

TEXTO PARA DISCUSSÃO

Nº 35

Handmaiden in Distress:
World Trade in the 1980s

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Setembro de 1982

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This paper was prepared for the North-South Institute, Ottawa. The authors are grateful to Bernard Wood and Margaret Biggs for comments on an earlier draft.

In November 1982, a Ministerial-level meeting of the contracting parties to the GATT will take place in Geneva. It will be the first such high level GATT meeting since that which launched the last major round of multilateral trade negotiations in Tokyo in 1973. This meeting may set the tone for the international trading environment for the rest of the century. It is therefore a major event affecting the immediate future of a significant part of the international economic order.

Many governments have been actively preparing for this event, and a GATT Preparatory Committee has also been carefully setting the stage. Drafts of a “political declaration” and of possible “policy actions” have been circulating for discussion. Particular governments have been pressing their specific concerns upon the other contracting parties and upon the GATT Secretariat, most notably that of the United States with its push for the inclusion of “services” in the GATT discussions. The developing countries’ interests therein have been addressed in a recent Commonwealth Secretariat report, but these countries do not appear themselves to have otherwise been considering them in preparatory meetings such as usually precede the meetings of the IMF and World Bank, or of the UNCTAD.

There has so far been remarkably little public discussion of the GATT Ministerial meeting, its possible agenda, or the crucial issues which may be at stake there. This paper seeks to stimulate awareness and concern by addressing what we see as some of the most important issues in the current world trading scene. Our discussion begins with a review of the recent evolution of world trade and the GATT’s place in it, in which we describe the alarming increase in protectionism in recent years and the relative inability of the GATT to “order” world trade. We then consider the continuing strong case for a liberal trading order in terms of the needs and perspectives of the 1980s. We particularly note the difference between trade in commodities and trade in Services, and emphasize the difficulty of transferring too crudely the robust liberal case relating to commodities to the complex and sensitive area of Services.

U.S. proposals for encouraging liberalized trade in Services through an expansion of the GATT into this area raise much broader issues concerning the appropriate future institutional framework for international exchange of all kinds. We therefore devote considerable attention to the genuine need for longer-term reform in the key multilateral institutions of international trade, and consider some of its most important necessary elements. The U.S. initiatives are unhelpful, we conclude, in terms of the real needs of the world trading system. While urging that an immediate start be made at the GATT Ministerial meeting to the process of longer-term reform, we suggest in the concluding section a number of priority measures for urgent Ministerial agreement and action.

I. World Trade and the GATT

The GATT Ministerial meeting will take place more than 35 years after the GATT was first negotiated. Post-Second World War international economic cooperation included the drafting of a charter for an ambitious International Trade Organization (ITO) which was discussed at the Havana Conference of 1947-48. The ITO was to address a wide range of international trade and employment issues, including commodity market stabilization, restrictive business practices, and non-tariff commercial policy measures.

A General Agreement on Tariffs and Trade (GATT) was also prepared in advance of the Havana meetings to cover tariffs and related matters, pending agreement on the full ITO charter. When the U.S. Congress eventually failed to ratify the Havana charter, the world was left with only the GATT.

Over the past 35 years, changes in international politics, in the character of international economic activity and in the behaviour of both private corporations and sovereign governments, have rendered increasingly salient some of the limitations in the original GATT, and have generated new problems for it. The GATT – originally the central institutional pillar of the post-war international trading system, a role it performed remarkably well – has gradually become less effective and less credible.

The GATT was constructed at a time when a major world war had just ended and memories of the protectionist and discriminatory practices of the 1930s were fresh, a time of unusual and worldwide commitment to the building of a more stable, efficient, and equitable international order. In the trade sphere, the Vision of the architects of the new order was of a more liberal and non-discriminatory system, within which independent and equally treated partners would trade in open and competitive markets. Macroeconomic events were to be more effectively managed than previously, it was hoped, by governments imbued with a new confidence in their capacity to maintain full employment. The international financial dimensions of these macro-economic aspirations were to be supported by the new International Monetary Fund (IMF).

The world economy grew, with relatively minor setbacks, at very rapid rates through the 1960s and 1970s. World trade grew even faster than did world output. Some of the credit for this successful burst of world trade must be assigned to the significant degree of tariff-cutting achieved in the seven rounds of multilateral trade negotiations conducted under GATT auspices. The last (the Tokyo Round) was completed only in 1979 and has not yet been fully implemented.

The rapid post-war growth in world trade was accompanied by increasing internationalization

of production. Transnational corporations took advantage of scale economies in management, marketing, finance, and information systems, as well as in production, by investing and participating in joint ventures and production cooperation, in new economic activities around the globe. Their activities generated a vast increase in international Service transactions and rapid growth in developed countries' earnings from both factor and non-factor Services. They also bred an important increase in the extent to which international trade in goods and Services was conducted on an intra-firm basis. The growth of enormous transnational corporations, often cooperating with one another in the same industry, and the expansion of international intra-firm trade, created new worries concerning the possibility of restrictive business practices in the world economy. Since the GATT had made no provision for these matters (although the ITO had), they were registered in such other multilateral fora as the UNCTAD and the UN Centre on Transnational Corporations.

At the same time that international economic interpenetration and interdependence were rapidly increasing, governments in the industrialized countries were assuming increasing responsibility for the well-being of their citizens. Concerns with social welfare, regional equity, the stability and level of rural incomes and, more recently, "industrial policy", brought governmental policies involving a greater degree of intervention in economic life than had been traditional in market economies. Such domestic policies are bound, in an interdependent world, to impact on various points upon other countries. Again, the GATT had no machinery for the systematic consideration, let alone resolution, of consequent international disputes.

International trade was also conducted to a significantly greater extent than was implicit in the GATT by state trading enterprises. This was by no means a phenomenon confined to the centrally planned economies. Between 30 and 40 percent of total U.S. trade has been estimated as taking place with foreign firms that are either state-owned or state-controlled. Governments, actively competing for possible future comparative advantages, have been particularly involved, directly or indirectly, on the high- technology end of the industrial spectrum.

The original norms and expectations of the GATT's founders were also breached in terms of the rise of preferential trading areas and arrangements. The multilateral and non-discriminatory aspirations implicit in the GATT were particularly confounded in the arrangements within the EEC and between it and many of its trading partners.

An even more severe blow to non-discriminatory principles was the negotiation, under GATT auspices, of discriminatory quotas against "low-cost" suppliers of textiles and textile products. Originally negotiated on a short-term basis for cotton textiles over 20 years ago, they have since been greatly extended in time and in product and country coverage. The Multi-Fibre Arrangement (MFA), the successor to the original short-term cotton agreement, continues to legitimize some of the most

egregious of the discriminatory practices of the industrialized countries, and constitutes a standing repudiation of the GATT's purported first principle of non-discrimination. It has been enormously harmful to the GATT's image and credibility, particularly among developing countries.

Also contrary to the non-discrimination principles of the GATT, although probably of relatively small overall significance, is the multilaterally agreed system of tariff preferences granted by industrialized countries, since the early 1960s, on semi-processed, processed, and manufactured products from developing countries. Only about two-thirds of world trade is now estimated to take place on the basis of non-discriminatory (most favoured nation) tariffs that are equally available to all, under firm and contractual commitments in the GATT.

Also damaging to the status and credibility of established multilateral institutions like the GATT was the increasing resort to international codes and agreements of a much less than universal character. In such areas as capital liberalizations, the terms of export credit, and the appropriate conduct of transnational companies, the Western industrialized countries negotiated their own codes or agreements within their Organization for Economic Cooperation and Development (OECD), without waiting for more universal accommodations to be reached. Even within the GATT, some of the codes governing non-tariff measures negotiated during the Tokyo Round are to be applied, contrary to previous principle and practice, only to the exports of some countries; eligibility for their benefits will be conditional upon signature of the codes.

In recent years there has been a quantum leap in the extent to which industrialized countries have employed non-traditional, i.e., non-tariff, measures to restrain imports. Many of these measures are neither specifically authorized nor explicitly forbidden by the GATT. The most visible of these much-discussed measures of "new protectionism" are so-called "voluntary export restraint, and "orderly marketing agreements" (similar in type to the MFA). These are bilaterally negotiated against threat of unilateral imposition of restrictions by the importing countries, and they are thus inherently discriminatory. It is widely feared that such arrangements, now applied to footwear, electronics, Steel, motor vehicles, textiles and clothing, and agricultures – sectors which together constitute close to one-half the total value of world trade – will gradually intrude upon more and more segments of International exchange. Obviously particularly vulnerable to these new instruments of protectionism are the newly expanding manufactured exports of the developing countries.

A variety of other new non-tariff measures have also been increasingly deployed. These include local content requirements; government procurement policies; laws concerning standards; variable levies on imports; and subsidies for local production under the terms of "industrial", "regional", or other national policies. Administrative discretion, complexity, and obscurity have substituted in these measures for the relative simplicity and automaticity of the import tariff. With these highly contingent

and lawyer-intensive protectionist instruments, inevitably also comes discrimination among trading partners. Where complexity and discretion take over from simple rules, the weaker firms and countries invariably lose most.

To the deterioration in the overall environment for world trade and investment created by changing politic-economic circumstances and declining respect for the previously agreed (GATT) norms, there has unfortunately recently been added the pressures from serious worldwide macro-economic dislocation. The 1982 GATT Ministerial-level meeting will take place against the background of a very sombre global economic scene. Unemployment rates in the OECD are at the highest levels since the Second World War. The prospects for renewed vigorous growth remain highly uncertain. At the same time, inflation continues at higher than acceptable rates.

These macro-economic difficulties have not only had direct effects upon world trade, but they have also generated sharp new pressures for protectionism to save jobs from competitive imports. In 1980 and 1981 the volume of world trade essentially stagnated, and the available data for 1982 indicate little or no improvement. Protectionist pressures are, if anything, still rising. There is increasing public discussion of the possibility of major "trade wars", most recently stimulated by acrimonious disputes among the U.S., the EEC, and Japan over trade in automobiles and steel.

The smaller industrialized countries and the developing countries, while typically highly vulnerable to events in the world economy, have rarely been able to exert much influence upon them. In the current difficult times, as in previous such periods, the weakest have been hit the hardest. Those developing countries which are not net exporters of oil – the vast majority – are at present experiencing very great difficulties. The purchasing power of the net oil importing developing countries' exports fell by 2.2 percent in 1980 and was stagnant in 1981 despite continued expansion (though at half the previous rate) of their export volume. Particularly serious is the plight of the poorest primary commodity exporters. With the sharp increases in oil import prices in 1979-80 followed in 1981-82 by the collapse of primary commodity prices and steady increases in the prices of manufactured imports, these countries have experienced enormous deterioration in their terms of trade. The low-income developing countries experienced declines in the purchasing power of their exports of 3.8 percent in 1979, 13.8 percent in 1980, and a further 9.7 percent in 1981 – that is, by over 25 percent in the past three to four years. The inevitable result has been sharp cutbacks in their imports achieved by massive retrenchment in both investment programs and already stringent levels of consumption.

This is not the place to address the need for global economic recovery, better support for those hardest hit by recent external shocks, back up for the international financial system, or the specific measures which might best serve these requirements. While these issues are bound to arise in the

Geneva discussions among Trade Ministers, they are not the designated responsibilities of the GATT. The problem before the trading community is that world trade and the GATT-based system of International trading rules and principles are themselves in greater jeopardy than at any time since the GATT's creation.

The immediate task must be to prevent any further deterioration in world trade and to arrest the dangerous downward slide into bilateralism, ad hoc protectionism, and the flouting of multilaterally agreed norms. uncertainties as to market access are prejudicial to investment, debt Management, and the prospects either for adjustment to the worsened circumstances or eventual recovery. Current discriminatory practices and demands for "reciprocity" are reminiscent of the bullying tactics and retaliatory practices of the 1930s, the very circumstances which led to the creation of the GATT in the first place. The only immediately available means is to enjoin renewed adherence to the principles of the original GATT system to the maximum extent possible. This would not only restore some predictability and order to a dangerously disorderly scene, but would also rebuild the GATT's credibility both among the contracting parties themselves and in the rest of the world, which still looks to the GATT as the centre of the trading system.

The key principles which must govern attempts to make the current system function effectively and to augment the existing apparatus are time-honoured: non-discrimination, transparency, and predictability. It is also crucially important that the effort should be multilateral and lead to a genuinely multilateral system. These issues will be taken up in the third section.

II. The Case for Freer Trade in 1982

It is important, in current circumstances, to re-state the rationale for liberal trading policies. For centuries, economists as a group have concluded that there is a strong presumption in favour of freer trade in commodities. There are caveats and qualifications to this conclusion, but it remains a robust one. It is particularly strong in countries which can rely on a wide variety of policy tools, which allows them to correct market imperfections and macroeconomic disequilibria without having to interfere with the international flow of goods. Such interference is typically a clumsy and costly way to tackle such imperfections and disequilibria.

The case for freer trade has always been demonstrated using examples involving the exchange of apples for blankets, or cloth for wine. This may be no accident. The case for freer international flows of Services, including Services of labour and capital which establish themselves outside their own country, may bear a formal resemblance to the case for freer trade in commodities? but in

historical practice the international mobility of labour and capital, and of Services associated with them, have generated serious economic and non-economic problems.

It is important to highlight the essential differences between trade in goods and trade in the extremely heterogeneous category of Services. Trade in goods can be quite unintrusive, as illustrated in the extreme case of the “silent trade” of primitive communities which are otherwise unable to communicate. Many cultures find the intimacy with foreigners involved in factor movements, particularly when they are accompanied by large differences in bargaining power, too high a price for the economic gains which those transactions may generate. As a result, few economists illustrate gains from trade using exchanges of interest payments for workers’ remittances. Nations have generally confined their commitments to freer trade in commodities, even at the height of enthusiasms for opening up their economies. Thus the GATT referred primarily to commodity trade.

While the case for freer commodity trade is robust, there are various opinions as to the exact quantitative magnitude of the gains from trade. The least controversial propositions in this area are that countries with small domestic markets benefit from trade more than larger ones, and that complete autarky would involve substantial costs (imagine a country without energy resources shut off from trade). Beyond those propositions, experts disagree as to whether trade is the “engine” or the “handmaiden” of growth, and whether a vigorously expanding trade sector is the cause or the result of domestic prosperity.

For about 30 years after the end of World War II, as already noted, impressive growth rates in both production and trade were registered in most countries, whether more or less developed. The trade liberalization framework adopted shortly after the war is given the credit by some authors for this “success story”. Other authors, closer to the “handmaiden school”, which we find more persuasive, are more cautious, but nevertheless regard the dismantling of import restrictions inherited from depression and war as a crucial input into post-war prosperity. Besides the traditional static gains from trade, the freer flow of commodities allowed the realization of economies of scale, increased competitive discipline, and provided consumers with a richer menu of products. The expanded markets made possible by import liberalization may also have further stimulated technical progress.

The system of non-discriminatory, multilateral trade pursued since World War II sought to leave behind forever the economically inefficient and politically otiose discriminatory trade practices which proliferated during the 1930s, and which contributed to World War II. Under the new system, the countries which had been vanquished during the war were reintegrated into the international economy much more quickly and successfully than anyone would have dared to hope in 1945. Ancient European animosities were reduced and submerged under deepening trade flows. The smaller

industrialized countries found in the new trading system greater economic security and more room for manoeuvre than they had before the war.

The post-war international economic order was on the whole created by and for the victorious industrialized powers. Africa, Asia, and the Caribbean were still mostly under colonial rule and were largely absent at the creation of the IMF, the World Bank, and the GATT. Latin American countries and India participated actively in some conferences, including that at Havana which framed the still-born ITO, but their arguments found few echoes in the institutions as they emerged during the 1950s and 1960. Bargaining at the GATT was dominated by countries seeking access to large industrial markets and offering reciprocity in kind; LDCs until recently remained passive spectators of this process. While the rules of the tariff bargaining game showed little concern for LDC interests, the great post-war expansion nevertheless brought new trade opportunities for many Third World countries. Their exports grew at faster rates than during the dismal inter-war period, and their export bills became more diversified, both as to products and geographical destinations. Some of the LDCs benefiting from trade expansion were simply lucky, but many others worked hard at generating a supply of exportable goods suitable for expanding International demand.

For some years after the war, many LDCs, remembering inter-war circumstances and wishing to promote their infant industries, preferred to provide incentives to boost production for sale in domestic markets rather than for export. This “import-substitution” strategy quickly ran into difficulties, particularly in countries with small markets. Beginning in the 1960s, leading LDCs began to redress the imbalance between incentives for domestic and foreign sales, i.e. between import substitution and export expansion.

As exports responded, imports of machinery, raw materials, and intermediate goods expanded, allowing faster growth rates of Gross National Product. Indeed, for the 1960s and 1970s there is a well-established empirical regularity showing a close link between export growth and output growth for all but the poorest of the LDCs. Despite the relatively greater importance to such countries of influences like the weather, the availability of aid, and the development of skills and infrastructure, exports are major determinants of their capacity to import and, consequently, to grow. LDC export earnings are thus the means to obtain, typically from industrialized countries, key development inputs which would be very expensive to produce at home. Expanding export earnings are also crucial for the smooth management of LDC external debt, and for the attraction of fresh foreign loans and investments. Northern protectionism that blocks LDC export earnings strikes not only at the heart of their development efforts but also threatens the normal functioning of International capital markets.

The LDCs, therefore, have a strong interest in an International environment that offers expanding trade opportunities. Most of them have much to gain from further liberalization of their

own foreign trade regimes as well. At the same time, such a process of liberalization is a delicate one, where both substance and style matter a great deal. During 1982, some industrialized countries have been pressing LDCs, particularly the newly industrializing countries (NICs), to reduce further their barriers against imports of commodities, Services, and direct foreign investment, suggesting that unless the LDCs go along with such demands, the industrialized countries may shut their markets to LDC goods. At the same time that LDCs are pressed to import more goods and Services, they are urged to cut back on some of their export promotion policies, this despite their large net deficits on manufactured goods trade with the industrialized countries. Not surprisingly, LDCs, particularly those heavily in debt, have regarded these proposals as misguided.

It is important to analyse demands for “reciprocity” from the LDCs both in general, and with particular reference to the NICs. International trade theory emphasizes that the gains from trade to a country do not depend on “reciprocity”, defined in the GATT sense from its trade partners. The founding fathers of the GATT were, of course, well aware that national gains could be achieved by unilateral reductions of trade barriers. The mumbo-jumbo on “reciprocity” was a (then) politically clever device to enlist within each country the support of mercantilists wanting to export more against the protectionists wanting to import less. An argument could be made for reciprocal reduction and binding of trade barriers, so as to avoid the temptation to each country of using import or export restrictions to improve its terms of trade. Such restrictions could easily lead to trade wars after which every country would end up worse off.

It is very doubtful that this is what today’s shouting about lack of LDC “reciprocity” is all about. When the conditionality of application of new GATT codes on subsidies and countervailing duties is already seen by many – and certainly by all the developing countries – as an important retreat by the industrialized countries from the first GATT principle of *unconditional* non-discrimination, further talk of “reciprocity” seems rather more like bullying, a style hardly conducive to fruitful negotiation.

Moreover, the increasingly insistent emphasis on problems presented by LDC’s import policies seems not only disproportionate, but also at odds with the long-term trends in their policies. As noted earlier, many LDCs began some time ago to turn away from excessive emphasis on import substitution and toward export promotion. The elimination of the bias against exports could have been achieved by the rapid abolition of all import barriers and the unification of exchange rates. Most of the now-NICs, plagued by macroeconomic and balance of payments disequilibria much less tractable than those sporadically affecting industrialized countries, wisely opted instead for a package of measures which included export subsidies (offsetting some of the effects of overvalued currencies), export guidelines of various sorts, steadier and more realistic exchange rates, plus an elimination of the most extreme import restrictions. Foreign investors operating within LDCs, who had in earlier

years received direct and indirect subsidies in their sales to the local market, were now nudged into exporting, often receiving further subsidies. (it is worth recalling that when foreign investors sold mainly within LDCs, the prevailing Northern advice was that a good investment climate called for generous LDC subsidies to transnational enterprises).

In many LDCs, balance of payments difficulties caused by post-1973 exogenous shocks, halted the virtuous circle of higher earnings and further relaxation of import controls, which in turn reinforced their export orientation. As a result, complex foreign trade systems combining import restrictions and export subsidies were frozen into place. Present incentive systems are uneven and probably still far from optimal from the national viewpoint of many LDCs. However, it is doubtful that, in many LDCs, average incentives to exporters now exceed those to firms engaged in production for the domestic market. It is also clear that few LDCs have recently been piling up foreign exchange reserves, or growing faster than their record for the last twenty years. Most LDCs today have long shopping lists for Northern goods, purchases which must be shelved due to a lack of foreign exchange. It is also well known that the servicing of the LDCs' external debt, especially following the unexpected increase in interest rates since 1980, takes up a large share of their foreign exchange earnings, earnings which during 1982 appear to be experiencing a further alarming decline.

Under present circumstances, therefore, a lowering of import restrictions and elimination of export subsidies by LDCs to accommodate demands from some industrialized countries, are likely to lead to further balance of payments troubles and a decline in LDC economic activity. Thus, such actions are more likely to lead to a decline in LDC imports from the North, than to their expansion. The most effective means of expanding Northern exports to the South is now, as it has always been, for the North to import more goods from the South.

The mercantilist spasm seizing industrialized countries during 1982 presents more immediate dangers to Northern interests than just lagging exports. To give a concrete example, a heavily indebted country like Brazil is being denied the means for a smooth servicing of its external liabilities. Not only are its Steel and shoe exports challenged as "artificially" competitive, but exports of sun-intensive orange juice and chickens are also decried as resulting from unfair subsidies. Even sugar, which Brazil has been exporting for about four centuries, is shut out by quotas in the United States and driven out of traditional markets by (in this case) *truly* dumped European sugar. Eurocurrency spreads and credit availability are closely linked to the export outlook, and external recession and protectionism are not helping Brazilian efforts to roll-over its debt, not to mention its search for additional finance at a reasonable cost. If recession and Northern protectionism persist, no one should be scandalized if Brazilian voices, and those from other LDCs, call for some form of recontracting of external obligations. Financial rules of the game should, after all, be no less flexible than those

regarding trade.

Post-war trade expansion benefitted on the whole both industrialized and developing countries, and contributed to less unpleasant International relations than those of 1919-1939. But there *are* gaps and flaws in International arrangements for trade and finance. The GATT has never overcome some of its birth defects, and Keynes' "lusty twins" (the IMF and the World Bank) are themselves undergoing a difficult menopause. The U.S. proposals in 1982 to extend the GATT into some Services are misguided in timing, style, and substance. However, they may at least highlight the long-run need to reform the GATT-Bretton Woods System, and in particular, to reconsider the possible advantages of elements in the ITO Havana charter, an issue raised by the LDCs almost ten years ago. We now turn to a discussion of these matters.

III. Thoughts on Long-run Reform of World Trade Institutions

This is not the place to propose either a detailed agenda or a precise calendar for reform. The purpose here is merely to suggest some of the most glaring gaps and weaknesses in the present international trading order, and to pinpoint those principles embodied in the GATT – above all, those of non-discrimination, predictability, and transparency – which appear worthiest of preservation, in the short and the long run.

To the founding fathers of the GATT, the principle of non-discriminatory multilateral trade, embodied in the unconditional most favoured nation clause, was as important as the search for a freer international flow of commodities. The motivation was not merely, or even mainly, considerations of economic efficiency.

Rather, it was the product of memories of International political frictions generated before the Second World War by the discriminatory preferential arrangements enforced by imperial powers, and other countries aspiring to hegemonic pre-eminence. In view of many historians, the scramble for preferential trading arrangements and the exclusion of rivals from both sources of raw materials and promising markets, contributed to the tensions which led to both World Wars. In particular, emerging commercial powers late-comers to both industrialization and colonial empires, were not easily integrated into trading and financial networks.

These lessons maintain their relevance in 1982. They should strongly discourage departures from the broad principle of *non-discrimination* in commodity trade, except for transitional preferences for LDCs (which will be further discussed below) and customs unions formed by those countries. Neither economic theory nor common sense favour the adoption of fresh discriminatory

practices by industrialized countries in commodity trade. Existing arrangements, such as the European Economic Community, present a difficult obstacle to the search for non-discrimination. While it may not be feasible to eliminate such arrangements, their discriminatory scope could at least be frozen.

It was the intention of those who framed both the GATT and the ITO to devise trading rules which would allow a maximum of *predictability* regarding the openness of foreign markets, so as to stimulate long-term investments. Naturally no nation will be able to commit itself to maintain the same degree of openness to trade under all circumstances, so allowances were made for “escape clauses”, such as Article XIX in the GATT. The intention, however, was to make the adoption of any departure from commitments as *transparent* as possible, so that it could be subjected to international review and surveillance. These principles of predictability and transparency maintain their attractiveness, even if, particularly during the last decade, they have been honoured more in the breach than in practice. Their attractiveness rests not just in the inducement they provide for efficient trade expansion, but also in the contribution they make to the creation of an atmosphere of fair play among competing economic agents, an atmosphere without which political pressures could arise, again leading to trade wars.

A structural weakness of the GATT, making it difficult for it to enforce the key principles of non-discrimination, predictability, and transparency, stems from its birth as a treaty rather than an institution, as the ITO would have been. The professional staff in the GATT Secretariat is very limited in numbers, a small fraction of the numbers working in the IMF and the World Bank. The small staff of the GATT, however able, can neither engage in vigorous multilateral surveillance of departures from its rules-, nor participate actively in dispute settlement, much less maintain detailed inventories of non-tariff barriers (a task more effectively carried out in recent years by the UNCTAD staff). Thus, the GATT has emerged as a forum for negotiations, rather than as an impartial and active referee of trade disputes. This has made trade negotiation outcomes in the GATT very vulnerable to the whims and pressures of the large trading nations and blocs. For this and other reasons noted earlier, it has often been described by the developing countries as a “rich man’s club”. A reformed GATT, to be credible to the weaker trading units of the world, would have to have sufficient resources to permit its secretariat to engage in interpretation, surveillance, and enforcement of trade rules.

A GATT with adequate staff and authority could play a crucial role in settling disputes concerning unfair trade-related subsidies and dumping. Such matters might be better handled by the accretion of decisions within a strong GATT, guided by its present charter, then by the writing of detailed new codes. In fact, unless GATT is infused with a new Vision neither present in the Tokyo Round nor evident in the present climate of reciprocity demands in the U.S. and defensive

protectionism in Europe and Japan, new codes may simply further erode the principle of non-discrimination. It is important, therefore, that before broad extensions of the GATT into new areas are undertaken, its authority, credibility, and basic principles – all now in very great jeopardy – first be restored.

When the process of reform is viewed over, say, a ten-year horizon, several areas covered in the ITO charter and other issues thrust forth by international economic events over the last four decades are natural candidates for further rule-making. Such rule-making should be seen in the context of a new and broader trade organization, built around the core of a restored GATT. Two such areas, highlighted by the U.S. proposals during 1982, are trade in Services and direct foreign investment.

(i) Services and Investment

It is best at the outset to recognize explicitly the links between international trade and international investment, and the inevitable implications of national policies for both. The International trading patterns of the future are determined by today's investment decisions; and, conversely, International investment decisions today are governed, to a substantial degree, by expectations as to the openness or restriction of trading opportunities in the future. Both private firms and national governments engage in practices which are restrictive of others' trading and investment possibilities. National policies respecting rights of establishment, national treatment of foreign firms once established, and the international flow of goods, Services, data, and factors of production, are all obviously matters for independent sovereign judgment. The rights and obligations of private firms in the national and international economic arena is a large and complex topic on which governments are bound to take divergent views. The object must nevertheless be to seek international accommodation and consensus among sovereign governments so that at least the *international* rules of the trading and investment game are subject to certain agreed principles, however small in number, which are understood and, to the maximum extent possible, accepted by all.

It has been noted that few Services were included in the original GATT rules. Some were regarded as involving national security concerns (e. g. telecommunications); others were at that time heavily controlled by nations who wanted no constraints on their freedom of action (e.g. shipping, which LDCs wanted included under GATT rules). Statistically speaking, international trade in “services” is by now of significant global proportions and has been growing at a much more rapid rate than did goods trade in the 1970s. The industrialized countries, particularly the U.S., are substantial and growing net exporters of Services, both of the factor and non- factor sort, while the developing countries' net deficits in Services continue to grow. But this category, a catch-all for that international exchange which is clearly not commodity trade, is so all-inclusive as to be nearly

meaning less for interpretation.

International Service flows, even leaving aside those generated by labour and capital living outside their own countries, are a heterogeneous and little studied category. Some are closely connected to commodity flows; others are not. Many involve a high degree of intrusiveness into local cultures and even sovereignty, or are at least perceived by various countries as doing so. Coastal shipping, radio and television, domestic air traffic, local telephones and telegraphs, are some of the Service activities many countries regard as out of bounds for foreign economic agents. Insurance, banking, and data flows, which figure prominently in the United States' push for the extension of GATT into Services, are also so regarded by many countries.

Many of these activities and concerns are at the very core of national development strategies, and are intimately related to policies on technology (both imported and domestic) and foreign investment. Indeed, if countries were to be given an all-or-nothing choice between a closed economy and one open not just to commodity trade, but to all Services (and factor movements) as well, many would choose to pass up the gains from commodity trade rather than to allow foreigners to run such “commanding heights” as their banking, shipping, and insurance sectors, as they often did during pre-World War II days. The thrust, by a U.S. administration of the present character, to place these matters upon the GATT agenda seems, to many, tantamount to launching an effort to dismantle the various screening and control measures slowly and painfully constructed over the post-war period, in Canada and other industrialized countries, as well as in LDCs, to “rein in” the burgeoning U.S.-based (and other) transnationals. Nor is the irony of the rising Northern clamour for the vetting and control of the *outward* flow of technology and foreign investment from industrialized countries lost on the bemused LDC assessors of the new Northern policy thrusts.

While the origins of the U.S. push for GATT involvement in international trade in services seem to lie primarily in the finance and telecommunications sectors, it is possible to interpret it, as many do, as an attempt much more generally to “open up” the markets of the GATT contracting parties to the direct foreign investment and other activities of transnational corporations. Access for developing countries goods in the markets of the rich in this scenario, may in future be traded off under legitimate GATT auspices, instead of via bilateral diplomatic pressure, against improved access for industrialized countries’ “services” and investments in the LDCs.

In the context, it is important to note that there have been important related international negotiations under way for many years in non-GATT arenas. These include the effort to construct a code of conduct for transnational corporations in the UN Centre for Transnational Corporations, UNCTAD’s work on the drafting of a code for the transfer of technology (and the principles and rules governing restrictive business practices) and the latter’s work relating to shipping and Insurance.

These activities, which presumably are not considered by the U.S. to be proceeding in a satisfactory direction, do not appear to figure in the new trading and investment order which is being so assiduously promoted by the U.S. in the GATT.

Earlier parts of this essay have highlighted the remarkable involvement of transnational corporations in the post-war trade boom. Even in the ITO charter, attention was given to possible restrictive business practices, an issue also stressed by LDCs and smaller industrialized countries in recent years. Scholars have remarked on the lack of international anti-trust rules and, more generally, on the lack of internationally-agreed rules of the game in respect of international factor flows of capital and labour. A broad reform agenda should certainly include a “GATT for investment” as well as a “GATT for migration”. Unfortunately, the 1983 U.S. proposals are not offered in this broad spirit; rather they seek to open doors for U.S. direct investment in specific areas, and in a manner which almost seems to regard other countries' culture and sovereignty as non-tariff barriers.

When an appropriately broad approach is taken, explosive issues are thrust upon the table: if Tokyo is to be made just like home for U.S. lawyers and bankers, why not have Texas give “national treatment” to Mexican maids? Will New York city be opened up to Indian doctors and South Korean construction crews? Which Services and factor flows, in short, are to be “opened up”, and what principles are to be followed in those decisions?

A key consideration should be that the creation of new rules for Services must not involve a retreat from established GATT principles applicable to commodity trade. It is conceivable that the consensus already reached on the benefits of multilateral commodity trade will not be reached either on Services or on capital or labour flows, so that the number of nations willing to commit themselves to freer rules in those new arenas will be smaller even than the GATT “club”. Failure to join any such new clubs should not impinge on the principles of non-discrimination, predictability and transparency already accepted, at least in theory, for commodity trade. In other words, while new Services codes may not involve unconditional most favoured nation clauses, because of culture-specific and politically potent notions as to the appropriate character of “reciprocity”, no nation should see its fundamental GATT rights in the area of commodity trade threatened for not wishing to adhere to the new codes.

The appeal of new codes will, of course, depend on their attractiveness to various types of countries, and on how balances between rights and obligations are struck. A “GATT for investment”, for example, should involve more than just an opening of doors. It should seek as well to clarify issues of jurisdiction and extraterritoriality (issues recently illustrated by disputes over the participation of U.S. subsidiaries in Europe in the construction of the Soviet pipeline). It should also be responsive to the concerns of LDCs and small industrialized countries regarding restrictive

business practices engaged in by transnational corporations, especially in the transfer of technology. Balance in overall coverage will also be important to some countries. The provision of greater security for direct foreign investors would be more easily granted, in some cases, if accompanied by codes giving greater security to migrants, a matter historically neglected in international economic relations, but of growing importance.

In sum the specific proposals made by the United States in 1982 to expand the purview of the GATT show that some remedies may be worse than the disease. The addition of services and investment to the present GATT seems to most observers a dubious way to begin to restore strength and credibility to a dangerously rickety trading system. Reforming GATT and other international agencies charged with the making and interpretation of rules for trade and financial flows will be a delicate process, in which care must be exercised so as not only to avoid throwing out any babies with the bathwater, but also to prevent the addition of pollutants to the next pouring.

(ii) LDC Preferences and “Graduation”

GATT has recognized the principle of special treatment for developing countries, most notably in the Generalized System of Preferences. While the net gains to NICs from such departures from non-discrimination are moot, the least developed countries could stand to benefit from the maintenance and expansion of such preferences. A broad reform and extension of the GATT should not only involve a reaffirmation of special treatment for developing countries, but also tackle the difficult issue of how NICs and other relatively advanced LDCs should gradually be expected to accept the rules for commodity trade which are applicable to industrialized countries, including their granting of preferences to the least developed countries in an unconditional most favoured nation fashion. In return, the NICs might at least expect to be “graduated”, along with the rest of the LDCs, from such openly discriminatory arrangements against them as the MFA.

Viewed in a long-term perspective, “graduation” becomes a legitimate and important issue, both for the system as a whole and for the possible graduates. For reason of their own national welfare, NICs will eventually want to liberalize their import regimes further, rationalize their export promotion schemes and become dues-paying members of the inner club in which trade rules are written and interpreted. Other LDCs, with smaller domestic markets but relatively high per capita incomes, may also seek to be on the “inside” of international rule-making, hoping to obtain greater predictability in their access to external markets.

LDCs have much to gain from resisting the lure of discriminatory special trading (or financial) relationships, which typically are sold to them by larger and richer economies as being aimed at other “exotic and unfair” trading blocs, but which historically have frequently ended up limiting both the economic and political development of the weaker countries. The gradual but complete incorporation

of the “new Germanys” and “new Japans” into the trading order, and the provision of a minimum of economic security for independent small countries, are necessary conditions for international stability.

(iii) Primary Commodities

The Havana charter of the ITO contained provisions for international commodity agreements which balanced the interests of consuming and producing countries. Those provisions promised an improvement over the shaky interwar performance of highly imperfect primary commodity markets, while addressing issues such as security and freedom of access to commodities and raw materials, which during the inter-war years created political frictions. Oil and soybean export embargoes and large fluctuations in commodity prices, especially since the early 1970s, are reminders that these issues are far from obsolete. LDCs, of course, have for many years pressed for International commodity agreements. Food and fuel- exporting countries have more or less on their own adopted their own market stabilization arrangements. A comprehensive code along ITO lines, covering commodities, food, and fuel would be a desirable aim for an expanded GATT. Such a code would have to balance concerns about stability and expansion. Within such a framework it may also be possible to tackle the stubborn problem of agricultural protectionism, often defended on the grounds of “national security”.

(iv) Macroeconomic Coordination

The 1970s and early 1980s have demonstrated how macroeconomic turbulence can seriously impinge not just on trade but on the rules guiding it. Unemployment and exchange rate overvaluation (both often caused by tight monetary policies) generate pressures for protectionism and create uncertainty about future adherence to the trading rules. It was noted earlier that recession and protectionism in the North also hamper the smooth servicing of the external debt of LDCs, threatening the stability of the international financial System. At present, the International coordination of decisions regarding macroeconomic stability, trade, and financial flows is at best loose. LDCs and small industrial countries seriously affected by the macroeconomic and trade decisions of the leading countries of the world economy have few responsive fora where these issues can be discussed multilaterally.

Bankers, insisting on the punctual servicing of LDC debt, appear to have little contact with the authorities in their own countries that are responsible for limiting LDC exports. At present, there is no International authority capable of calling attention to and helping to correct such inconsistencies and anomalies. These considerations indicate the need for closer coordination between a stronger and reformed GATT/ITO and institutions such as the IMF and the World Bank (also no doubt in need of substantial reform, but those are longer stories). Such coordination could both deter protectionism in

industrialized countries, and smooth the way for the eventual possible “graduation” of the NICs.

(v) State Trading

The original ITO contemplated not only the active participation of socialist countries in the International trading system but also substantial state trading by market economies. Rules covering “planned trade” and state enterprises were not worked out in detail, and such a task would indeed be formidable. Nevertheless, state trading, which is already of wider significance than is generally realized, and the accommodation of “planned trade”, deserve priority in a long-term reform agenda. This is not just because the participation of socialist countries in a rule-oriented trading system appears to be a desirable goal, but also because many LDCs, and even industrialized countries may in the future give even greater importance than they already do to commodity trade carried out by state enterprises. In this as in many other issues, transparency will be crucial to an atmosphere of fairness, and the implementation of transparency will require a strong trade secretariat.

(vi) Negotiating a New Trade Order

Sceptics may doubt that the many complex items placed on such a reform agenda could be successfully negotiated in a world composed of over 150 heterogeneous nation-states. It could be a profound mistake, however, to think only in terms of agreements on a region-by-region basis or among those with which it might in the first instance be a little easier to agree. The temptations of that route must be resisted, lest the multilateral system to which the world must eventually turn be set back for years or even decades, and the world risk degeneration into a period of trade blocs, spheres of influence, bilateral frictions, and possible anarchy. It is dangerous for the world to be divided into separate political and/or economic blocs within which different “club rules” apply but between which there are no agreed rules. While some amount of bloc formation is inevitable and even desirable, world order depends upon a minimum degree of recognition of and adherence to universal norms. The United Nations system is the expression of this universally felt need and, for all its faults, if it were not there it would be necessary to create a new equivalent.

In the sphere of international economic events and policies, the UN has many different instruments of which the GATT, which is formally nothing more than a contract among some of its members, is only one. The formal membership of the GATT is, in fact, far less than that of the entire UN. Its membership nevertheless includes many centrally planned economies and many developing countries which, although they do not formally belong to the GATT, participate in its “regime” on a de facto basis. Other trade issues are regularly considered within the UN Conference on Trade and Development (UNCTAD), the UN Centre on Transnational Corporations, and other bodies. It will be important to seek to involve all of the interested and capable parts of the multilateral system in whatever ways are most appropriate in any effort to restore and rebuild the trading order.

The task of negotiating a new world trading order is far from impossible. One may note some recent encouraging precedents. A draft treaty acceptable to almost all nations was produced by the UN Conference on the Law of the Sea. Negotiations during the 1970s on International monetary reform established a system of indirect representation, so that a Committee of Twenty could carry out discussions on questions ultimately involving a much larger number of countries. In the proposed trade negotiations, it may be necessary – on efficiency grounds – to devise some such means of achieving representation without full participation.

In the negotiating process, North-South polarization may be avoided by the emergence of new coalitions cutting across such categories. In particular, an association of “middle” countries, including both NICs and the smaller industrialized countries could play an important role in balancing the bargaining power of the largest trading units. It should be a major objective of these nations in particular, but of all concerned with the longer-run survival of a credible, efficient, and equitable system of global economic exchange, to set in motion a *process* through which these “gaps”, possible reforms, and other requirements are systematically and holistically addressed. One might easily imagine another representative Committee of Twenty, perhaps reporting to a joint GATT/UNCTAD Committee, or perhaps working to a precise timetable geared to a world conference in International trade, a second Havana. The mechanics are not for us to detail. What matters is that such a process be discussed and launched in 1982-83.

IV. Immediate Action for the GATT Ministerial Meeting

While the launching of a longer-term negotiation process leading to a more complete and updated global trading order could be the most important single achievement of the forthcoming GATT Ministerial meeting, there are pressing matters which require urgent and immediate attention. Realistically, these immediate priority questions may take up most of the allotted time of the meeting, and it is important to try to get them right. Detailed progress in these priority areas need not and should not await the results of the suggested wider-ranging discussions and negotiations on the future elements of the entire system.

(i) The Safeguard Clause

The most important immediate issue before the GATT Ministerial meeting is unfinished business from the Tokyo Round of multilateral trade negotiation. That is the question of the terms of a revised “safeguard” clause which would be both effective and equitable, and thus prevent or at least greatly reduce, the total evasion on the GATT, to which importing countries have increasingly

resorted in recent years. Indeed, the object must be generally to bring the growing range of non-tariff, trade-restricting measures, both formal and informal, under International surveillance and to subject them to multilaterally agreed rules and procedures. Quotas, voluntary restraints, orderly marketing agreements and the like must be reined in before they bolt away with the whole system, and themselves become the norm. Until this is achieved there can be little hope of arresting the continuing process of “rot” in the International trading framework.

It is therefore fundamental to the restoration of the credibility of the GATT that a satisfactory safeguard mechanism quickly be agreed. Its principal elements must include arrangements for detailed International monitoring and surveillance of trade-restricting safeguard measures and related adjustment, together with equitable procedures for dispute settlement; specific and strict time limits and phasing-down procedures; strictly defined and internationally agreed objective criteria, based on economic principles, for the circumstances, scope and terms of their use; with the onus of proof of the need for such measures resting upon the importing country. (The “serious injury” which authorizes safeguard action in the current article XIX has never been defined, so it is, in fact, still unilaterally determined by the importing country on its own terms).

In the traditional GATT principles are to be honoured, safeguard action should be permissible only on a non-discriminatory basis, unless discrimination – say, in favour of the poorest countries – is itself multilaterally agreed. European insistence upon the right to “selectivity”, a more innocuous-sounding word than discrimination, has been at the root of the failure so far to achieve a new safeguard agreement; it must be said that some exporters are willing to acquiesce in discriminatory arrangements in order to protect their own future market shares. The principle of non-discrimination is so fundamental to a well-functioning world trading system that it *must* be retained, and deviations therefrom – actual or proposed – systematically rejected. Only temporary derogations, in narrowly defined and strictly time-bound circumstances, should ever be tolerated; and, even then, only if the maintenance of trading “order” – the return to *some* set of agreed rules – absolutely requires it.

Agreement on a revised safeguard system should logically be followed by a negotiated “winding down” and “phasing out” of voluntary restraint and orderly marketing agreements which do not meet its terms, not the least of which must be the recently renewed Multi-Fibre Arrangement (MFA) which, for those that have signed it, has another four years to run. The tendency for other industrialized countries to go along with the Europeans in selectivity must be strenuously resisted.

(ii) Codes on Non-Tariff Measures

The GATT codes on non-tariff measures, laboriously constructed during the Tokyo Round, have not as yet shown much sign of meeting the high expectations held by many commentators at the time of their agreement. Ambiguities (sometimes purposeful) and uncertainties abound in their

carefully negotiated texts, and there is as yet little sign of the promised accumulation of “case law” which would help to resolve them. While a strengthened GATT Secretariat may ultimately be the most important element in a workable system of codes, a more positive immediate approach might now be to resolve remaining ambiguities, such as the precise meaning of the “material injury” which authorizes anti-dumping and countervailing duties; an agreed means of establishing a causal link between “injury” and imports; and a universally agreed basis for measuring the extent of export subsidies in different countries and circumstances and appropriate offsetting duties.

Such agreements should accompany renewed efforts to bolster the development of open, efficient, and impartial dispute settlement procedures, without which the existing system of trading rules, even with the new codes, is likely to generate outcomes consistently biased against the smallest and weakest partners.

(iii) Unconditional Non-discrimination

It is also crucial to stop, and seek to reverse, the process through which the new GATT codes have encouraged further erosion of the principle of *unconditional* non-discrimination in trade. Reciprocity is demanded of countries before they are to be treated in accordance with the terms of the codes on subsidies and countervailing duties, and government procurement. This conditionality of their non-discriminatory treatment is contrary to the first, most fundamental, article of the GATT; and, in the case of the developing countries, also contradicts Part IV, which expressly states that the developed contracting parties do not expect reciprocity from them in return for their provision of access to their markets. Without early return to first principles in these respects, the developing countries seem unlikely to join in efforts to bolster the GATT-based codes.

(iv) “Transparency”

Whatever else is done, it is vital, at a time of increasing resort to opaque, contingent, and discretionary instruments of trade policy, to increase the transparency of international trade-restricting practices. The visibility and predictability of the (GATT-“bound”) import tariff were major advantages of that particular trade policy instrument, advantages perhaps only now being fully appreciated. The GATT, the UNCTAD, and the IMF all seek to monitor trade-restrictive practices in their own ways. A way must urgently be found regularly and systematically to collect and publicly disseminate information concerning the new instruments of trade policy – their extent, incidence, and effects; and their changes, country-by-country, over time. Discriminatory practices should be particularly sought out and publicized in the light of their uniquely damaging effects upon the system.

(v) Tariff-Escalation

Developing countries and certain industrialized countries, notably Canada, have long protested

the effects of escalation in tariffs and other trade barriers upon their exports of semi-processed and processed primary products. Since demand elasticities typically rise with the level of processing of the final product, the trade in semi-processed and processed products displaced by these escalating barriers is potentially very great. Surely a start could at last be made toward the phased de-escalation of trade barriers in the primary product sector.

(vi) “Standstills” on Trade Barriers

The history of declared “standstills” on trade barriers has not been a very impressive one. A GATT Programme of Action as far back as 1963 declared that “no new tariff or non-tariff barriers should be erected by industrialized countries against the export trade of any less-developed country in the products identified as of particular interest to the less – developed countries (...) particularly (...) barriers of a discriminatory nature”. Declarations committing future governments are obviously subject to reviews and re-interpretations. Nevertheless, if ever there was a time when a credible announcement of a firm political commitment to hold the line against further protectionism against the developing countries would be helpful, it is in the debt-ridden, nervous, and depressed second half of 1982. The GATT Ministerial meeting provides an occasion for a joint declaration which rises above the expected platitudes and offers a specific, say five-year, commitment to such a “standstill”.

At the end, we return to the themes we have emphasized throughout. Thirty-five years after its origins, following a period of dramatic changes in the International economy, the functioning of the GATT is in need of major reconsideration. Rather than beginning on a selective series of fresh new tasks, such as some now suggest, the most important current requirement, particularly at a time of great International disorder and trade uncertainty and growing disrespect for existing trading principles and rules, is the restoration of the credibility and authority of established, but now weakened, GATT-based system.

The case for a more liberal trading order is as powerful as it ever was; yet the world is in grave jeopardy of sliding back into the discredited mercantilist practices of earlier periods. The basic principles of non-discrimination, predictability, and transparency are fundamental to an efficient and equitable trading order, and it is crucial to pursue them in a fully multilateral manner. The pressure from some quarters to add new elements to the GATT should be seen as an opportunity for a longer-run review of the entire international framework for the conduct of world trade in goods and Services and in international flows of capital and labour.

A process for the conduct of such a holistic review should be set in motion as soon as possible, and could be launched at the GATT Ministerial meeting.

In the meantime, there are urgent requirements which the GATT meeting should immediately

address, the most important of which are the negotiation of a revised safeguard clause and the phasing out of all trade-restricting measures not consistent with it; the sharpening up of existing GATT codes and arresting of the tendency toward conditionality in the application of GATT norms; the development of instruments to increase greatly the transparency of international restraints on trade; measures to reduce the continuing escalation of trade barriers with levels of Processing; and the proclamation of an effective “standstill” on trade barriers against the products of developing countries.