A New Trend in International Trade Policy

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International Trade Policy at the Crossroad

The thesis of this paper is that an important period, perhaps an era, in international trade policy has come to an end. But a new one has not yet started, and so a temporal vacuum has thus developed, where international trade relations are drifting dangerously without a clear course and where the instruments are lacking with which to maintain any course which would be consistent with the changed demands of economic realities of today. This is to say that the world trade relations are currently guided by policies which have, to a great extent, outlived their usefulness and that the new policies which are needed are yet to be formulated and implemented. This vacuum is a natural spawning ground for unscrupulous forces which can distort and debase transboundary business relations. It is, therefore, incumbent upon the business community as a whole, but especially upon the foreign trade circles, to lucidify the issues and to generate the action which is needed to redirect and redesign the basic policies governing international trade relations; and, even more importantly, to generate the force that would keep the pace and provide the forward motion that is needed if the lack of policy is not to become a trade barrier in itself.

Trade Policy of the Great Depression

The era that I am talking about was born in a turmoil of the Great Depression and came to an end in the signing of the final accord of the Kennedy Round tariff negotiations. After the overheated American economy collapse in 1929 and the crisis spread like a wildfire across the globe, frantic efforts were made everywhere to cope with the massive unemployment and shrinking incomes of the bewildered people. Among the many measures born in the turmoil of the depression was the 1930 Tariff Act of the United States. Popularly known as the Smoot-Hawley Tariff, this law can claim the dubious distinction of having been the most protectionist tariff act ever passed by American Congress.

The Act was passed in the tragically comic belief, that by preventing imports from abroad the import demand would be shifted to domestic goods and, as a result, production as well as employment will be increased in the country. If there are any readers who have historical interest, I can recommend for your reading the newspaper columns and speeches

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of politicians which were published in connection with the debate of the Smoot-Hawley bill in 1930. The bill was to be a panacea to provide a cure against the terrible ills of the depression. In reality, it turned out to be a curse which caused the crisis to plunge to new depths and prolong the agony for all. What had been overlooked in passing this bill was the possibility, that when one major country raises its tariffs the others may retaliate. And this is exactly what happened. Within a few days a rash of counter-measures were taken by practically all trading nations of the world.

In any such protectionist war the greatest losers are those countries which have the largest trade surpluses. It so happens that the United States has enjoyed a consistent export surplus in its trade balance. Thus, when the barriers went up, it stood to lose much more on the export side than it ever could gain on the import side. When these disastrous consequences started to materialize, action had to be taken to prevent this fatal process from running its full course. This called for a new direction and a new policy. A crucial turning point had been reached in international trade relations. It is this turn that marks the beginning of the evolution of the objectives and instruments of the trade policies which we have witnessed to date.

The Reciprocal Trade Agreements Program

Having so decisively contributed to the calamity of the early 1930's, the United States recognized that it had to show new initiative, to implement a positive program which would stop the protectionist trend and provide a basis for trade reorganization. Such a program was put forth in 1934 in the form of the first reciprocal trade agreement act.

The aim of the act was to bring about international negotiations to reduce tariffs. This law was necessary because in the American system of government, tariff-making powers are reserved exclusively to Congress; the President and his cabinet have no jurisdiction over tariff-making. Therefore, to enable the President to negotiate and to make binding international agreements on tariffs, it was necessary that Congress delegate to him the power to do so. The Reciprocal Trade Agreement Act of 1934 thus started a process of delegating to the United States President some of the congressional powers of tariff-making, for a certain but defined period of time a process that each subsequent trade agreement acts carried on until the last such act expired in summer, 1967. Consequently, it was a 33-year sequence.

The most important instant effect of the reciprocal trade agreements legislation was to establish a new direction for the development of international trade relations: a direction toward trade liberalization rather than trade restriction. But the methods and instruments to create a concrete policy were left undefined. We had a new direction but not much more.

The concept of trade liberalization on which the early trade agreement acts were based could be described in two essentials:

a. Deduction of tariffs through bilateral negotiations, and

b. Avoidance of injury to domestic industry.

Although the M.F.N. principle was officially proclaimed by the United States and a corresponding clause used in its trade agreements, bilateralism remained a characteristic feature of international trade relations until the creation of GATT, in the late 1940's. This meant that preferential treatment, special privileges, and other forms of commercial discrimination were commonplace among the nations.

As to the noninjury principle, there was little difficulty in the early period since the ultra-protectionist tariffs of the 1930's left ample room for moderate reductions without the hazard of any serious import competition. Thus, in these early days tariff reductions for the sake of a reduction as such rather than for the sake of any real effect on trade.

Multilateralism

The signing of the general agreement on tariffs and trade (GATT) signified a general acceptance of trade liberalization as a major objective. It also provided the institutional forum on which this objective could be pursued in a multilateral context. The M.F.N. became mandatory and bilateral discrimination illegal. This new arrangement helped to make general tariff cutting the policy in both words and deeds of all major trading nations. But it also helped to bring out the inconsistencies or contradictions between trade liberalization and the noninjury principle on which the policy was to rest. As the tariff cuts started to reach the levels where import competition became a reality, new devices had to be invented to safeguard the interests of the domestic industry. This led to the invention of the peril point and escape clause mechanisms, which have contributed so much to international ill will and the debasement of the sanctity of international agreements. By the peril point was meant the level of tariffs which could not be lowered without compelling the domestic industry to make some competitive adjustments. In other words, it was a point below which a tariff cut could have resulted in a real import competition. Such competitive "peril" had to be prevented by redetermining where the peril point was located for any particular product and then limiting any tariff cuts to this level. For the eventuality that a greater tariff concession might have been made by mistake or because of inadequate information, there was an escape clause which gave the government the right to unilaterally cancel any such concessions regardless of what the effect.

Together these two devices not only symbolized the schizophrenic mentality of this policy but also blocked the prescript for tariff reduction in an increasing number of commodity classifications: the peril point set an absolute floor, and the escape clause created the uncertainty. Clearly, the policy which had started in the direction of trade liberalization had been sidetracked into a lateral motion which was dissipating its energies in gimmickery and manipulations reminiscent of the current international monetary situation.

The Impact of the European Common Market

A new thrust forward came from the creation of the EEC in 1968. While the GATT program had been devoted to gimmickery and the OEEC trade discussions had bogged down in oratorical bickering, six European nations concluded the customs union and embarked upon a program of complete economic and social integration of their countries. This provided the prospect for a mass market and ultimately a mammoth economy comparable to that of the United States.

The new union provided two kinds of incentives to the outside world for a broader trade liberalization. First, there was immediate danger of the trade diversion from non-member countries to the member countries since the internal import duties were to disappear while a uniform external tariff was to be imposed. Second, there was a longer range prospect for mass marketing and mass production which had never existed outside the United States. Both of these were realities which, to the American businessman, spoke louder than any theories or concepts.

Thus, the business community in the United States as well as most of the non-member countries began to demand concrete steps for obtaining an easy access to the European market. Riding on the crest of this grounds well, President John F. Kennedy boldly put forward his trade program which Congress enacted as the 1962 Trade Expansion Act. Last in the series of the reciprocal trade agreement acts, this law broke with the principle of non-injury; it made import competition a legitimate alternative and, thereby, opened the way for real trade liberalization. This law added also other significant demensions to the United States trade policy, almost all geared to negotiations with the European Common Market, President Kennedy, himself, went so far as to call this trade expansion act a new trade policy for the country.

The Kennedy Round

As in all trade agreement acts, the 1962 Trade Expansion Act was only enabling legislation. To implement it, to put it into practice, it was necessary to negotiate with EEC and to reach an agreement which would transform the provisions of the Act into actual tariff reductions. Since most of the rest of the world was equally anxious to gain access to the Common Market, and since both partners themselves: the United States and the Common Market, were members of GATT, the negotiations were held in the framework of GATT.

The GATT Conference which followed became the Kennedy Round which set historic landmarks in tariff negotiations.

Lasting some four years, tension-ridden to the breaking point, the bargaining and haggling involved the most comprehensive tariff reduction that has ever been achieved. Over fifty nations participated and all categories of commodities were covered, including raw materials, finished goods, and agricultural commodities. For the United States the average cuts of tariffs resulting from these negotiations amounted to 35 per cent on industrial products (50 per cent in many categories) significant, though not sufficient reductions were also made in agricultural sectors and an international grains agreement was negotiated. These tariff cuts are to be implemented gradually during the next five years.

Non-Tariff Barriers

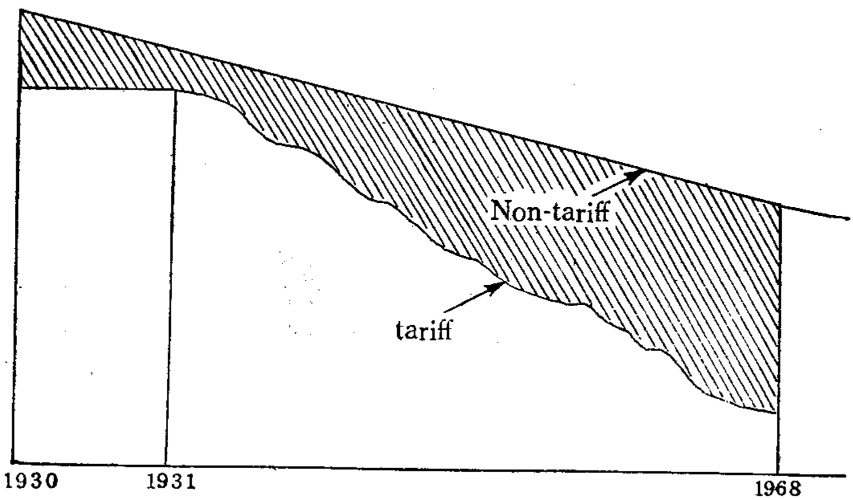
During the Kennedy Round negotiations, the issue of non-tariff barriers rose again and again. Import quotas, taxes, customs valuation, administrative procedures, labeling and marking requirements, health and safety regulations, and other forms of restraining international trade by different countries constituted the subject matter of this issue. Not much immediate progress was made on this front. And as an irony, the United States President issued a new order for import quotas on certain agricultural commodities almost simultaneously with the signing of the Geneva accord. Yet it would be most unfair and misleading to claim, as some ill-informed critics have done, that in the area of non-tariff barriers, the Kennedy Round was a failure.

In the context of past policies, it would be much more correct to claim the opposite namely, that it was a success. Not a success. Not a success in the absolute sense of having brought about an end of such barriers, but a success in the sense of having focused attention on them, brought out the fact that they are in wide use, defined and publicized their character and stimulated further research and investigation of this very complex problem.

Viewing the evolution of the trade policy in a longer perspective, one cannot help but find that from 1932 until 1934 trade policy had for all practical purposes been synonymous with tariff policy. The reciprocal trade agreement acts were tariff acts, and the international agreements based upon them were tariff agreements in substance, though not in name. In GATT there were provisions prohibiting quantitative restrictions but there were also escape clauses enabling any country to coutinue their use unhampered.

New Focus

The evidence now available points up the fact that while tariff has occupied the stage for international trade negotiations under the reciprocal agreements program and in the GATT forums, non-tariff restrictions were quietly harnessed by individual countries to neutralize tariff concessions made in the trade agreements. Schematically, the situation might be depicted as in the figure below.



After 33 years of tariffs reduction and especially after the Kennedy Round reduction have become effective, tariffs will remain but a minor hurdles to trade, the non-tariff barriers, on the other hand, have become increasingly formidable both in relative absolute terms. It is, therefore, self deception to equate tariff reductions with trade liberalizations as we have done to date. To have trade liberalization, all barriers—tariffs and non-tariffs—must be eliminated. As the tariff problem has, by and large, been solved, it is imperative to shift the focus now against the non-tariffs—the invisibles which often can be more destructive to trade than the visible tariffs. To do this, new concepts and new instruments of trade legislation and commercial diplomacy are needed. The Kennedy Round talks have given us a beginning in this respect but the main job remains yet to be done.

Protectionist Backlash

By all indications this will be a precarious task. Not only is every effort to dismantle the non-tariffs met with savage resistance by various self-interest groups, but an almost global offensive is being currently waged by protectionist forces to raise the existing non-tariffs and to introduce non-tariffs to many new sectors of the business system.

Hardly had the cheers over the successful completion of the Kennedy Round subsided before the protectionist forces mounted their furious counter offensive. This was particularly pronounced in the United States. The old protectionist elements, including glass, watches, and textiles found reinforcement in such powerful industries as steel, machine tools, electronics and chemicals. A rash of new bills and amendments to those already pending were introduced in the United States Congress by both democrates and republicans—protectionism in the United States is a bi-partisan matter, as is trade liberalization—demanding quotas, licenses and similar devices which were designed to nullify the gains achieved by the Kennedy Round. Together there are fifteen industries who have put in bills for special protection. If all these bills were enacted by Congress, there would be rigid limitations on 43 per cent of United States total imports.

Cleverly, this protectionist counter-offensive has been clothed in a veil of patriotism and served to the public as a remedy for reducing the United States balance of payments deficit —a chronic sore in the United States economic body and as a means of preserving the strength of the United States dollar in the face of serious pressures on its integrity.

This offensive reaction of the protectionist elements, while not unanticipated, bas been surprising because of its vigor and power. The free trade forces have, so far, had to fight a holding action to prevent the gains of the Kennedy Round from being annihilated. They hope that this delaying tactic will enable a new initiative for the trade liberalization, not only in the United States but also in other countries where similar protection is precious, are felt. But this hope is far from becoming reality at this time.

The Dollar Dilemma

New fuel to the protectionist fire has been provided by President Johnson's program to defend the dollar. In his January 1, 1968 program the President imposed strict curbs on foreign investment and lending and asked Congress to enact legislation to restrict foreign trade, to limit tourist purchases and duty-free gifts, and to compell foreign-based affiliates of U.S. firms to bring their profits into the U.S. instead of using them for investment or working capital in the countries where they are earned.

This is not the place to debate whether or not such measures would cure the U.S. balance of payments problem. I am quite convinced that they will not. At best they might buy some time but even that at a very high price. What has been proposed is a protectionist program. It runs counter to all the efforts of the last 33 years. And what is worse, it indirectly reinforces the industry pressure for restrictive measures and spawns protectionist policies elsewhere around the world. Solution to the dollar problem must be sought elsewhere —in the organization of an international monetary system and in expanded international trade— not in restriction and stagnation.

The Multinational Corporation

This brings us to the last and probably the most important aspect of contemporary international business relations—one which so far seems to have completely escaped the purview of policy makers; namely, the multinational corporation. Since World War II, but especially in the last ten or fifteen years, we have seen the rise of multi-unit industrial companies whose operations span the lands of many nations. At least in part they were an answer to restrictive trade barriers. To enable to climb the barriers more and more companies found it advantageous to establish subsidiaries or other affiliates inside the country concerned. Experience has shown, that once established there is a strong tendency for the affiliate to grow in size and to multiply in numbers. Also, management has found that the multinational corporate structure offers many distinct advantages over a national structure. Among these are the ability to draw upon a broader and more diversified resource base, to specialize production according to labor cost and available technology, to spread risks—including inflation factor on business cycle—over a number of countries, and to have control over international transactions and operations of the corporate family.

The shift from national to multinational corporate organization has been much more extensive than is generally recognized. In the United States one is hard-pressed to name a single company in the large or medium sized group which has not become multinational. And even among the small ones foreign operating bases in form of subsidiaries, joint venture or licences are becoming commonplace. In Western Europe, where I have just spent a fortnight, the same tendencies appear to be observable.

What has a multinational company got to do with international trade policy?

A great deal more than our policy makers and economic advisers have realized. First, the multinational company is rapidly changing the channels through which international trade flows. The traditional export and import firms are disappearing as the industrial companies absorb their functions. Thus, international trade channels which, in the past, consisted of independent trading companies are now becoming intracompany arrangements and transboundary trade which for the nation is an extra (or international) matter becomes increasingly an internal matter for the multinational corporation.

Second, traditional independent traders in each country had to make a profit to exist. This is not required from all units of a multinational company. The primary interest of the company is the total profit of the multinational structure. If that profit can be increased by showing a loss in some countries or some operating units of the system, any prudent management will insist that such a loss be incurred. This is to say, a multinational company can trade on a different bases, using different prices than the independent trader; it prices international transfers not necessarily as independent or self-sufficing transactions but as sub-transactions in each overall production and marketing network.

Third, the multinational company is subject to no inherent compulsions to receive payment in "buyers" currency or to convert it into its own monetary unit. Instead, it can accumulate claims and obligations according to its own managerial objectives and to accumulate its financial assets not in any one currency but in a portfolio of many currencies again according to its own needs and objectives.

Consequently, the multinational company does not behave in its international trade the way the text books tell us international traders are supposed to behave. It has outgrown the rules and principles that economists have been expounding and refining since the days of Adam Smith and David Ricardo. But we continue to depend on both the theoretical principles and policies which are developed to an era where multinational organizations had no bearing on international economic relations.

This antiquated conceptual framework is perhaps the greatest barrier of all that the contemporary world must surmount. It clears not only on trade relations, but equally on the near-bankrupt state of the international monetary relations, and to most other aspects of ternational economic interaction.

This is not the place to open a discussion on the theory of trade. Suffice it to say, that meaningful and realistic policies can neither be formulated nor enforced in today's world unless it is really understood that we live in a much more sophisticated and complicated system than that which is used in our theoretical models of trade and investments and that new ways of approaching these problems are badly needed.

Here the burden falls squarely upon the theoretician. It is he who has fallen behind while he is supposed to lead. Even worse, it is the theoretician who seems to be the last to recognize the result which the multinational enterprise has caused an international economic relation. In his backwardness, he continues to insist that solutions of the past be applied to the reality of the present.

What the world needs now is a three-pronged approach:

a. To continue with general trade liberalization but placing the emphasis upon non-tariff barriers rather than tariffs as in the past.

b. To accelerate economic integration on regional and, where feasible, continental basis; such integration programs have proven to be the only practical approach for complete elimination of trade restriction and for creating mass markets where modern technology can find its full utilization.

c. To create a wider and more flexible conceptual framework for international interaction; how this framework should be constructed poses a great challenge to us all.