas.

Structure of Wages in Less Developed Countries

One of the conditions for a continued rapid growth of the trade is that the structure of wages in less developed countries not be such as to nullify their comparative advantage in labor-intensive products. A few years ago Lloyd Reynolds suggested that "interindustry wage dispersion tends to reach a maximum some time during the early stages of industrialization and to diminish gradually after that point."[8] This is what one would expect under free-market conditions, assuming that skills are relatively short and unskilled labor abundant in newly developing countries, and that these disparities in supply are gradually overcome.

Recently, however, a growing literature indicates that interferences of one kind or another tend to narrow wage differentials between industries or occupations in many of the less developed countries and so to raise costs in their more labor-intensive manufacturing branches. Frequently the stress is placed on labor unions as the main force underlying the development of wages. Legal minimum wages may, however, be a more general and powerful influence on the level and structure of wages in less developed countries to a degree not matched in more developed countries. An authoritative analysis in the organ of the International Labour Office,[9] in discussing changes in wage differentials by skill in the less developed countries, attributes minimum-wage policies to widespread disapproval of the wage levels of unskilled workers that would otherwise obtain. But he adds that "if governments insist that unskilled wages should increase independently of the forces of demand for and supply of unskilled labor, there is a likelihood that unskilled wages may increase faster than skilled wages." The author then quotes an earlier article in the same review (1959), finding "an extreme uniformity of wage rates in Brazil" attributable to public intervention, particularly the minimum wage, and cites other evidence of a tendency for the skilled-unskilled wage differential to narrow in "many African countries" and "some Asian countries." "This," he explains, "is because legal minimum wages are relatively high in these countries and are raised from time to time irrespective of the underlying conditions."[10]

Several unfavorable economic consequences are associated with tendencies toward uniformity of wage rates irrespective of skills. One is the discouragement of effort by workers to acquire higher skills. Another is the inducement to entrepreneurs to adopt more capital-intensive methods of production than they otherwise would or to save on labor in other ways, thus inhibiting the growth of employment. A

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[8] L. G. Reynolds and C. H. Taft, *The Evolution of Wage Structure*, New Haven, 1956, p. 356.

[9] "Wage Differentials in Developing Countries: A Survey of Findings," by Koji Taira, *International Labour Review*, March 1966, pp. 281–301.

[10] P. 287.

TABLE II-1.—IMPORTS OF MANUFACTURES BY DEVELOPED FROM LESS DEVELOPED COUNTRIES—IMPORTS IN 1960 AND 1965 AND BALASSA'S PROJECTIONS FOR 1975

[In millions of dollars]

Product group	Imports in 1960 (current prices)					Imports in 1965 (current prices)					Balassa's projections for 1975 (1960 prices) (average of high and low)				
	All developed countries	North America	Western Europe	Japan	Oceania	All developed countries	North America	Western Europe	Japan	Oceania	All developed countries	North America	Western Europe	Japan	Oceania
1. Chemicals	119	54	59	5	1	267	109	131	22	5	227	100	111	15	1
2. Leather and footwear	81	14	64	2	1	132	36	90	5	1	154	36	106	10	3
3. Veneer, plywood, wood and cork manufactures, and paper	50	25	23	....	2	140	97	39	1	3	268	179	84	....	5
4. Textile yarn, cotton fabrics, and clothing	316	145	151	....	20	622	285	297	2	38	658	281	332	....	45
5. Jute manufactures	175	103	34	1	37	279	192	46	....	42	217	121	50	1	45
6. Floor coverings and other textile products	102	39	59	1	3	217	65	142	3	7	246	79	156	4	7
7. Silver, precious stones, pearls, and jewelry	94	28	64	2	....	277	95	161	20	1	291	88	190	9	4
8. Machinery and metal manufactures	42	20	21	....	1	252	117	108	24	2	132	62	66	....	3
9. Other manufactured goods	96	53	37	1	5	284	173	89	10	12	253	138	97	4	14
Total	1,075	481	512	12	70	2,470	1,169	1,103	87	111	2,446	1,084	1,192	43	127

third effect of particular relevance here is the brake on the diversification of exports: A country unable to compete abroad in capital-intensive manufactures may also find itself priced out of the market in more labor-intensive manufactures and thus forced to continue to rely on exports of primary products.

These considerations may help to explain why it is that some of the less developed countries, notably those with an earlier start on industrialization, have fared so poorly in exporting manufactures and why, in contrast, some others, particularly some of the countries of Southeast Asia, have made such rapid headway.

Possible Areas of Rapid Growth

At least for those less developed countries which do strengthen their comparative advantage in labor-intensive manufactures, the very unevenness of the trade hitherto may provide a key to future growth sectors. Imports from less developed countries of many light consumer manufactures have scarcely scratched the surface of the market. This certainly seems true of the United States on even a rough comparison of domestic production and imports from the less developed countries. There are, indeed, very few products of which total U.S. imports from all sources make up a significant part of supply. It seems plausible to expect that a growing, adaptable economy will absorb increasing amounts of these miscellaneous consumer goods from the less developed countries.

This may be true also of many other developed countries, in some of which imports of consumer manufactures from the less developed countries have scarcely begun to play a role. Restrictive import policies and practices are doubtless one explanation. But perhaps also a learning period is required, and the experience gained by some of the less developed countries in exporting to the larger and higher cost U.S. market, and by those of the Commonwealth with their privileged access to the British market, may now be applied to the conquest of still other markets.

Some of the greatest opportunities for expansion may be offered by marginally labor-intensive manufactures. The field of components and parts for use in electronic products and perhaps also in machinery, automobiles, and other transportation equipment seems particularly interesting. American manufacturers of electronic goods have reached out not only to Japan and Puerto Rico but also to Hong Kong, Taiwan, and Korea for components or even complete products.

Chapter III. Commercial Policies of Developed Countries

The assessment of market potentials concluding chapter II may be too optimistic. How far the expansionary forces go depends heavily on the commercial policies of the developed countries with regard to imports of manufatures from less developed countries. It remains therefore to consider in this regard both the tariff structures of the developed countries and nontariff barriers which, in some cases, may have a far more restrictive effect.

TARIFF STRUCTURES: NOMINAL VERSUS EFFECTIVE RATES

A standing complaint of less developed countries is that the import tariffs of the developed countries tend to be graduated according to stage of manufacture so as to bear lightly, if at all, on imports of

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raw materials for use in manufacture and to penalize imports of processed or finished goods. To the extent that these influences prevailed, many of the less developed countries would have to remain hewers of wood and drawers of water.

Theoretical and empirical support for the view that the "escalated tariff structures" of the advanced countries are "a potentially powerful inhibitor of economic growth in the underdeveloped countries" has been developed by a number of distinguished economists. Their analyses make the point that nominal tariffs may be quite different from effective tariffs, the latter being related to value added by manufacture after taking account of duties paid on material inputs. When the rates specified in the tariffs are graduated according to stage of manufacture, the effective rates are higher, and frequently much higher, than the nominal rates.

Suppose, for example, that an important consignment of cotton cloth worth $500 is subject to an import duty of $100. Suppose further that the same amount and quality of cloth produced at home would require $240 of yarn which, if imported, would bear a duty of $30. In this case the value added by weaving is $260, protected by a duty of $70.[11] The effective rate of duty, computed in relation to value added, is therefore 26.9 percent as contrasted with the nominal rate of 20 percent.

Moreover, it may be more meaningful to relate the duty only to the wage part of value added on the assumption that capital costs are not likely to be lower, and may well be higher, in less developed than in developed countries. On this basis, and assuming that payroll makes up 60 percent of value added in the example chosen, the effective rate of protection would be about 45 percent. This would be the amount by which labor costs per unit of output in the importing country could exceed those in the exporting country. The difference will be greater still to the extent that capital costs, transportation charges, and other costs work in favor of the importing country. (And, of course, the difference in earnings per worker will be much greater still when the difference in productivity of labor is as large as it typically is between less developed and developed countries.)

Table III–1 drawn from a current study by Balassa, presents nominal tariff rates and estimates of the effective rates, on both of the bases just described, for a number of intermediate products and finished manufactures of interest in this study. These estimates necessarily involve an element of approximation regarding input coefficients and can perhaps best be regarded as illustrative rather than as precise measurements. In most cases the effective rates are much higher than nominal tariffs. The effective rates in Japan are in most instances higher than in the United States or the Common Market. In the United Kingdom, the structure of protection is not very different from that of other developed countries as far as tariff rates imposed on imports from outside the Commonwealth are concerned. These rates are, however, of less relevance than those of other countries (and are accordingly omitted from the table), since imports from the Commonwealth, including such major suppliers as Hong Kong and India, are generally free of duty (though not necessarily free of other restraints, as in cotton textiles and jute products).

[11] It is relevant to the history of economic doctrine to note that this example is drawn from a study of tariff protection and free trade published more than 60 years ago by the Austrian economist and former Underscretary of State Richard Schüller.

TABLE III-1.—NOMINAL TARIFF RATES AND ESTIMATED EFFECTIVE RATES ON IMPORTS OF SELECTED INTERMEDIATE PRODUCTS AND FINISHED MANUFACTURES BY THE UNITED STATES, THE EUROPEAN ECONOMIC COMMUNITY AND JAPAN

[In percent]

SITC No.	Product	Nominal tariff rates			Estimated effective rates on value added			Estimated effective rates on value added by labor [a]		
		United States	EEC	Japan	United States	EEC	Japan	United States	EEC	Japan
	INTERMEDIATE PRODUCTS									
6513	Cotton yarn and thread	13.1	10.0	5.6	32.8	31.4	13.9	46.0	44.0	19.5
6512	Yarn of wool and animal hair	23.0	5.7	10.0	53.2	16.1	29.6	74.5	22.5	41.5
611	Leather	9.6	7.3	19.9	25.7	18.3	59.0	48.1	34.3	110.4
243	Wood, shaped or simply worked	.7	3.2	5.9	1.1	4.5	13.3	1.9	7.5	22.5
	FINISHED MANUFACTURES									
652	Cotton fabrics, woven	17.5	15.0	10.5	31.2	27.5	20.0	43.4	38.5	27.8
6532	Woolen fabrics, woven	50.1	16.0	20.0	119.1	36.9	43.1	165.6	51.3	60.0
841 [b]	Cotton clothing	26.6	18.5	21.0	48.1	28.1	40.3	77.4	45.2	64.8
841 [b]	Wool clothing	22.1	20.5	22.0	−5.4	32.4	30.8	−8.7	52.2	49.6
8414	Clothing and accessories, knitted	25.6	18.6	26.0	48.7	41.3	60.8	68.5	58.1	85.5
6534	Jute fabrics, woven	2.8	23.0	25.0	7.0	62.2	67.5	9.9	86.6	94.0
6561	Jute sacks and bags	7.5	19.4	25.0	16.6	19.2	34.5	25.0	29.0	52.0
6556	Cordage, ropes, nets, etc	4.0	14.3	19.2	11.3	41.9	57.2	32.7	121.8	166.4
851	Shoes	16.6	19.9	29.5	25.3	33.0	45.1	47.6	62.0	84.8
612, 831	Other leather goods	15.5	14.7	23.6	24.5	24.3	33.6	34.3	34.0	47.0
6312	Plywood	17.1	15.0	20.0	43.7	32.5	44.2	87.5	65.0	88.4
632, 821	Other wood products including furniture	12.8	15.1	19.5	26.4	28.6	33.9	46.4	50.3	59.6

[a] The estimated effective rate on value added by labor is the lower of 2 sets of estimates given by Balassa (the higher estimates allowing for higher capital costs in developing countries).

[b] Data relate to selected components of SITC No. 841.

Note: Rates relate to structure prior to completion of Kennedy round of GATT negotiations.

Source: Bela Balassa, "The Structure of Protection in the Industrial Countries and Its Effect on the Exports of Processed Goods from Developing Nations" (manuscript).

It is noteworthy that, though the U.S. tariff appears in general to be no less graduated or escalated than those of other countries and is sometimes held to be more so, the effect on the structure of its imports seems to be much less marked than in some other developed countries, especially some of the members of the Common Market and Japan. One important reason is that the United States is itself a major producer and exporter of some of the crude materials included in the table, notably, cotton, cattle hides, and hardwoods. This alone would tend to cause a higher ratio of manufactured to unmanufactured imports than would be true of most other developed countries. The same influence may affect the composition of imports by Canada, Australia, and New Zealand.

Nevertheless, imports of finished manufactures from less-developed countries by most countries of Western Continental Europe look very small, and those of Japan altogether trivial, compared both with their own imports of crude materials and intermediate products and with imports of finished goods by the United States from less-developed countries. Part of the explanation may be that, even if effective tariff rates in the United States are the same as in Europe or Japan, they may be less effective, in fact, in restricting imports of labor-intensive goods, if wage costs per unit of output in manufacturing these goods are higher here than in other developed countries.

NONTARIFF BARRIERS TO IMPORTS

There are, however, other more specific though sometimes less visible hindrances to the growth of the trade than those presented by tariffs. The most obvious, at least so far as they are reported, are quantitative restrictions. After taking note of some further, but slow, progress in removing these restrictions, a mid-1966 report by UNCTAD observes that "the area of exports still affected is considerable and includes a number of products of major export interest to developing countries." The report then summarizes the position as follows: "Out of 63 Brussels tariff nomenclature items of export interest to developing countries, quantitative restrictions on the following among them are still maintained in the developed countries; namely France 56, Japan 24, Federal Republic of Germany 21, Denmark 15, Norway 14, Austria 13, Italy 10, United Kingdom 7, Switzerland 6, Sweden 3, United States 3, Netherlands 2, Belgium-Luxembourg 2, Canada 1." [12]

It is hard to judge the significance of these restrictions, since they may be nominal in some cases and rigorously enforced in others. It is even more difficult to judge the incidence and effect of other more subtle hindrances, such as administrative redtape or collusion among private producers and distributors within the developed countries, but the absence of trade is sometimes difficult to explain otherwise. Though it is difficult to separate from other influences noted, perhaps something should be allowed for the view that competition is keener in the U.S. market than in other developed countries, and that American entrepreneurs are more active in seeking out foreign sources of supply.

[12] United Nations Conference on Trade and Development, "Review of International Trade and Development, 1966," summary of report by the Secretary-General, July 20, 1966 (TD/B/82), p. 15.

Restraints on Imports of Cotton Textiles

The history of cotton textiles in recent years illustrates how the very growth of trade can be its own undoing through provoking restrictive measures by the importing countries. Following the swift increase in imports of cotton textiles from India, Hong Kong, and other Commonwealth sources in the 1950's,[13] the United Kingdom made a series of bilateral agreements aimed at limiting the further growth of the trade. The United States, after a rapid rise in imports from some of these countries and from Japan, took the lead in negotiating in 1961 a short-term and then, in 1962, a long-term international cotton textile "arrangement," under which it has made numerous bilateral agreements for "voluntary restraints" by the exporters. Continental European countries were happy to join in the arrangement, with the blessing it confers on avoidance of "market disruption," but for the greater part have continued to prove willing and able to apply their own import restraints.

These restraints are sometimes more than meet the eye. The director-general of the GATT, in opening the major review called for in the arrangement at the end of the third year, noted that all trade restrictions on cotton textiles are not fully notified by participating governments and urged them to help lift the haze which still rests over this subject.[14]

Despite these open and hidden restrictions, imports of cotton textiles by the developed countries from developing exporting countries have increased relatively fast. Those of Western Continental European countries doubled from about $50 million in 1961 to something over $100 million in 1964. At that level, however, they still fell short of imports from the same sources by the United Kingdom (around $170 million) and by the United States ($126 million), both of which had risen substantially as well.

Apart from the United Kingdom, these increases have all been from extremely low levels compared with home consumption—so low in several of the Western Continental European countries that even their commitment to large percentage increases under the 5-year arrangement was regarded by some of the exporting countries as

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[13] The rise in these imports is explained as follows by A. M. Alfred, the chief economist for Courtaulds Ltd., in a paper read at the Manchester Statistical Society on November 10, 1965 ("United Kingdom Textiles—A Growth Industry"):

On the import side, you will know well that the United Kingdom textile industry, particularly the cotton sector, has suffered from an unforeseen consequence of the Imperial Preference Treaty negotiated at Ottawa in 1932. Under that treaty, it was agreed that cotton and wool textiles and madeup goods could enter the United Kingdom duty free if coming from the Commonwealth. At that time there was no textile activity of relevance in India, Pakistan, or Hong Kong. In fact India (then undivided) imported 550 million yards of cloth from the United Kingdom. In 1964 the United Kingdom imported 450 million square yards of cloth and madeup goods from India, Pakistan and Hong Kong—a reversal of a billion yards. This large volume arose because of the channelling of these Commonwealth exports into the only country into which they could come duty free.

After noting that these imports, together with imports from other underdeveloped countries made up 35 percent of British consumption, compared with his estimates of 8 percent for the United States and 9 percent for the European Common Market, Mr. Alfred went on to speak of "the ridiculous state of affairs whereby the United Kingdom cotton industry is the only industry in any developed country of the world to have zero protection against a major supplier."

While recognizing that the "market disruption" in the British textile industry has been far greater than in other developed countries, one cannot fail to detect in this account a double standard frequently characteristic of attitudes in developed countries toward trade with the less-developed countries: Free trade in textiles within the Commonwealth seemed logical and desirable as long as the flow was from the United Kingdom outward, but ceased to be so when the flow reversed (through the initial impact of British factory-produced textiles on the Indian handicraft industry in the 19th century had been no less disruptive than that more recently experienced in the United Kingdom when the tide turned).

[14] Press release GATT/946, Dec. 8, 1965.

bordering on fraud.[15] In his remarks quoted above opening the major review of the arrangement, the director-general of the GATT expressed the hope that it had brought some semblance of order into the trade through restraint actions, and that the parties to the arrangement could begin to give effect to its long-term and positive aims, including in particular expanded access to markets for the less developed countries.

It remains to see how much emphasis will be given to these long-run objectives during the further 3-year period, starting October 1, 1967, for which the cotton textile arrangement has been extended. At least as far as the United States is concerned, government officials reporting to business groups on the renewal of the arrangement have stressed rather the objective of avoiding market disruption, the expectation that the rapid growth of U.S. imports of cotton textiles would be greatly slowed down, the intention of acting to regulate imports from new supplies, and continued close cooperation with the industry through the Management-Labor Textile Advisory Committee.[16] In connection with the extension of the arrangement, stress has also been placed on the limited extent of the tariff cuts on textiles made by the United States and other developed countries in the Kennedy Round.[17]

THE PROBLEM OF INCREASED ACCESS TO MARKETS

The issue of preferences

The first condition for a continued rapid growth of exports of manufactures by the less developed countries to the advanced countries would seem to be greater accessibility to these markets. Greater accessibility would mean the scaling down of the tariff rates of developed countries, particularly the effective rates, on goods of which the less developed countries are actual or potential suppliers; the progressive loosening of quantitative restrictions, both those imposed by the importing countries and the voluntary restraints exercised by the exporting countries; and the identification and removal of other, less obvious impediments to imports. More broadly, greater accessibility would mean recognition that international specialization has a place for the products in which the less developed countries have a comparative advantage, and that this place will widen and deepen as the rise in productivity and wages in the developed countries produces divergent effects on unit wage costs in different industries.

The great debate in recent years on commercial policies affecting the less developed countries, culminating at the United Nations Conference on Trade and Development in 1964 and still continuing, has turned increasingly on the issue of tariff preferences; that is, whether the enlargement of market opportunities for the less developed countries should be sought within the most-favored-nation framework embodied in the GATT, whereby the concessions made would be gen-

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[15] Gardner Patterson, "Discrimination in International Trade: The Policy Issues, 1945–65." Princeton. 1966. p. 311.

[16] See especially the address by Stanley Nehmer, Deputy Assistant Secretary of Commerce for Resources, before the Underwear Institute in Atlantic City on May 9, 1967.

[17] "Because of the import sensitivity of textiles in general here and abroad, the cuts made by the United States and other major importing countries average less than 25 percent and much less than that on the more sensitive product areas such as woolen and manmade textiles. Many textile products were excluded altogether" (quoted from address by the then Acting Secretary of Commerce, Alexander B. Trowbridge, at the Alabama International Business Forum, Tuscaloosa, May 17, 1967).

eralized and extended also to developed countries, or whether the less developed countries should be accorded preferential treatment in recognition of their difficulties in competing with the developed countries. Rightly or wrongly, the less developed countries seem to have become convinced that only a system of preferences would meet their needs, though they differ among themselves, as well as with the developed countries, as to what the terms of the preferences should be. The United States, adhering to the principle of nondiscrimination, has been in the invidious position of leading the opposition to these demands, sometimes to the point of seeming to be the only voice in opposition. Harry G. Johnson, though severely critical of the negative stance of the United States and of its failure to develop a more positive and imaginative policy, suggests that, to an important extent, the United States served as a scapegoat for other countries, especially the European Common Market countries, which avoided commitment by abstaining from voting while the United States carried the burden of resistance.[17a]

After the vast exceptions to the most-favored-nation principle constituted by the European Economic Community and the European Free Trade Area, the idea of tariff preferences to favor the less developed countries may appear to be a modest objective. It seems to accord ill, however, with the realities of the present trading situation in which, as the director-general of GATT has observed, "the tendency is, in the sectors where the less developed countries are already competitive, for the developed countries to discriminate against the export products of these countries.[18] Unless the developed countries are ready to forgo those features of their commercial policies which seem to fall with particular severity on exports of the less developed countries, what expectation can there be of shifting all the way over to discrimination in their favor?

The heart of the difficulty, as far as exports of labor-intensive manufactures by the less developed countries are concerned, is that these products tend to compete with those sectors in the developed countries which are frequently the least prosperous and the most successful in obtaining protection against imports. The problem is illustrated by one of the provisions of the U.S. Trade Expansion Act of 1962; namely, that authorizing the President to negotiate tariffs down to zero on groups of industrial products of which the United States and the European Common Market together accounted for 80 percent or more of world exports. This formula reflected an erroneous expectation that the United Kingdom was about to become a member of the Common Market (without which the 80-percent level would be realized only exceptionally). But it also had the important effect of excluding products, notably textiles, of which Japan and the less developed countries were significant exporters. In other words, the United States was prepared to consider reducing tariffs by as much as 100 percent on products which, as President Kennedy said, "can be produced here or in Europe more efficiently than anywhere else in the world,"[19] but only by half as much in principle (perhaps a good deal less in

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[17a] "Economic Policies Toward Less Developed Countries," Washington, 1967, especially p. 39.

[18] Address in Bad Godesberg, Germany, Oct. 27, 1966.

[19] See "Department of State Bulletin," Feb. 12, 1962, p. 236.

practice) on products in which Japan and the less developed countries were most competitive. This, however, is only a specific illustration of the general tendency of U.S. tariffs to bear more heavily on labor-intensive manufactures than on other goods. It raises the question whether, even if the most-favored-nation rule is rigorously respected, unequal tariff treatment of different products may not be tantamount to unequal treatment of different countries.

The Prebisch Proposals

Awareness of these difficulties led Raúl Prebisch, in his advance message as secretary-general to UNCTAD in 1964, to envisage something less than a fully generalized system of preferences.[20] As he saw it, developed countries could not be expected to give preferential treatment to those industries in the less developed countries that were already fully competitive in world markets, and each country granting preferences might therefore establish a reserve list of such products to be excluded from preferences (but not, he stressed, from most-favored-nation treatment under GATT). Prebisch's case for preferences was, as he said, "a logical extension of the infant industry argument" aimed at enabling the less developed countries to become competitive in manufactures that they could not now export. Both the duration of the preferences (a minimum of 10 years was suggested) and the margin of preference should be great enough to provide adequate incentive for the establishment of new export industries.

Prebisch considered it desirable, but not indispensible, that all developed countries participate in granting preferences. He hoped that they would avoid the crippling complexities of a highly selective country-byproduct approach, but recognized that they might insist on an overall quota, and possibly quotas on particular categories, governing the amount of goods to be imported preferentially.

As to the preference-receiving countries, Prebisch recognized that it would not be easy to set any kind of cutoff point above which countries would not be eligible. Among those which were eligible, he felt it necessary to distinguish between the "more advanced" and the "less developed" among them, suggesting for the latter wider margins of preference. This might be reinforced by a special grant of quotas in their behalf and perhaps even by preferential tariff treatment on items which the developed countries had reserved from general preferences.

Australian Preference System

Despite vigorous efforts by the less developed countries at UNCTAD for a declaration of principle in favor of preferences, all that emerged in the final act of the 1964 conference was a decision to set up a committee to consider the best method of implementing such a system and to discuss differences of views on the question of principle. The topic seems destined to figure even more prominently in the debates of the second conference scheduled for 1968. Meanwhile, the only specific action by way of preferences favoring imports from the less developed countries is that taken by Australia under a waiver from the most-favored-nation rule approved by GATT in March 1966. Though stanchly defended by Australia as a manifestation of its willingness to

[20] "Proceedings of the United Nations Conference on Trade and Development," vol. II, policy statements, 1964, pp. 35–40.

help overcome the trade problems of the less developed countries and as a lead to other developed countries wishing to apply similar methods, the Australian preferential system may also be taken as indicative of the limitations and problems in this approach. Its main features may be summed up as follows from materials made public at the time of requesting the waiver from GATT: [21]

1. Preferential duties, zero in some cases, were to be introduced in favor of the less developed countries, comprehensively defined, on some sixty items.
2. Each such concession was, however, subject to a quota limit, above which regular duties would apply to imports from less developed countries.
3. These quotas added up to a total of £A6,680,000, or about $15,000,000, representing in principle the amount of goods that might enter in a year's time on a preferential basis.
4. More than 40 percent of this total was made up of items which, it would seem, were unlikely to provide the basis for any new export industries in less developed countries, at least in the near future. These included, in particular, newsprint, £A2,000,000; machinemade paper £A500,000; rubber thread, vulcanized, £A100,000; household washing machines, £A150,000; machine tools £A150.000.
5. Other, generally more likely, items thus added up to £A3,780,000, or about $8,500,000 in terms of amounts eligible for preferential treatment, made up chiefly of consumer manufactures.
6. More generally, it was indicated that the list was drawn up so as to omit "products in which less developed countries are already competitive in world markets," and that "the preferential rates should be subject to modification as producers in less developed countries become competitive."
7. On the other hand, it was also indicated that the items specified constituted an "initial list" and that other products might be added from time to time.

Unless the Australian list were to be significantly expanded, it could scarcely be said to open up major new export possibilities for the less developed countries or to provide a challenging example for other developed countries to follow. Indeed, the positive effect of Australia's action was at least partially offset by another step taken at the same time whereby it informed GATT that, in accepting the new part IV on trade and development, it would not consider itself bound by the provisions under which the developed countries undertook "to accord high priority to the reduction and elimination of tariff and nontariff barriers to products of actual or potential export interest to less developed countries" and "to refrain from increasing tariff and nontariff barriers against such products." [22]

The "Brasseur Plan"

Except for the exclusion of Hong Kong from the benefits on certain items, the Australian preferences are available to all less developed countries, broadly defined. In this respect the Australian system appears to be more generous than the "Brasseur plan," with which it has been compared, would be. This plan, named after the Belgian Minister of Foreign Trade and Technical Assistance who made the proposals to GATT in 1963, would entail negotiations with individual less developed countries to determine in each case the products to be covered, the margin and duration of preference, and the quantities eligible to benefit. If the plan were seriously looked upon as applying to most bilateral relationships between developed and less developed countries and to most items of interest in the trade, the amount of negotiation and specification required would be astronomical. Patterson

[21] From statement and accompanying exhibits submitted by the Rt. Hon. J. McEwen, Deputy Prime Minister and Minister for Trade and Industry, to the Australian House of Representatives on May 19, 1965.
[22] From Mr. McEwen's statement of May 19, 1965.

suggests, however, that "this approach had the great virtue to some members of the European Economic Community that it would facilitate their safeguarding the value of the existing preferences to each other and, more important, to the Associated States." [23] It is not clear how valuable these latter preferences are, in fact, to the Associated States—i.e., the former African dependencies of France and Belgium—in view of the extremely low level of their exports of manufactures to the former mother countries or other members of the European Economic Community.

Diverse Policies and Common Objectives

The effectiveness of tariff preferences in opening new markets for the less developed countries cannot be judged in the abstract, but depends on the terms of the preferences in each case. The measures adopted in Australia and those contemplated under the Brasseur plan are not reassuring, however, if taken as a foretaste of the kind of preferential concessions to be expected. Rather, they give point to Prebisch's warning that "it would not be worth facing all the political and other difficulties entailed in a new departure from the most-favored-nation principle simply for the sake of token margins of preference on a few selected products for a very limited period, amounting to little more in toto than a gesture in the face of the immense problems of the trade gap." [24] He might have added that, the more selective preferences are by beneficiaries, the more fragmented is the bargaining power of the less developed countries and the greater their economic dependence becomes on particular developed countries.

It is equally true that the gains to be achieved by the less developed countries through the most-favored-nation approach cannot be judged in the abstract. In principle, their bargaining position for obtaining meaningful concessions from the developed countries is strengthened by three considerations. First, the developed countries have, as noted, pledged themselves in GATT as well as at UNCTAD to give "high priority" to the reduction of both tariff and nontariff barriers to the exports of the less developed countries. Second, the need of the less developed countries to increase exports to cover their growing import requirements is widely recognized. Third, the gains from trade between countries with wide differences in factor endowments should be particularly large to both sides.

In fact, however, the Kennedy Round of GATT negotiations seems to have been regarded by the developed countries as primarily concerned with trade relations among themselves, with only incidental benefits to others, and it is by no means clear what will follow to give effect to their commitments to the less developed countries. As far as the United States is concerned, the tariff-cutting authority vested in the executive branch by the Trade Expansion Act of 1962 does not extend beyond mid-1967, and proposals for a new trade program remain to be formulated and approved. In the European Economic Community there seems to be an increasing tendency to look on the common external tariff as a condition for internal unification, while the United Kingdom appears to be mainly concerned with joining the EEC and perhaps more inclined to reduce than to increase its imports from less developed countries.

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[23] *Discrimination in International Trade*, p. 361.

[24] Proceedings of the United Nations Conference on Trade and Development, vol. II, Policy Statements, p. 38.

Under these conditions, it may be difficult to develop and carry out a common program of action by developed countries to remove barriers to imports of manufactures from less developed countries, whether by the preferential route or by the most-favored-nation approach. The United States and other countries wishing to provide enlarged trade opportunities to the less developed countries may therefore be faced with the difficult choice, noted by Harry Johnson,[25] between (1) unilaterally reducing tariffs on items of interest to these countries without insisting on reciprocal concessions by developed countries benefitting under the most-favored-nation principle, or (2) abandoning that principle and granting concessions to the less developed countries only, or to some of them, on a preferential basis compared with the tariff treatment accorded imports from developed countries. The United States would thus have to abandon one of two basic principles—either that of reciprocity or that of nondiscrimination.

Whatever the answer to this last question,[26] it seems likely that, viewed as a whole, the trade policies of the developed countries vis-à-vis the less developed countries will continue to be a mixed bag—equal treatment in some sectors and areas and unequal treatment in others, measures to expand trade along with restraints, declarations of good intentions followed by good, bad, and indifferent results. One of the weaknesses of the selective preferential approach in particular is that it lends itself to illusions, by both preference-giving and preference-receiving countries, as to how much has been accomplished. A great amount of paperwork may yield very little trade.

In the face of this prospective diversity and uncertainty, the question arises whether it would be useful to try to make sure that the policies pursued by the developed countries, whatever their form in each case, were consistent with the results aimed at, which would involve quantifying these aims with regard to the levels and rates of increase contemplated for the trade. It may be recalled that Prebisch broached such an idea in his advance report to the United Nations Conference on Trade and Development in 1964, though it was only briefly considered, with little support, at that meeting; that is, that targets be set for developed countries, collectively and individually, with respect to their imports of manufactures from less developed countries.

Possible disadvantages of such a course are immediately obvious. If the targets were set too low in relation to the potentialities of the trade, they would be more of a hindrance than a help to its development. If they were set too high, achievement of the targets could present serious embarrassment to private enterprise economies.

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[25] "Economic Policies Toward Less Developed Countries," pp. 41 and 239.

[26] An indication that the United States was willing to consider some modification of its position against trade preferences was given in President Johnson's statement at Punta del Este in April 1967 "We are ready to explore with other Industrialized countries—and with our own people—the possibility of temporary preferential tariff advantages for all developing countries in the markets of all the industrialized countries." (See "Department of State Bulletin," May 8, 1967, p. 709.)

The likelihood of a more specific and immediate step, agreed on with other countries, was indicated in the statement issued on May 15, 1967, by the director-general of GATT in summing up the results of the Kennedy Round. Noting that the tariff reductions agreed on in the negotiations would, in general, be phased over a period of years, he said that the participants had, however, "recognized that, for the developing countries, the immediate implementation of such tariff cuts would be of great value in maximizing the benefits to them of these negotiations." He further stated that efforts to achieve the advance application of the cuts to imports from the developing countries would continue, and that a decision on this point was expected to be reached by the time that the agreement embodying the results of the Kennedy Round was ready for signature. GATT press release, May 17, 1967 (GATT 1990).

Such problems may, however, be more theoretical than real in the present instance. Reasons have been given in chapter II for believing that the forces underlying the rapid growth of the trade from the early 1950's to the mid-1960's may become progressively stronger. If that view is correct, it would probably not be too much to suggest that, by 1975, the trade will again have grown fourfold, or more to something like $10 billion (at present prices). Higher figures could be envisaged if the enlargement of market opportunities extended to all of the developed countries, including those that so far have lagged behind.

Fulfillment of targets by the developed countries in these conditions would not be a matter of creating artificial inducements but of removing artificial impediments to the trade. Some developed countries might elect to do so by reducing import barriers over the whole range of products of interest to less developed countries and to do so on a most-favored-nation basis. Some others might choose to proceed much more selectively with respect to both the products and the countries benefiting by the concessions. Whatever the method, a set of agreed targets should help to give a common purpose and meaningful content to their actions.

It would doubtless require a good deal of study and negotiations to obtain agreement on a global target for imports of manufactures from the less developed countries that would be both consistent with their growing foreign exchange needs and acceptable to the developed countries. Arriving at an agreed basis for distributing a global target among individual importing countries could well prove even more difficult.[27] If agreement were impossible on such an allocation, or even on a global target, the effort should at least serve to direct thinking about commercial policies affecting less developed countries toward results as well as methods and to make it more difficult to generate schemes lacking in effective content.

It would no doubt be more difficult—but also more questionable—to divide up a global import target among individual exporting countries. Too much depends on their own economic situations and policies in each case. The Prebisch proposal on preferences calling for gradation of preferential margins among the less developed countries implies that the ability to export manufactures is positively correlated with their stage of economic development. This must be true in some sense, if one thinks of potential exports. But the analysis offered here has also revealed that, typically, the "more advanced" of the less developed countries, including some that have had preferential access to certain developed countries' markets, have not done well as exporters of manufactures to developed countries. If, as this experience suggests, the basic difficulty lies in their own economic situations and policies, it would be of little advantage to them, and an unnecessary limitation on other less developed countries' possibilities, to reserve for them specified shares in a global import target. Even in such cases, however, a more receptive attitude by developed countries toward imports from less developed countries would help to clarify the issues and to encourage policies in the less developed countries conducive to the growth of their exports.

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[27] Prebisch suggested that the total might be divided up (1) according to each importing country's consumption of manufactures or (2) according to its share in total imports of manufactures from all sources. The first criterion, however, would tend to overstate, and the second to understate, import objectives for large countries with diversified economies and less dependent on imports than small countries with more specialized economies. Prebisch concluded that a combination of the two criteria might yield a formula acceptable to all developed countries (p. 38 of vol. II of the conference proceedings).

EAST-WEST TRADE: DILEMMA OR DELUSION?

BY KENNETH R. HANSEN *

"A little of both" would be the way to characterize this uniquely U.S. issue today. On the one hand, there is a virtual standoff in policy attitudes between the administration and the Congress; on the other, there are exaggerated fears of harm and hopes of gain regarding any significant change in U.S. trade policy toward Eastern Europe.

Overshadowing this issue today as it has in the past is a cloud of self-righteous rhetoric, dire prophesy, and congressional timorousness which too often obscures the boundaries of our legitimate national interest and immobilizes U.S. official, business, and cultural forces which might otherwise be exploring the extent of cost and opportunity which this area holds for the United States in the 1970's.

Paradoxically, although we have persisted in following a highly restrictive trade policy with the Communist sphere for over 20 years, we are not at all sure of the costs and benefits of our prolonged period of self-imposed abstinence from this trade.

Ironically, we know we have paid a high price in increased isolation from and friction with our Western Allies by obdurately pursuing an increasingly divergent trade policy with Communist areas.

Tragically, we are only lately coming to realize that we might achieve affirmative and peaceful purposes by seeking and granting trade opportunity rather than yielding this field of traditional American excellence because of apprehension of unequal benefit or one-sided exploitation by Communist trading states.

Providentially, we now appear to stand on the threshold of change in East-West trade policy.

This paper is intended to probe provocatively but constructively this congested artery of U.S. vital interest in the hope that our East-West trade policy paralysis will yield somewhat to the prophylaxis of plain speaking and while it is not always useful to recount the partially remembered past for fear of redundancy, the overhang of some past attitudes and actions so strongly biases future decision in this area that some retrospective analysis seems merited. To a considerable degree, U.S. East-West trade policy and legislation must be freed of past misconceptions and misconceptions of the past before actions in this field may contribute to our national purposes and objectives of the future.

* Mr. Hansen, currently vice president for planning of Syntex Corp., was previously Assistant Director of the Budget, 1961–64, with the Center for International Affairs, Harvard University, and spent many years in East-West trade work in the United States and abroad during the Marshall plan and subsequently during the Korean war period. The views expressed in this paper are the author's only.

I. The Heritage of the Past

PEARL HARBOR, THE COLD WAR, AND M'CARTHY REVISITED

No field of contemporary national policy carries a heavier burden of colorful, controversial, or connotative public utterance tending to coerce attitude and judgment than U.S. East-West trade policy: Scrap iron to Japan, trading with the enemy, strategic commodities, war material, Communist trade, slave labor goods, and Soviet dumping.

From the first overt legislative reference to East-West trade in the act of Congress authorizing the Marshall plan in the 1948–49 period, up to—but not including—the present debate on the East-West Trade Regulations Act of 1966, our official policies, private actions, and public dialogs have been dominated by the emotional reactions and apparent moral connotations of the seemingly perpetual state of East-West tension, hostility, and struggle. As a result there has been little ambiguity of public opinion in the United States during the past 20 years on this issue. And as the cold war has waxed and waned, to be succeeded by Korea, Cuba, and Vietnam in the roster of direct U.S.-Communist confrontations, the public posture of the United States has been steadfastly in opposition to "traffic with the enemy." For most of the period since World War II, therefore, there has existed in the United States a simple two-valued orientation: the Communist bloc was hostile to the West; therefore, trade with the East was at the least unwise—and at worst, treasonable or suicidal.

And, for much of the period, the general thrust of this attitude was justified. Although in many instances public attitudes were exploited and public and press sensationalism and congressional demagoguery were the overreactive concomitants to the more selective and restrained executive actions, diplomatic endeavors, and congressional mandates governing our relations with other countries, it was a fact that Soviet bloc trade policy in the post-World War II period constituted a significant threat to the security of the Atlantic community and other free world countries.

THE 1946–49 PERIOD: THE COLD WAR FREEZE

East-West trade controls, therefore, originated as an aspect of the cold war and have retained for the United States the form and spirit engendered by those times.

A vignette of that period shows the vengeful and illogical industrial dismantling of East Germany and the Soviet zone of Austria by the Soviet armies, partial looting along with poltical subjugation of parts of Eastern Europe, and the emergence of Communist attempts to penetrate the war-weakened West-European political and economic structures. This dynamic period saw the hardening of East-West distrust and the discord of wartime allied interests. East to West and then West to East, trade and economic intercourse slowly rebuilding in the wake of war was disrupted and most of that interrupted by the war was not actively resumed. In addition, extensive and worldwide networks of Soviet agents, black-marketeers, and international adventurers engaged in all manner of illicit dealings in so-called strategic trade items from West to East.

Systematic attempts were made and often thwarted—to ship strategic and short supply items from Western Europe to the Soviet and satellite economies. As a consequence, the press was liberally festooned with disclosures of allegedly enormous illegal trade in precision instruments, ball bearings, critical and precious metals, prototype and production machine tools, and other items deemed strategic in nature.

In countermeasure, West-East trade control programs were formulated—initially by individual countries, and later by the soon-to-be-designated NATO countries in the Coordinating Committee (COCOM). First—to place embargoes and quantitative controls on items deemed strategic, and then to strengthen defense against illicit trade in the form of transshipping, mislabeling, smuggling, false invoicing, and other devices.

As these Western trade control programs evolved, they became increasingly militant and far reaching. The proposal and adoption of restrictive measures were virtually unanimous among the Western allies and Japan. It was in the spirit of the times—the NATO buildup, the Greek Communist insurgency, the Berlin blockade, the Italian and French Communist election crises. East-West restrictive trade policy developed as a measure of resistance to Stalinist aggression and the strategic control program evolved to become an active element of the containment strategy.

In these circumstances, the definition of strategic materials did not constitute a difficult task; there was a presumption that most industrial items for which there was demonstrated demand by the Soviets were ipso facto of some strategic importance. Similarly, any large quantities of metals, minerals, or scarce commodities were considered to be of value to a war machine poised for potential aggression. And finally, even so-called peaceful goods such as textiles or consumer goods or agricultural products which might conceivably free up manpower for the military, or permit reallocation of key resources elsewhere were popularly viewed as contributing to the warmaking capability of a potential enemy—the so-called fungibility principle.

It is of major relevance that this combined selective and complete embargo policy was compatible with other strategic circumstances of the times as well: East-West trade was being conscientiously throttled by a Stalinist drive for European Communist bloc political and economic hegemony, and Western Europe was going through a tremendous effort at economic reconstruction which served to place a comparable scarcity value on the so-called primary strategic industrial goods.

Thus, born of necessity and consonant with political policies and economic circumstances, controls on trade with Eastern Europe and Communist China were both a talisman and an instrument of Western unity in the face of Communist hostility and aggression.

THE BIRTH OF CONGRESSIONAL "OVERKILL"

There emerged in this initial period several other concepts, however, which achieved unwarranted currency in thought and action in the United States, and subsequently contributed to friction and disunity among the Western countries. One of these was the rather crude device embodied in U.S. legislation of indicating to Marshall plan and other U.S.-aid-recipient countries that if they didn't refrain from trade in "strategic" materials with the Sino-Soviet bloc, all U.S. military and economic assistance would be cut off to them. The list of strategic items, moreover, was to be determined arbitrarily by the United States, and (until executive branch protestations prevailed) action to cut off aid was intended by the congressional authors and supporters of the legislation to be automatic and irrevocable. After bitter battles over the so-called Kem amendment to the pending foreign aid legislation—there was a compromise whereby action to discontinue aid must be taken in the case of shipment of designated atomic energy and military items (arms, ammunition, and implements of war)—but aid could be reinstated if the President deemed that the offending nation would thereafter comply with the embargo. Or if the items were of a "primary strategic nature" the President could continue aid if he determined that the discontinuance of aid "would clearly be detrimental to the security of the United States."[1] These provisions remain in controlling legislation up to the present day—but attempts to remove or diminish Presidential discretion have been numerous in the troubled years of this program up to the present.

In many sectors of U.S. public and congressional opinion, the Western European countries trading modestly in this period with the European bloc and Communist China, were variously held to be profiteers, ingrates, or foolishly insensitive to the threats of the worldwide Communist conspiracy. Particular criticism was leveled against the British—heightened because of their additional involvemnet in East-West trade through their extensive worldwide shipping—and against the West Germans, considered to be hedging their bets against possible Communist takeover of Central Europe. Considerable apprehension was volubly expressed concerning the alleged hunger of the Japanese for a trade rapprochement with the vast potential market of Communist China. And as major potential East-West trade exchanges of a compensation transaction and barter nature were bandied about in the international press—considerable anxiety was felt regarding possible overdependency of this or that Western country on the Soviet bloc as a source of supply or as a market. There was, in short, an atmosphere of suspicion on the East-West trade issue between the United States and the European countries * * * and this was conclusively embodied in U.S. legislation from the very outset.

A third aspect of congressional oversight—which happily has not persisted to the present day—related to the administrators of the trade control programs themselves. At a very early period, the economic warriers of the United States were sometimes extolled as sterling characters who ingeniously thwarted the devious designs of the Soviets and exposed their worldwide machinations. At a later period—especially during the reign of terror of Senator Joseph McCarthy—many of these same people became suspect security threats or alleged fellow travelers or Communist dupes if they (or the administration) showed any possible weakness in fervor and effectiveness, or took a policy stand on East-West trade other than of uncompromising opposition. These circumstances doubtlessly had some influence on the persistent rigidity of policies in this field up to the present time.

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[1] Defense Assistance Control Act 1951—title I (Battle Act).

THE 1950–57 PERIOD: THE GROWING DIFFERENTIAL IN CONTROLS

This period—ushered in by the Korean conflict—initially saw a high level of control, and a reasonably high degree of agreement between the allies regarding the necessity and value of trade controls.

It was during these years, too, that controls over free world shipping—especially that engaged in the China trade—became a major element in U.S. international trade relations. "Flag of convenience," neutral country and long-term allied ship charter to Sovbloc nations and Communist China became the target of U.S. diplomatic pressure. During the Korean conflict these problems became especially acute and, in general, U.S. efforts were successful in stemming the involvement of free country shipping in intrabloc trade. Little impact, however, was made on western shipping engaged in carriage of so-called "peaceful" goods to Communist China and this led to unilateral U.S. measures such as bunkering controls, denial of use of U.S. ports and blacklisting of vessel fleets of a common owner from participation in U.S. Government financed cargoes—especially foreign aid.

These latter types of restrictive measures were short lived and largely related to the Korean struggle. In most respects they were psychological in their intent and impact; they had relatively little effect on intrabloc goods movements. Nevertheless, they were considered an appropriate adjunct to the military measures being undertaken in Korea in response to Communist aggression (a similar situation to that of North Vietnam today). It is noteworthy, however, that even in the wartime circumstances of those days there was western unanimity only as it related to denying Communist China strategic materials and war materials on a longer list than that multilaterally agreed for denial to the Sovbloc in Europe. No other major trading nations have followed the U.S. policy of virtually complete trade and financial embargo of Communist China which still exists in full force today because of the persistence of Chinese hostility, vituperation and aggression.

As noted earlier, this period was further marked by the traumatic effect of McCarthyism on U.S. foreign affairs—initially related to China trade and later more broadly addressed to terrorizing the U.S. political countryside. This was widely held by the Europeans to have contributed to a "freezing" of the U.S. position on East-West trade controls, and immediately following the Korean war there was soon evidence of a deep and growing official difference of outlook between the United States and the Western European countries and Japan regarding the necessity, utility or relative effectiveness of controls on trade with the Eastern European countries and the U.S.S.R. The fact that this was coupled at the time with Soviet blandishments of large purchase orders and seemingly tempting markets made for even greater strain. And in 1953–54 the Europeans—led by the United Kingdom and France—literally forced a severe retrenchment in the scope and severity of agreed multilateral controls on trade with the European Soviet bloc. In effect, they challenged the purpose and scope of the embargoes and asserted the potential positive value of expanded trade in nonstrategic goods. And this "trade policy gap" which developed between the United States and Western Europe was soon broadened into a "strategic controls gap" since formal U.S. unilateral controls still extended far beyond the diminishing multilateral level—

heralding the polarity of other East-West political objectives and approaches yet to come. In this connection it is important to note that, whereas the action taken was to decontrol various so-called strategic items, the assertion by the NATO countries and Japan [2] was that it was important to liberalize trade as an instrument of positive policy in dealing with the Soviet bloc in the post-Stalin period.

1957–66: THE GROWING DIFFERENTIAL IN CONCEPT AND PRACTICE

Strategic Trade

The trade control gap between the United States and CoCom countries became wider throughout this long period. The differential level of multilateral controls regarding trade with Communist China and North Korea was rescinded in the multilateral strategic control program in July of 1957 although the United States, as noted, still maintains complete embargo. In 1958 another substantial revision (freeing-up) of the CoCom embargo list took place, without any substantial impact on U.S. unilateral policy. And while there were several subsequent additions and redefinitions of the lists, in each instance these actions have represented a tacit recognition by the United States that further agreement to a strict control level by the CoCom countries was not possible and that the shared scope of strategic controls would soon not extend beyond the obvious war materials and some of the new and more exotic industrial and scientific hardware and technology.

Such has indeed been the case—there has been constant net attrition and "updating" of the strategic lists. The multilateral definition of strategic has shrunk and become more concentrated on a concept of assuring a lag in technological development in fields related to modern warfare, in space missile and nuclear applications especially. Concepts of impairment of economic growth of the U.S.S.R. and the Eastern European countries by denial of general industrial exports has long since been abandoned. And denial of trade in hopes to cause economic disruption, greater cost of production, or inconvenient reallocation of resources in the Communist economies are no longer criteria which govern the multilateral program.

On this basis, much of the present-day multilateral activity revolves around discussion and consultation regarding individual strategic trade problems. Orders of large magnitude by the U.S.S.R. or the other eastern countries for items of generally known end uses, such as the FIAT auto plant, large diameter oil pipelines, transportation equipment, special machine tools, et cetera are debated and dealt with on a case-by-case basis.

Meanwhile, the trade the West Europeans and Japanese carry on with the Communist areas has become wider in scope and greater in magnitude. And the marginally greater permissiveness of recent changes in U.S. export policy has not altered this disparate trend.

General Trade

This brings us to the fundamental East-West trade phenomenon of the past decade. Free world exports to Eastern Europe including the U.S.S.R. have risen steadily from a low point of $1.1 billion in

[2] The CoCom countries.

1950 to $4.8 billion in 1963, to about $6.2 billion in 1965. Imports have roughly kept pace: with $1.2 billion in 1950, $4.8 billion in 1963 and $6.3 billion in 1965. Of this, our CoCom partners have generally accounted for more than half.

U.S. trade, on the other hand has been relatively stagnant over the same period at a level of between $130–180 million of exports and roughly $120–130 million of imports. (In 1964 we sold $259 million worth of surplus agricultural commodities to push our 1-year total to $340 million of exports versus $99 million of imports, but this has not been repeated.)

The overall East-West trade development picture, while apparently dynamic, has not been a runaway situation by any means * * * in the 5 year period 1961–65, total free world trade with Eastern Europe increased by 49 percent, while free world trade with all countries increased by about 40 percent. And today, East-West trade only accounts for about 3 to 4 percent of the total trade of Western countries. Paradoxically, in spite of early fears of possible dependency of Western countries on the bloc, trade with the West now plays a relatively more important role in the economies of various of the Communist countries.

The U.S. share of this large and growing market, however, is barely 3 percent—extremely narrow in products exchanged—and declining in relative terms.

Obviously, this disparity of general trade has not been largely or even significantly the direct result of our differential strategic materials control policy. It is partly the result of many circumstances encountered naturally as obstacles to trade between the market economy of the United States and the state trading economies of Eastern Europe. It is the result of a lack of credit, financial and other aid to bring about enlarged exchange of goods and services. It is partly a consequence of the lack of mechanisms of advertising and supply and distribution and cross-servicing. There are many technical and objective barriers to expanded United States-Soviet bloc trade. But principally the relatively small volume of trade has been the result of the negative thrust of U.S. national policies regarding East-West trade—amply reinforced or occasioned by public and congressional opinion vociferously against trading with the Communist areas of the world.

The only significant breaks in these policies have been the hard-fought exceptions won by successive administrations from a grudging Congress: (*i*) to permit more liberal trade and credit support for Yugoslavia in 1949; (*ii*) Public Law 480 credits to Poland in 1957 and subsequent years; and (*iii*) the precarious year-to-year and on-and-off extension of most-favored-nation (MFN) treatment to be accorded imports from Yugoslavia (1951) and Poland (1960). The other steps in this direction have largely been by Executive (Presidential) initiative in ways not requiring congressional ratification—but also virtually without congresssional encouragement.

In the past four years these actions have been numerous—Johnson Act credits, extension of Export-Import Bank guarantees to several Eastern European countries, liberalization of trade with Rumania, and most recently the decontrol of a number of items from the general license list of the Department of Commerce.

The current culmination of these actions, of course, is the proposed East-West Trade Relations Act of 1966 now pending before the Congress.

SOME CONCLUSIONS

Before going into the new issues and future prospects of policy in this field, it is useful to evaluate further some of these past developments. While the record of the past is incomplete and far from clear—I believe it is possible to make some judgments which are relevant for future policy and action in this important and controversial field.

The hard facts appear to be these:

1. The initiation and active development of East-West trade controls in the Stalinist and Korean periods were appropriate to the circumstances of the cold war, complementary to our foreign policies, and contributory to our security objectives.
2. Since this was a critical period in the relative growth of economic and military potential of both areas—Western Europe and the Soviet bloc—and Western Europe had the United States to rely on as a source of capital, advanced technology, and industrial plant and markets, there is little question that, with its smaller and less advanced industrial base, the European Soviet bloc would have been greatly helped to have had greater or free access to Western supplies and markets.
3. In some respects, however, this was denied as much by the Soviet drive for bloc economic hegemony and the other natural obstacles to expanded trade inherent in the state trading system—as well as the self-imposed political isolation of the bloc—as it was by the multilateral trade control program.
4. Thus, both the strategic controls program and the mutual discouragement of trade probably worked to the relative economic-military advantage of the West, although this period was used behind the Iron Curtain for pursuing political and economic consolidation of the Eastern European countries and the isolation may have been a mixed blessing for the West in this respect.
5. The wide gap that has developed between the United States and the other Cocom countries from the period of the mid-1950's to today in the area of strategic trade controls has been vexatious and has exascerbated relationships among the NATO allies from time to time. These differences have not been judged to be a threat to our security, however, even though the availability of machinery and equipment from these countries offsets substantially the more extensive denial of these items by the United States.
6. In any event the additional restrictions in so-called strategic trade with the U.S.S.R. and Eastern Europe which we specifically impose today in isolation from our friends and allies must be judged to have long since ceased to have material significance to the military and economic potential of the European Soviet bloc.

The utility of the differential in the strategic trade controls can be challenged on two grounds: (*i*) Whether in fact, unless available solely from the United States the Soviet bloc cannot readily obtain U.S. proscribed exports from elsewhere in the free world, and (*ii*) whether the Soviets, generally self-reliant as they are, are truly affected by the denial in any case.

The justification most often advanced is that were it not for this differential, the West Europeans would relax the trade even further (they ship very few of the contested items in any event)—and since these are largely items of advanced technology, the United States has some other means to limit their sale to the East through end-use control over components and technical data control and private industrial cooperation.

The burden of these arguments are not, and need not be, to pare our lists of strategic items to the Cocom level. It is far more important merely to realize that maintaining this differential does not necessarily serve our national interest in any truly effective manner—and that we seriously err if we insist that the disagreement of others is not genuine—or is occasioned by the alleged opportunity to profit at the expense of our higher standards of trade morality and greater sensibility to security interests.

The discussions, analyses and attempts at reconciling views about strategic list items have gone on with our European allies and Japan too long and with too great sincerity to merit that suspicion and disdain. We shall probably have to just accept the fact that there is disagreement on this range of items. Similarly, we shall have to accept the fact that as the economies and technological prowess of the U.S.S.R. and the other East European countries grow—along with their military capabilities—it will be harder still to identify items which would be sought by them in overt trade which will have apparent direct relevancy to Soviet bloc military potential. Our NATO allies and Japan are not disregarding strategic considerations in their trade dealings. They do, however, take the view that selective denial is in any case extremely uncertain as to effectiveness and almost hopeless to maintain indefinitely in the face of technological progress the world over. In effect, they question—as we must—whether these measures are not so extremely marginal in their possible present and future effect on the relative strengths of East and West as to be almost inconsequential.

Finally, we should also realize that as we appear to have gained little in a substantive sense by our insistent and isolated posture, we similarly have often made it more difficult to obtain the understanding, agreement and cooperation of our friends and allies on other policies and programs when our apparent and prolonged intransigence in this field is of related consequence.

7. This brings us to the point of real disparity and difference which has existed between the United States and our free world friends. That is, the basic difference in general trade policy vis-a-vis the European Soviet bloc.

This difference has been based largely upon U.S. political and foreign policy and public opinion considerations not shared in extent or degree by most other free world countries. It is exemplified and underscored by the fact that in the 1961–65 period alone, there has been an exchange of goods and services between the free world and the Soviet bloc of an aggregate of about $51 billion—$25.4 billion exports and $26.2 billion imports. Of this, somewhat over half was CoCom country trade. And for the same period, total United States-Communist bloc trade was $1.4 billion ($906 million exports; $496 million imports).

This growing trade gap, rather than the strategic controls disparity, is the key policy consideration today.

8. Admittedly, this nonstrategic trade is limited by factors other than trade policy. Foreign exchange shortages, lack of established channels of trade, inadequate or inappropriate distribution methods, packaging, servicing, high duties, and other circumstances inhibit the Communist trading capabilities with the United States. Lack of marketing contacts, credit arrangements, uncertainty as to business arrangements, fear for adverse public relations and other obstacles occur on the side of U.S. business. But generally, the public U.S. posture has been predominantly in opposition to expanded trade for fear of giving unequal benefits through such trade to the communist areas.

9. Positive actions to change these circumstances and attitudes have been generally lacking on both sides—the United States and Eastern Europe—and steps have only recently been initiated by either side with any credibility that the actions might literally "mean business."

As noted earlier, however, most of these actions to encourage U.S. nonstrategic trade with Communist areas have been undertaken on the U.S. side by Presidential initiative—and largely in the absence of any congressional mandate. Almost all existing legislation in the field of East-West trade or pertaining thereto is based upon the cold war ethic: the Battle Act, the Export Control Act, the Foreign Assistance Act—and a motley crew of riders to annual appropriation bills and food-for-peace program.

10. The latest action of the administration—the proposed East-West Trade Relations Act of 1966—is an effort to obtain congressional sanction for a different policy approach to East-West trade, and to change the heretofore predominant sentiment in this area from one of moral outrage to at least one of acquiescence.

11. Given the long, controversial, and single-valued history of U.S. East-West trade policy in the past, and current resentment of Eastern Europe's trade with Cuba and North Vietnam, this will be a difficult task. Here again, however, the test of any ancillary policy is the requirement that it further the overall objectives and strategies being pursued in the national interest; East-West trade relations are an integral part of our foreign policy. And the manner in which East-West trade relations are managed in the decades ahead clearly must be more affirmative and daring than in the past if a positive contribution is to be sought.

II. The Issues of the Future

The initial debate regarding the specific aspects of the administration's proposed East-West Trade Relations Act of 1966 is already a matter of congressional record. Its main provisions are clear in concept and intent:

To use peaceful trade as a means of advancing the long-range interests of the United States.

To authorize commercial agreements with a Communist country when the President determines—

It will be in national interest.

It will result in equivalent benefit to the United States.

To authorize the President to confer most-favored-nation (MFN) treatment for Communist countries' imports as part of the commercial agreements—subject to periodic renewal—and subject to withdrawal if no longer warranted.

As such, this proposal symbolizes a proposed new formal dimension of East-West relations: an opportunity approach to trade and political relationships with individual East European countries; a recognition that possibilities for expanded East European trade with the United States will require special commercial arrangements; an acknowledgement that access to our market must not be discriminatory if trade is to flourish; and finally, while the proposed bill signifies no change in the other safeguarding legislation which up to now tended to govern both the letter and spirit of U.S. policy in East-West trade, it is clear that this legislation calls for a new direction in trade relations with Eastern Europe and the U.S.S.R.

There are, of course, certain issues related to the specifics of this legislative proposal, but it is not necessary to go into these here. They will be subject to detailed scrutiny in the follow-on hearings. Rather it is important to go behind the proposed change in overall policy and to consider the underlying questions and issues which arise regarding a possible expansion of peaceful U.S. trade with Eastern Europe and to consider finally how this may relate to other world problems and the U.S. role in dealing with them.

INCREASED EAST-WEST TRADE: COST/BENEFIT

Given the security context in which this question is inevitably viewed, the first question is: Will it be possible to bring about an expansion of peaceful trade without reducing U.S. strategic trade controls?

Earlier the point was made that these controls are not the real barrier to expanded trade. In fact, very few of these solely U.S. proscribed items are proposed for export, and thus, few licenses are denied. More practically, however, the controls do not cover such a vast range of items so as to seriously inhibit a wide choice of goods from this country if there indeed were a determination to expand peaceful trade.

There are other ramifications to this question, however; these have to do with the attitudes of the Soviets and the Eastern European countries themselves.

The first is whether they would choose to make an issue of the more extensive U.S. denial program in the negotiations regarding commercial agreements. Past exchanges with the East Europeans and the U.S.S.R. have indicated that these measures constituted somewhat of a "bone in the throat" in relations with the United States. But, by the same token, in the trade arrangements with other Western countries, the strategic control programs have not been at issue to the extent of seriously interfering with the growth of peaceful trade.

Second is whether the Eastern countries will believe in United States sincerity and willingness to expand peaceful trade if there is apparent continued U.S. militancy in maintaining a much higher level of strategic controls and continual striving to have other free world countries do so.

Fundamentally, it would appear that maintenance of this differential will not be a major obstacle to expanded East-West trade unless either side chooses to make it so.

The major question then asked regarding a change in U.S. trade policy vis-a-vis Eastern Europe, of course, is whether increased trade with the United States will tend to strengthen the military-economic system in the Eastern European countries.

The answer is "yes." And the answer will always be "yes" unless someone has invented a way to bring about an exchange of goods and services and information where the benefits bestowed will accrue solely to one party to the exchange—or, where the exchange is so particularized or minuscule as to be devoid of any meaningful economic impact.

Obviously, trade must be mutually beneficial or it will not take place between two parties who have the power of consent or denial. And as long as a significant portion of the total resources of the Eastern European countries are allocated to armaments and armed forces, anything which materially affects the output and use of those resources will strengthen that area in some degree as well.

The critical question then is: Will the Eastern Europeans and the U.S.S.R. obtain gains or benefits from an expansion of nonstrategic trade with the United States which outweigh the possible benefits sought to be obtained by the United States? Or the corollary: does the United States now stand to benefit more by a continued denial and discouragement of trade in nonstrategic items, than by a policy of developing and encouraging such trade with Eastern Europe?

A changed official, public, and congressional attitude on these questions constitutes the major hurdle which the new U.S. initiative in East-West trade policy must clear. And if the case is to be made, it will require a steadfast belief that the political gains from such a policy will be more real and meaningful than the apparent tangible contribution which might be made through increased trade to the growth and power of Communist Europe. In effect, increased political opportunity and the possibility of accelerating the processes of peaceful change in the Communist areas is considered the crux of the matter, and this is looked to offset the small potential benefits which the Communist areas might derive from encouragement of higher levels of trade.

For one thing, it must be made clear that the genesis of this policy change is to be found in the changing objectives, strategies, and intent of overall U.S. East-West policies; and, for another, the hoped-for outcome of a change in East-West trade policy is not only a new and larger pattern of two-way trade, but a new and more hopeful pattern of political and economic relationships between the United States and the nations of Eastern Europe and the U.S.S.R. This is the basic proposition underlying the new approach; a change in U.S. East-West trade policy is being pursued primarily as an avenue to peace—rather than as an adjunct to defense or in hopes of commercial gain.

It is necessary, I feel, to pursue this question more fully at this point—even before considering whether, in fact, U.S.-Eastern Europe nonstrategic trade can be appreciably increased. The reason for this is simple: it will indeed be difficult to increase such trade—and the perceived political benefits must be very apparent before we will be prepared to undertake the kind of efforts and make the kinds of concessions necessary to bring about meaningful increases in peaceful trade with the Communist countries.

WIN-LOSE: OR, WIN-WIN?

Heretofore, we have basically applied a "win-lose" calibration to our East-West trade policy and many of our relations with the Soviet bloc. By this arithmetic, since the Soviet bloc was a somewhat industrially retarded and semibackward adversary in the economic-military competition between our two worlds, trade which would somewhat strengthen the growth and increase the national income of the Communist countries was to be generally avoided even though this similarly denied the west the additional outlets and sources of supply for burgeoning production and demand. As noted, this logic fitted consistently with past times and events, both practically and politically.

As the practical aspects of this have changed—and trade denial has become of marginal importance as a defensive measure—greater nonstrategic trade has developed and the political climate has been changing as well. And if the past United States aloofness or hostility to nonstrategic trade has been judged to be largely ineffectual in the strategic sense, what, then, must be asked is the balance of political benefit which increased trade might bring?

It is not difficult to judge that, considered alone, a greater exchange of goods between the United States and Eastern Europe and the U.S.S.R. would bring apparent economic benefit to the eastern countries; there is great diversity, economy and technological content to the manufactures and industrial and consumer goods we provide from our large and efficient production base. And while these items in greater quantity would probably not make a major impact on economic growth and development of the Eastern European economies—expanded trade per se would be of considerable benefit to the Communist areas. In fact, of course, this is already true with regard to existing nonstrategic trade by Western Europe and other free world countries today. The economic quid pro quo for us would be of more general and pervasive nature—largely associated with cost factors related to alternative sources of supply, economies of scale and greater competitiveness of exports, some possible contribution to the balance-of-payments picture, and the diffuse economic benefits of a slightly higher level of economic activity engendered by foreign trade—all very small when considered in comparison with our total trade picture and growth of GNP.

One might judge from this that if some increase in general world trade could take place elsewhere without major political implications, the United States should be highly indifferent to an increase of trade with the Communist areas—and could as well choose to concentrate its efforts elsewhere. In other words, by the "win-lose" test, there is little point in adopting an affirmative policy toward nonstrategic trade with the Communist areas when we might address the same efforts to improving the level of trade with other parts of the free world. Besides, the West Europeans and Japan as well as other free world countries are doing very nicely, thank you, in reciprocal trade exchanges with the Communist world, and are not having the trauma of internal and external political dissent which we generate on this issue.

Obviously, the calculus of judgment is for us to become convinced that the previous dismal arithmetic of "win-lose"—with U.S. security presumably the loser—can be transformed into "win-win" where there is at least equivalent benefit, and that this benefit can be reciprocal politically as well as economically.

The administration's thesis behind advocacy of a change in U.S. East-West trade policy is essentially that an increase in nonstrategic trade and attendant commercial, diplomatic and other contacts will contribute to the pursuit of peace between otherwise hostile camps. By this thinking, it is asserted that either increased or diminished trade in nonstrategic items can today hardly prove critical or even very important in East-West economic or military relationships; whereas it is possible that increased trade and contacts may serve as a creditable and effective accompaniment to sincere and genuine efforts to bridge differences and resolve conflicts and create a new avenue for seeking East-West understanding.

The implication of this thesis, it must be added, is also that the increase of U.S.-Eastern European trade should not be passive—but should be pressed as a positive element and "instrument" of our foreign policy.

This total concept is now embodied in the administration's proposal now pending before the Congress: the draft statement of purposes reads "* * * to use peaceful trade and related contacts with Communist countries * * * to promote constructive relations * * * to increase peaceful trade and related contacts * * * to expand markets * * * in those countries by creating similar opportunities * * * to compete in U.S. markets on a nondiscriminatory basis." [3]

The President has clearly indicated that a change in East-West trade policy is a corollary to his other efforts toward "building bridges" to and with the Communist areas.

There is little question that vast changes have occurred and are now in progress in the Communist world that are favorable to our interest—and that we should seek to reinforce and promote the processes of change. Most of these changes are well known and documented: the shattered Moscow-Peking axis, the loosening hold of Moscow over some of the East European countries, the increasing independent initiatives of these countries in their relations with each other and with the West. There has been an opening up within the Communist societies as well—less obvious uses of police power, growing contacts with Western people, greater travel possibilities, and the much more extensive preoccupation with economic reforms, criticism of Communist systems and values and inefficiencies, and somewhat of a retreat from centralized controls and rigid ideological disciplines.

It is this accelerated process of change which provides hope that enhanced economic intercourse and personal contacts and more extensive diplomatic probing for common interests might reduce the chances of hostile actions and confrontations between the United States and the European Communist sphere.

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[3] Proposed East-West Relations Act of 1966, sec. 2, statement of purposes.

INCREASED TRADE: HOW?

This brings us to the other major aspect of this policy change: what are the prospects for an increase of trade?

There are many difficult aspects to the engineering of a greater flow of trade between the United States and the Eastern European countries. The most fundamental involve:

1. Providing greater access to the U.S. market, principally by modification of U.S. tariff restrictions on imports (most-favored-nation treatment already being sought in pending legislation), improved and more extensive consular relationships (in process), and commercial agreements facilitating elements of contractual relationships (authority being sought).
2. Encouragement and support for U.S. efforts to penetrate and develop the Eastern European markets, including:

   Modification of export controls (some action recently taken);

   Support of U.S. trade missions and trade exhibits (could be substantially stepped up);

   Extension of credit facilities and guarantees (partially undertaken on normal commercial terms);

   Development of better means for personal and business contacts and relationships.

Most testimony by trade experts indicates that, even with active promotional efforts and vigorous attempts to remove various barriers to greater two-way trade, the best that can be foreseen is an annual level of trade of perhaps a modest $500 million within several years. This estimate is based upon general premises, however, which need not hold indefinitely for the future. First, that the extension of commercial credit will be very restricted; second, that the exchange will continue to be in strict balance; and finally, that shortage of foreign exchange holdings and lack of capabilities for earning more by the Eastern European countries will prove a severely limiting factor to an expansion of trade with the United States.

If, indeed, an expansion of direct United States-Eastern European trade is deemed beneficial by both parties and reasonably facilitated—there is no reason to believe that trade preference for U.S. products might not arise in Eastern European nations as it has with many other countries—in spite of other free world competition. Similarly, there is no compelling reason why the rigid pattern of rigorously balanced exchanges between the Communist nations and Western European areas need be maintained forever. In fact, an eventual three-way trade and payments development would appear a more logical pattern than the present—with West Europe importing relatively more from the East, the eastern countries buying relatively more from the United States and the usual increases in United States demand for West European exports completing the circle. Obviously, this change would take some doing—but it would be consistent with the avowed purpose of bringing the eastern countries more fully and freely into the world trading community. In this case, one could wish that the essence of the political argument supporting a change in policy would be more consistent with regard to the expected or desired economic outcome of such a policy. Many of the exponents of the proposed change in United

States east-west policy appear to be somewhat avoiding the implications of success—at least at the economic level. One must, it seems to me, set the economic sights as high as the political—and an early target of $1 billion annual trade would be more in keeping with a healthy level of economic interchange between these two vast marketing areas.

In other words, we should not expect very substantial and affirmative results from policies which are carried out haltingly and almost grudgingly. If the gains are indeed worth the risks, we should not run the added risk of suffering inadequate results because of halfhearted effort.

It is in this area of expectation and disappointment, too, that another feature of the political argument must be touched upon.

TRADE AS AN "INSTRUMENT OF POLICY"

Already we have found creeping into the debate on future East-West trade policy, a manipulative if not an aggressive overtone which may ill-serve the formulation of policy in this field. In contrast to the "little old ladies in tennis shoes" attitudes of fear and moral outrage which often dominated earlier discussion, we hear increasingly the view advanced that peaceful trade is the next best thing to James Bond for the political subversion of the Soviet bloc and the overthrow of worldwide communism. According to this view, for example, greater U.S. trade and commercial intercourse with Eastern European countries would not only permit the economic benefits of greater access to their markets and greater export earnings for the United States but the new and prolific East-West contacts engendered by this will vigorously fan the latent fires of European nationalism, cause irresistible yearnings for capitalistic affluence, quicken the urges for political freedom by the broad masses behind the Iron Curtain, and subvert and transform the Communist system in short order.

Now, this admitted burlesque of an often sincerely expressed rationale of expanded East-West economic interchange is not to deny or decry some of the expectations of what might ensue from a change of policy—marginal, indirect or remote as these developments may be. The point to be exposed is that—if a straight "win-lose" political calibration is also applied to a change in a trade policy—not only may there be extreme disappointment and disillusionment, but increased East-West trade may be discredited for those purposes it can legitimately serve—whereas the other results it may only incidentally or indirectly promise.

The principal factor to be judged is whether increased East-West trade will contribute to peace—to its development, and to its maintenance.

As an aggressive "instrument of political policy," trade is not a very sharp or lethal weapon. Two-way trade is a channel or conduit of goods, services, knowledge, and personal and official contacts. Expanded trade will serve to increase the plurality of international exchanges—and it is an area where there can be struck a balance of perceived benefit to both parties. In international negotiation it has already been demonstrated that principles of reciprocity are increasingly being perceived as problems of attempting to match demands and concessions on otherwise unrelated matters in order to strike bargains. And it is in this role—as a springboard of discussion and a medium of exchange—that expanded trade and personal and commercial contacts may contribute to a more hopeful East-West dialog.

If this is so, expanded trade may indeed "fan the winds of change," but we would be foolish to expect or demand that it also fan the winds of insurrection, subversion or disaffection. Our national interest to be served by a modification of our trade policies as addressed to the European Communist nations will be to reinforce and promote processes of change which will make them less a threat to peace and their regimes less enemies of individual freedom.

Changes are indeed taking place in these areas—major political, social and economic change—even as they are in free world societies. And trade can be a major and positive force in both spheres and between both spheres to increase the possibility of developing cooperative efforts and peaceful pursuits. But it is not a panacea—just as it is not a dread one-sided threat to our security.

THE BROADER INTERESTS

Much of the preceding discussion has been somewhat artificially limited to consideration of U.S. trade with the Eastern European countries and the U.S.S.R. It is clear that an expansion of peaceful trade between these two areas will not take place in a vacuum—without regard to the policies and actions of other nations and certainly not without regard to their political, economic and competitive interests.

In fact, it is in this international and multilateral area—perhaps more than the bilateral—that more rapid progress may be made. As East-West trade becomes larger and progresses even further from the primitive bilateral stage—there will be need to develop better systems of reciprocal dealings and clearings and adjustments. The state trading nature of the Communist countries—which renders some of the traditional bargaining and safeguarding elements of reciprocity in free world trade inappropriate, unenforceable, or unreliable—will have to be changed to accommodate the legitimate needs of western commercial practice. An entire range of new undertakings will have to be worked out: arbitration procedures, protection of patents and other property rights, settlement of financial claims, agreed principles and objective criteria to govern and judge potential market disruption and dumping. In the final analysis, the Communist nations will have to seek ways to remove commercial obstacles arising from differences in their economic systems just as Western countries have adjusted to one another.

With proper authority and flexibility granted the President, the United States will be able to become a major factor in bringing this about—not alone, but in concert again with its other trading partners. As the United States and the Common Market countries and the UNCTAD countries have found it necessary and advantageous to be members of international financial and trade organizations and adherents to international agreements such as GATT—so, in fact will the Eastern Europe countries, if they seek meaningful increases in peaceful trade. Some sort of multilateral machinery—whether in the form of altered or broadened existing organizations—or newly created ones, will be needed to overcome the limiting features of present day East-West bilateral trade relations. And while the United States has not heretofore expressed interest in or exerted leadership to bring such developments about, under a changed East-West trade policy this will be one of the logical next steps to be taken.

It is noteworthy that this change in U.S. policy is proposed to be undertaken in the dawn of a new trade era in the free world—shortly following the formulation of the Common Market and the major and comprehensive trade overhauls of the Kennedy Round and coincident with greater recognition of the need to concentrate on the other enormous trade gap—that between the developed and less-developed countries. Perhaps this new era may see East-West trade as a major vehicle for political change as well.

In final judgment, therefore, East-West trade need be neither a dilemma nor a delusion for the United States, but we must be more forthright and mature in our judgments regarding this field. Too much is at stake to take sole counsel of our fears as we have in the past; too little is to be gained if we do not act in confidence that genuine efforts toward peaceful relations will be reciprocated.

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