6 The First Twenty-Five Years of the New Trade Regime

From a global point of view, the first quarter century of the new trade regime was a politically tense and dangerous period. Antagonism between the Soviet Union and the United States, as leaders of two opposing groups of nations, was persistent and acute, flaring up in such confrontations as the Berlin blockade and the Cuban missile crisis. Wars were fought in Korea and Vietnam to contain the feared expansion of communist rule. Soviet troops marched into Czechoslovakia and Hungary to suppress rebellions. As the Kuomintang government collapsed on mainland China and retreated to Taiwan, a new regime hostile to the West emerged in China.

For the major trading nations of the noncommunist world, however, the global political tensions in no way impeded the consolidation and growth of their newly formalized trade relations. On the contrary, the national security concerns of the United States reinforced its economic and commercial interests in urging trade cooperation on other friendly or neutral countries. In the 1950s and the 1960s, a conviction of most in the American policy community was that the country's foreign policy interests were best served by an open, multilateral trading regime linked with a stable, international monetary and financial system. The resoundingly successful Marshall Plan saved Western Europe from grave social malaise and helped to place its economies on a path of rapid economic recovery and growth. For similar geopolitical reasons, President Eisenhower was concerned in the 1950s that Japan should not be driven to seek markets for its exports in China or other communist countries, and he strove to give Japan access to the American market. The belief in strengthening eco-

nomic and commercial ties extended to the developing world, where both the United States and its Western European allies employed financial and trade measures to edge countries into aligning themselves with them.

Taking the first quarter century as a whole, economic conditions in the industrially more established countries created an environment favorable to the expansion of trade and the development of trade cooperation. For these countries, the period has been dubbed a golden age of economic performance. Thanks partly to a high rate of growth in productivity, their economic growth averaged 4.9 percent per annum between 1950 and 1973, a sustained rate of increase in output well in excess of anything that had been known in earlier decades. Rates of unemployment consequently remained persistently low, and the upward trend of prices was relatively modest. Assisted by the stable exchange rate regime established at the Bretton Woods Conference, trade flourished. The growth of world trade easily surpassed that of world production, and everywhere, the relative size of the export sector within national economies regained a status that it had not known since before the First World War. For the developing world generally, however, the period was less evidently buoyant. Though benefiting positively from the prosperous time in the industrially more established countries, a great many developing countries were still largely peasant or semisubsistence economies taking only their first steps toward industrialization, as was reflected in the modest pace of their economic growth.

THE EARLY ROUNDS

The first twenty-five years of the General Agreement on Tariffs and Trade saw a succession of negotiating rounds conducted among GATT members. The most significant was the Kennedy Round, held in 1964–67; it proved to be the occasion for notable changes in how trade relations were conducted. The Kennedy Round, however, was preceded by negotiating rounds in Annecy in 1949, Torquay in 1951, and Geneva in 1956 and again in 1960–61 (the last being known as the Dillon Round). While these rounds produced some reductions in trade barriers and improvements in the rules, their effects were of modest proportions.

A Reluctance to Move Forward

The reasons for the absence of any large forward steps in multilateral trade liberalization and cooperation in the years immediately after the new regime was founded were rooted mainly in the economic circumstances of the time. Tariffs and the other trade barriers, to which the General Agreement on Tariffs and Trade largely addressed itself, were not, in fact, the primary obstacles limiting access to markets in these years. Dominating trade and financial relations was the acute scarcity of convertible currencies that most countries other than the United States experienced as a consequence of the war. Governments felt compelled to apply tight exchange and import controls, and these controls limited market access.

The lack of foreign exchange to settle accounts was a principal constraint on trade between countries. In the late 1940s, governments in Western Europe sought to relieve this constraint through an arrangement for the multilateral clearing of bilateral balances among themselves. This arrangement was discriminatory, but it nonetheless permitted a mutual expansion of trade. Countries in the British Commonwealth, through their membership in the sterling area, were similarly able to relax this constraint on their trade with each other. It was not until after the end of the Korean War, in 1952, that the "dollar shortage" began to diminish and that some Western European countries initiated the gradual dismantling of their exchange and import controls. As these controls slowly receded into the background, tariffs and other trade barriers moved toward the front of the stage as operationally significant restrictions on market access.

Without strong pressure from commercial export interests, the U.S. Congress was reluctant to approve new trade initiatives that might upset domestic industries fearful of increased import competition. It kept a tight leash on trade policy by renewing the presidential authority to enter into trade negotiations for only two years at a time and sometimes for the even shorter period of one year. Until the Dillon Round, it also limited to 5 percent the magnitude of the tariff cuts that could be negotiated. Further, Congress intermittently revised legislation relating to the incorporation of an "escape clause" that weakened or limited tariff concessions in

trade agreements.[1] Thus, in 1951, the Tariff Commission was called on to estimate the point below which a tariff could not be reduced without causing injury to the competing domestic industry, and negotiators were enjoined not to make tariff concessions below this "peril point." If a mistake was made about the "peril point," industries could still seek relief under the escape clause that provided for redress for injuries sustained as a consequence of tariff concessions (see Destler 1986, 20).

With tariff negotiations based on item-by-item bargaining and hobbled by the U.S. "peril point" restrictions, most countries expressed considerable dissatisfaction with the paucity of the results of these early trade negotiations. Forces were at work, however, that would break down the reluctance of the U.S. Congress to move forward in trade liberalization. The underlying factor was undoubtedly the continuing and strong growth in American industrial exports; merchandise exports almost doubled in value between 1950 and 1960. The more immediate precipitating cause was the formation of the European Economic Community (EEC), which came into being in 1958–by far the most important event in international trade relations in the 1950s.

New Impetus: Formation of the EEC

As I observed earlier, the movement toward economic integration in Western Europe was fathered more by political beliefs than by economic ones. Certainly, for the smaller countries, the economic consideration of the need for market expansion through foreign trade was dominant. When Belgium, Luxembourg, and the Netherlands formed the Benelux customs union in 1948, their economic size and the long-standing importance of foreign trade for their economies were powerful motives. But the lineage of the European Economic Community is different; it goes back to the founding of the European Coal and Steel Community (ECSC) in 1951. Brilliantly conceived by Jean Monnet (then head of the French Commissariat Générale du Plan) and politically managed by Robert Schuman (then French foreign minister), the ECSC was proposed partly to overcome the immediate political problem of what to do about the Saar. Because of the Saar's great coal resources and its iron and steel industry, it

was a territory of economic importance to both France and Germany. (It had also been a cause of rancorous conflict after the First World War.) The formation of the ECSC created, in effect, a unified market for coal and steel among the member countries. For these countries—France, Germany, the Benelux countries, and Italy—the ECSC was a political stepping-stone to the even larger goal of economic integration. Through a restatement of the political relations of Western European countries in terms of their common economic interests, centuries of deep political hostility and conflict lost their relevance.[2] In 1957, when the six countries signed the Treaty of Rome that brought the European Economic Community into being, they initiated the formation of a huge customs union, the European Common Market, which evolved into what we know today as the European Union. The formation of this union almost immediately began to have large consequences for international trading relations.

The first reaction came from Britain. Fearing that the new customs union would harm its commercial interests, Britain proposed the formation of a larger European free trade area, a frankly preferential area emptied of the political intent of the European Economic Community. However, this proposal was rejected. As a defensive response, Britain, the Scandinavian countries, and other Western European countries set about establishing a second large trading bloc, the European Free Trade Association (EFTA).

For geopolitical reasons, the United States fully supported the formation of the new European Economic Community and its principal arm, the European Common Market. The United States recognized that the newly proposed customs union would clearly discriminate against American exports, contradicting a principal reason why the nation had championed the General Agreement on Tariffs and Trade; in American eyes, a prime purpose of the agreement had been to outlaw the trade discrimination practiced by preferential trading arrangements, particularly the British system of Commonwealth preferences. But because of the political importance of the new European Economic Community, the United States willingly accepted this departure from nondiscrimination, even though it placed American exporters at a disadvan-

tage in competing with EEC members within the Common Market.[3] Another source of potential damage to some American export interests arose from the way in which the customs union proposed to establish a common external tariff; the new tariff was to be an arithmetical average of existing national tariffs, which implied that the tariffs of Germany and the Benelux countries would rise while those of France and Italy would fall. In these circumstances, the one way to safeguard American commercial interests as much as practicable was to negotiate reductions in the external tariff of the Common Market both to minimize the extent of the discrimination and to limit the tariff increases required of Germany and the Benelux countries.[4]

Both the Dillon and the Kennedy Rounds were responses to this new situation. The Kennedy Round (discussed shortly) was a milestone in the postwar history of trade cooperation. The earlier Dillon Round was important because it signaled the renewal of a more activist role by the United States in promoting trade liberalization. However, the U.S. administration still faced a Congress reluctant to do anything that might upset domestic industries or their workers. The European Economic Community sought to be helpful to the administration in its dealings with Congress, offering to make across-the-board cuts in its tariffs of up to 20 percent if Congress would authorize the administration to reciprocate (see Foreman-Peck 1995, 268). But Congress was not willing to relinquish its power to protect specific industries and would not deviate from the established method of negotiating tariff reductions on an item-by-item basis. It did agree that individual cuts of up to 20 percent could be negotiated. In the end, the Dillon Round did not achieve item-by-item cuts of more than 10 percent. A broader, less precise approach to reciprocity had to await the Kennedy Round.

THE KENNEDY ROUND: A MILESTONE

In terms of postwar, trade liberalization among the industrially more established countries, the Kennedy Round was a large step forward, since it accomplished substantial reductions in tariffs on manufactures. It was also notable, more generally, in terms of the changing nature of trade cooperation, for two quite opposite rea-

sons: it marked a shift in the United States–the leading trading nation–toward a broader interpretation of reciprocity (one that was essential to the advances in trade liberalization made in later rounds), but it also moved in a less liberal direction. While restrictions by individual countries on imports to protect specific industries were not new, the Kennedy Round was the first occasion in which the industrially more established nations collectively agreed to act in a discriminatory way against much weaker countries. The industry at issue was textiles and apparel. The discriminatory action was in violation of the norms–if not of the rules–embodied in the General Agreement on Tariffs and Trade so recently ratified by these countries.

While the Kennedy Round was, in large part, a response to the formation of the European Economic Community, the vigor with which the Kennedy administration pursued the aim of trade liberalization also owed something to its particular stance on foreign policy. The administration chose to meet the perceived threat of Soviet expansionism with a reaffirmation of American leadership in both the political and the economic spheres. It reasserted trade liberalization as part of its strategy to broaden and strengthen links among friendly countries. In regard to the developing world, the emphasis in policy shifted from preservation of the status quo to support for governments engaged in social and economic reforms. Foreign aid was stepped up, and such new programs as the Alliance for Progress and the Peace Corps were launched.

In seeking negotiating authority from the U.S. Congress, earlier administrations had been cautious in their approach, fearful of arousing too much opposition from protectionist lobbies. The Kennedy administration, after having first placated the textile lobby (as will be described shortly), took a bolder line. (George Ball, then undersecretary of state and a convinced internationalist who had worked closely with Jean Monnet, played a large part in initiating the new policy.) For one thing, the administration took steps to set aside the "peril point" legislation that had so emasculated the position of American negotiators in earlier rounds. More positively, it won authority from Congress to negotiate tar-

iff cuts on an across-the-board basis, not only item by item as in the past.

Proposals to cut tariffs by a uniform percentage were not new. They had been mooted at international conferences during the interwar years but had not been implemented. They had been proposed again by Britain at the outset of the postwar years and most recently by the EEC. Now, new circumstances that demanded a bolder response had arisen, in the form of two, huge, European preferential trading areas; only for this reason did the American administration feel strong enough vis-à-vis Congress to dismiss the demand for a more precise accounting of equivalence.[5]

The Kennedy Round negotiations began in 1964 and were completed in 1967. (Despite the name of the round, the Johnson administration represented the United States; President Kennedy had been assassinated in 1963.) The immediate result was a substantial reduction in the tariffs on manufactures of the industrially more established countries. Tariffs on dutiable manufactures were cut, on the average, by 36 percent in the EEC and the United States and by 39 percent in Britain and Japan (see Preeg 1970, 208–11). Agricultural products were relatively unaffected by the round. The United States had requested a waiver from GATT rules for agricultural trade in 1955, and the EEC was adamant, as it had been in the Dillon Round, that its Common Agricultural Policy was not a negotiable subject.[6]

While the Kennedy Round was successful in reducing tariffs, it did not bring about any significant changes in the GATT rules that governed the conduct of trade. During the negotiations, governments reached agreement on the redrafting of the antidumping rule and on changes in methods of customs valuation of dutiable goods.[7] However, the U.S. Congress remained sensitive to any apparent infringement of its authority to determine trade policy, and it refused to ratify the agreed changes, on the grounds that in going beyond tariff reductions, the administration had exceeded its mandate.

Despite the friction between Congress and the administration, the Kennedy Round marked an important shift in the American

attitude toward trade cooperation. That attitude moved away from an interpretation that focused on the narrow balancing of mutual benefits that might be generated by specific product-by-product concessions. The United States came to consider benefits in more general, economy-wide terms. This shift to what Robert Keohane has called “diffuse reciprocity” cleared the way for the broadening of future negotiations to embrace trade-offs whose costs and benefits were much less easily calculable (Keohane 1986, 19).

The Textile Expedient: Not Breaking the Letter of the Law

The Kennedy Round’s progress in tariff reduction and the accompanying U.S. embrace of a broader concept of reciprocity came with a heavy price: the introduction, at the multilateral level, of a measure that was both protectionist and discriminatory. At the behest of the United States, the most powerful trading nations joined together to draw up a multilateral agreement that, by indirectly but effectively imposing quantitative restrictions, discriminated against the cotton textile exports of Japan and, soon after, those of Hong Kong, Taiwan, and South Korea. These powerful nations insisted on negotiating the agreement under the auspices of GATT, though that was an incongruous move.[8] For the advocates of free markets, the agreement was an uncomfortably retrograde step. For those who hoped to promote the conduct of trade relations on the basis of agreed rules, its worst feature was that it so blatantly broke the rule of nondiscrimination.

The measure was first introduced as a politically expedient act that the Kennedy administration deemed necessary. The textile and apparel industry in the United States had warned of its discontent with imports from Japan during the preceding Eisenhower administration. Though Japanese imports accounted for only 2 percent of apparent consumption in 1956, they dominated certain very specific lines of production, such as gingham and women’s blouses. President Eisenhower was loathe to use overt quantitative restrictions that would both be in violation of GATT obligations and hurt European textile exports to the United States, so his administration brought pressure on Japan to apply voluntary export restrictions. However, the American textile and

apparel industry was not satisfied. It was, moreover, politically influential, being a large employer scattered throughout numerous congressional districts.[9] When John F. Kennedy became a candidate for president and sought support from the southeastern states where the cotton textile industry was well established, he promised more rigorous action. However, his administration was equally reluctant to violate GATT openly. At the same time, it was well aware that most European countries were still making use of quantitative restrictions, not only for balance-of-payments reasons, but also to keep out Japanese products.[10] Britain's government had also already resorted to voluntary export restraints in response to rising imports from India and Pakistan under Commonwealth preferences. For the United States, therefore, a multilateral agreement appeared attractive; it would draw the European countries into an orderly marketing arrangement that would make for a better sharing of the burden of Japan's exports.[11]

The initial Short-Term Arrangement regarding International Trade in Textiles did not make much of a dent in the exports of Japan or in those of Hong Kong (which it also initially covered). The arrangement was at first very limited in its product coverage and made relatively generous provision for annual growth in quotas. It was presented as a measure that importing countries would invoke only to deal with import surges that threatened "market disruption." But as George Ball, its main author, recognized, the arrangement was open to abuse. Having become an accepted instrument among the industrially more established countries and being a politically convenient way for placating protectionist demands, the Short-Term Arrangement regarding International Trade in Textiles soon became the Long-Term Cotton Textile Arrangement (which later graduated into the Multi-Fiber Arrangement). Over time, the arrangement embraced an ever more extended range of textile and apparel manufactures and an ever widening group of developing countries, and the annual increase in quotas was steadily pared down. Not long into the operation of these arrangements, Japan largely shifted out of textile and apparel exports to focus on higher-technology products. Accordingly, the Multi-Fiber Arrangement became a discriminatory measure used by the more powerful, industrial countries against

the exports of a principal manufacture from weaker, developing countries.

At least in the earlier years of these arrangements, their "voluntary" character gave the exporting countries room for maneuver.[12] Since the export restraints had to be negotiated, the exporting countries could bargain for better terms. Their bargaining power was, however, small. They could have refused to cooperate, protested to GATT, and been authorized to threaten retaliation, but they would have then run the risk of a worse fate, namely, the unilateral imposition of quotas by the industrially more established countries. For the latter, retaliatory action might have harmed some of their own exporting industries and caused some political lobbying at home. But even more feared at the time, at least in the United States, was that GATT rules and procedures might be invoked, which would have openly called into question the good faith of the United States in abiding by internationally agreed obligations of which it had been the main author.[13] This might have been of no consequence to the textile and apparel industry and hardly more to its representatives in Congress concerned with votes in their districts, but it mattered to officials in Washington attuned to the fragile nature of foreign relations.[14]

Intended as a short-term expedient, the initial arrangement formally respected the rules of GATT by sidestepping them. Had it been a transient arrangement, it might have been regarded as no more than a temporary aberration. GATT had not failed to recognize that circumstances could arise in which countries might want to restrict specific imports to give their industries some time to adjust to intensified competition. Article 19, better known as the "safeguard clause," was intended for that purpose. But it was expected to be applied in a nondiscriminatory way. Further, it was intended to deal with the kind of surges in imports that might follow a negotiated reduction in tariffs. It was not intended to arrest the kind of lasting structural change in comparative advantage that was taking place in the world's textile industry. When the arrangements became institutionalized, it was not possible to characterize them as anything but an exercise in power entirely at

odds with the spirit of GATT (understood as a set of agreed rules for the conduct of trade).

THE DEVELOPING COUNTRIES AS PETITIONERS

If a reminder was needed, the arrangements governing trade in textiles and apparel made clear once again the unequal nature of economic relations between the developing countries and the industrially more established countries. For a great many developing nations, the balance of advantage in the 1960s continued to remain, as in the 1950s, with nonmembership in GATT. By 1965, thirty-five more developing countries had joined GATT. However, a good number of these were ex-colonial African territories whose accession to GATT was not negotiated but was inherited from the former colonial powers.

Lacking bargaining power individually, developing countries endeavored in the 1960s to articulate a collective policy toward their commercial relations with the industrially more established countries. They gradually formed a worldview of these relations that, as it evolved in the 1970s, increasingly challenged the Western model of free market capitalism. In the 1960s, however, the first collective endeavors of the newly formed Group of Seventy-Seven (as it was known in UN forums) was to call for stronger commodity agreements, more foreign aid, the establishment of UNCTAD as a counterpoint to GATT, and preferential treatment in trade. In their economic assessment of world trade, the Group of Seventy-Seven was strongly influenced by the pessimism of opinion makers in the earlier postwar decades about the long-term export prospects of the primary producing countries—which included nearly all developing countries. Many people gave credence to the theory of Raul Prebisch and others that there was an inherent tendency for the terms of trade of these countries to deteriorate in the long run.[15] Even among those who did not subscribe to this particular argument, the common expectation was that the inability to achieve adequate growth in export earnings would constrain the pace of domestic economic development.

Part of the response to this perceived situation was to place the expansion of domestic import-substituting production at the cen-

ter of development policy. Another part, articulated through the Group of Seventy-Seven, was to put forward a distinctively different view of the norms and practices that should govern trade relations between the developing countries and the industrially more established countries. At its heart was the idea of no reciprocity, a position that was in direct contradiction to the central operating principle on which trade cooperation among the industrially more established countries had been built. The Group of Seventy-Seven argued that to promote the industrialization and development of their countries, their exports should enjoy preferential treatment in access to the markets of the industrially more established countries, whereas the latter should accept the need of the developing countries to protect their nascent industries. The developing countries thus assumed the role of petitioners. They were hoping that, for foreign policy reasons or out of a sense of human solidarity, the industrially more established countries would set aside the central condition of the trade cooperation that had so far emerged.

Because of the climate of East-West rivalry that prevailed in this period, the industrially more established countries, in their official statements, did not oppose the main thrust of the developing countries' argument. Indeed, they responded positively. As a measure of their formal concurrence, they agreed in 1965 to include in the General Agreement on Tariffs and Trade a part recognizing special and differential treatment for developing countries (Part IV).

On a more practical plane, the industrially more established countries agreed at the second meeting of UNCTAD in 1968 to study the introduction of a generalized system of tariff preferences–called simply the Generalized System of Preferences (GSP)–to apply to developing countries. It was not, of course, a new thing for the industrially more established countries to grant developing countries preferential access to their markets. Preferential arrangements between colonial territories and the metropolitan powers had a long history, and even after the former gained their independence, these arrangements persisted; a notable instance was the Yaoundé Convention signed in the 1960s between the European Economic Community and former

colonies. However, these arrangements usually provided for reciprocal preferences and were limited to particular countries. By contrast, the Generalized System of Preferences was nonreciprocal and applied to developing countries in general. The European Economic Community introduced the GSP in 1971, followed by the United States in 1976. The members of GATT granted such schemes a waiver from the nondiscrimination rule for a period of ten years (see Rahman 2001, 196–97).

On the face of it, the 1960s might appear to have been relatively benign in terms of trade policy for the developing countries. But the benefits were uncertain and ambiguous. While the systems of generalized tariff preferences accorded not insignificant benefits, the industrial countries granted tariff reductions on a quite selective basis, subjected these reductions to quotas, and retained the freedom to remove them virtually at will. Moreover, against the preferential system must be weighed the introduction of the discriminatory textile arrangements that were gradually made more restrictive and extended to other products and countries. The broader reality was that the developing countries, lacking bargaining power, were at the mercy of one-sided decisions made by the industrially more established countries in response to foreign policy considerations or internal political pressures. While these decisions had consequences that were by no means always baneful, their arbitrary character deprived trade relations of the stability that is a main benefit of a rules-based system.