5 The Founding of the Postwar System

The foundations of the multilateral trade regime that we know today were laid in the years immediately after the Second World War. The time was auspicious for a large advance to be made in trade cooperation. The United States had emerged as an unquestioned superpower, and it had both foreign policy and commercial reasons for wanting to promote its trade relations with other countries.

The immediate steps taken toward greater trade cooperation were strongly influenced by the response of American policymakers, both political and economic, to the near anarchy of the world's interwar years. Their vision was for a grand assembly of international institutions, with the United Nations at the apex. These institutions were to be bulwarks against the aggressive political behavior and economic nationalism that had together bred the turbulent history of the 1920s and 1930s. The driving force behind this new order was a remarkable combination of American power and idealism, an idealism described by Dean Acheson, then assistant secretary of state and later to become secretary of state, as a mixture of "Wilsonian liberalism and utopian dream." As part of this vision, "economic arrangements–even the new ideas of Maynard Keynes–were to be brought into conformity with the classical economic goals of removing obstructions from the free movement of goods, people, and funds as means of expanding trade and development" (Acheson 1969, 726).

The political blueprint, which Dean Acheson disparaged with reason, quickly proved to be unrealistic, even naive. But the economic framework, embracing a smaller world of market-oriented countries, emerged as a remarkable creation of enlightened statesmanship. It provided an orderly and largely benign environment for international monetary and financial relations over the next quarter century and for trade relations up to the present day.

Among those planning for the economic world of the postwar years, the interwar experience had left no doubt about the close interdependence of international monetary, financial, and trade policies or about the broader interdependence between national macroeconomic policies and external economic relations. Disparate national economic policies could destabilize international monetary and financial relations and be highly disruptive of trade, yet independently pursued national economic policies appeared the key to protecting high levels of domestic economic activity. The dilemma was far from academic. There was a widespread concern at the time—mainly, but not exclusively, among the British policymakers—that once the high level of aggregate demand generated by wartime requirements had abated, the United States might not be able to avoid another crippling depression. The message for international policymakers was that the design of a new international monetary and financial system in which orderly exchange rates would be consistent with the maintenance of high levels of economic activity was the first order of business. It was seen as the precondition of expanding trade relations. Before the war ended, American and British officials had in fact already agreed on the establishment of the Bretton Woods institutions. The International Monetary Fund was to oversee an orderly exchange rate system and to facilitate balance-of-payments adjustments through the provision of credit, and the International Bank for Development and Reconstruction was to promote long-term capital flows. However, the birth of a new regime for trade relations did not immediately follow. It came later and was more troubled.

THE HAVANA CHARTER: AN ILL-CONCEIVED PROPOSAL

American ideas for a new trade regime were discussed intermittently with the British during the war years. Proposals were not put forward, however, until the end of 1945, partly because of the

U.S. administration's fear of arousing the protectionist lobbies in Congress. This was well after the other political and economic elements of the new order had been introduced and even established. When the jointly sponsored proposals did come, they were nonetheless imbued with the same hopeful intention of the American postwar planners to establish a new system of global economic relations.[1]

The American and British Proposals

The American drafters saw the charter as a vehicle for urging universal acceptance of their own conception of a freely competitive, private enterprise system. The proposals went well beyond the boundaries of trade policy as it had been understood in the past. Their draft was unexceptional in reaffirming the long-standing principles of nondiscrimination and national treatment and unremarkable in calling for the elimination of quantitative restrictions. But it also encompassed other, less familiar areas, introducing guidelines for restrictive business practices, for international commodity agreements, and—at the behest of the American business community—for the treatment of foreign direct investment by host countries.

By contrast, the British, who had participated in the drafting, differed strongly in their economic beliefs and priorities. True to their overriding concern with protecting the level of economic activity at home, they insisted that the draft assert the obligation of all countries to maintain high levels of employment. While fulfillment of this obligation was recognized to be largely an internal matter, its inclusion in the draft charter provided a justification for the use of quantitative import restrictions in some circumstances.

The Response of the European and Developing Countries

The draft drawn up by American and British officials was discussed at several international meetings, culminating in the conference convened at Havana in October 1947 (and not concluded until March 1948). Negotiations on reductions in trade barriers were initiated as part of these meetings. Because the negotiating authority of the U.S. administration—as granted by Congress—

expired at the end of 1947, these negotiations were completed in the middle of that year. The outcome was the General Agreement on Tariffs and Trade, which is discussed more fully later in this chapter. At the time, it was expected that this agreement would be incorporated into the Havana Charter as the segment dealing with trade relations proper.

Both in the preliminary meetings and at the Havana conference, many countries criticized the draft charter for failing to take adequate account of their political beliefs and aspirations or of their specific economic circumstances. The American advocacy of a liberal, free market international economy found few enthusiastic supporters. Because of their interwar experience, their current economic circumstances, and their social philosophies, both the other industrially more established countries and the developing countries were more convinced than the United States of the need for substantial state participation in the management of the economy.

The wartorn countries of Europe disagreed with the draft on a number of points. The most important source of disagreement arose from the gap in understanding of their actual economic circumstances at the time. For the Europeans, the overwhelming need was to undertake the extensive physical reconstruction of their economies and to adapt themselves to substantially altered economic circumstances. They were not prepared to risk the rapid dismantling of their wartime systems of economic controls and to rely on freely functioning markets to effect the adjustment to the new circumstances. (Underscoring the point was the debacle of sterling convertibility, which had been undertaken reluctantly by the British in the middle of 1947 on the urging of the United States.) Fearing the internal dislocation that might ensue from this course of action, the Europeans preferred to pursue a more gradualist strategy in the relaxation of controls. They accordingly differed markedly with the United States on the issue of quantitative restrictions. Not only did they want to retain use of these restrictions for balance-of-payments reasons, but in view of the "dollar shortage," they also wanted to apply them in a discriminatory way as a means of increasing their total volume of trade.

There were also other, more specific points of disagreement.

For instance, the Europeans wanted tighter rules on export subsidies than the United States was willing to accept, since the latter was aware of the agricultural surpluses that its price support program was capable of generating. The Europeans also wanted more rigorous rules on safeguards for weak industries than the U.S. administration believed Congress would accept. Further, the Europeans and the Americans interpreted restrictive business practices differently.

The developing countries–led by Brazil, India, and Chile–were likewise critical. The issue of economic development had been largely neglected by the British and Americans in their initial drafts. At the insistence of the developing countries themselves, an amendment to the draft charter declared economic development as a primary objective of the proposed International Trade Organization. Both the British and the Americans subsequently opposed the developing countries when they suggested more specific amendments that would allow them to implement their own development policies and programs. For instance, the developing countries pressed their case to be free to use quantitative restrictions as they saw fit in support of their own development aims. The United States representative strongly resisted this position, arguing that if other countries freely used quantitative restrictions, the demand would arise in the United States for it to follow suit; if the most powerful country employed this weapon, other countries would be the losers. Equally wide differences of opinion appeared over the issue of the treatment of foreign direct investment. Imbued with a desire to assert their economic, as well as their political, independence and often suspicious of foreign economic domination, developing countries held drastically different views about the rights and obligations of host countries. At their insistence, an interpretative note attached to the Geneva draft of the charter even asserted their right to confiscate foreign investments without compensation under certain circumstances (see Gardner 1969, 364–68).

The Hapless Outcome

The charter that emerged from Havana in March 1948 was weighed down with exceptions to the rules that it enunciated, and neither of the original sponsors retained much interest in it. By that time, the wartime enthusiasm for planning a new international economic order had dissipated. The Cold War had become an ugly reality, the North Atlantic Treaty Organization was taking shape, and a more pragmatic spirit was dominating American foreign policy. As Richard Gardner has observed, there was now much less faith in the idea that “elaboration and enforcement of formal principles would always promote the orderly settlement of national differences” (Gardner 1969, 373). The American business community, moreover, was fiercely critical of the final document. In its view, the document failed to condemn trade preferences and quantitative restrictions with sufficient vigor, it appeared to condone state planning, and its revised provisions about the treatment of foreign direct investment were quite unacceptable to the original sponsors. Some members of the U.S. Senate also expressed concern that the charter infringed too much on national sovereignty. In the end, the U.S. administration never sought congressional approval of the charter, which quietly disappeared into limbo.

As an exercise in multilateral cooperation, the charter was a dismal failure. In the circumstances that confronted them at the time, many countries could not see what net benefit might accrue to them from participation on the terms put forward by the original drafters. To accommodate their own interests, they accordingly insisted on the inclusion of numerous exceptions to the rules. Some exceptions to rules are inevitable if the rules are to encompass a variety of circumstances, but when exceptions become too numerous or far-reaching, they only underline the absence of a basis for mutually advantageous cooperation. Perhaps the charter’s greatest weakness was that its American drafters had planned for a world of free market economies that did not exist. They failed to appreciate the magnitude of the transitional problems that the European countries faced (in response to which the Marshall Plan was a delayed, but generous, recognition), and both they and their European allies showed scant understanding of the economic problems, aspirations, and nationalist sentiment of the developing countries.

GATT: THE SALVAGED CORE

A more pragmatic core to the Havana Charter survived: the General Agreement on Tariffs and Trade, successfully negotiated in Geneva during 1947. With the Havana Charter not ratified, this agreement set the framework for the postwar trade regime. The agreement came into effect on January 1, 1948.

While the agreement drew much of its language from the Reciprocal Trade Agreements Act passed by the U.S. Congress in 1934, its key principles of reciprocity, nondiscrimination, and national treatment were of much longer standing. They had been forged over a great many decades and had begun to acquire general currency among nations as far back as the mid–nineteenth century. In a broad sense, the General Agreement on Tariffs and Trade built on the network of nondiscriminatory agreements that had existed among European countries in pre-1914 years. The large change was that it transformed such bilateral agreements into a single multilateral convention, in a new recognition of the interdependence of countries and of their mutual interest in international cooperation.

A New Endeavor in Multilateral Rule Making

Much less ambitious than the Havana Charter, the General Agreement on Tariffs and Trade was nonetheless a landmark in the history of trade cooperation. For the first time, nations agreed on a multilateral set of norms, principles, rules, and procedures to guide the conduct of their trade relations. The broad intent of the agreement was that countries should enter "into reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade."[2] The agreement reaffirmed nondiscrimination and national treatment as broad principles that should guide trade relations. It also endeavored to spell out a number of specific rules and procedures that would both facilitate customs clearance and reassure governments that their trading partners would not be able to evade agreed reductions in tariff barriers.

For those engaged in the export trade, the ways in which customs authorities administered national trade laws often mattered as much as tariff rates themselves, since the interpretations and practices of the authorities affected the amount of tariff that traders had to pay and the length of time necessary to clear goods through customs. There were several customs regulations that could affect the amount of duty that was paid. How goods were classified in a tariff schedule determined the rate of duty that they would attract. So, too, did the method of valuing the imported goods for the purpose of calculating the duty. Then, there were the criteria used to determine whether the imported goods could be regarded as originating in a country to which the GATT most-favored-nation tariffs applied. In addition, other costs could arise for exporters because customs formalities caused delays in moving goods out of the bonded warehouses or because the goods had to be scrutinized to determine whether they met national health or safety standards. Further, there were the practices of subsidizing products or of dumping them at below-cost prices in foreign markets; both could render ineffective the tariff schedules that governments had agreed to apply to each other's trade.

National practices and policies in regard to these matters differed quite substantially and were usually well embedded in national administrations. The elaboration of multilaterally agreed rules was a new venture, and there were many technical and policy differences to resolve. For example, even at the level of such a largely technical issue as customs classification, though some attempt had been made in the interwar years to move toward a more uniform customs nomenclature, considerable differences remained when the General Agreement on Tariffs and Trade was drawn up. In these circumstances, the rules concerning customs practices and procedures drafted at the inception of GATT were less specific injunctions than broad statements about what national practices were expected to conform to. Years passed before more uniform systems of classification and more standardized customs formalities were introduced and before more comprehensive and explicit sets of rules on such matters as customs valuation and technical standards were adopted. (In fact, not until the Tokyo Round of the 1970s did such rule making move to a new level. Revisions and refinements have continued up to the present day.)[3]

On the still more sensitive issues of subsidies and dumping, the drafters of the General Agreement on Tariffs and Trade barely succeeded in doing more than acknowledge the problems. On subsidies–then extensively employed by all GATT signatories–the most the negotiators could accomplish was an agreement that countries should not seek to nullify agreed tariff reductions by introducing subsidies for competing domestic products. (Though some countries also wanted an agreement that exports should not be subsidized, the United States–concerned about agricultural exports–objected.) On dumping, the GATT rule was hardly more than a recognition of the right of countries to impose countervailing duties, though it did include the condition that action should not be taken unless the dumping was causing or threatened to cause "material injury."[4]

Yet another important innovation of the new GATT regime was a procedure for the settlement of disputes between trading partners. The negotiators expected that, for the most part, disputes would continue to be settled in what was the traditional way for sovereign states–through diplomatic consultation and conciliation. However, the General Agreement on Tariffs and Trade provided that if a country was dissatisfied with the outcome of bilateral consultations and still felt that its trading partner was failing to abide by its obligations as a contracting party to GATT, it could take the dispute to the governing body of GATT. Moreover, if the governing body agreed with the complaint, it could authorize the complainant to suspend its obligation to the offending party. This provision tentatively introduced into the settlement of disputes an element of adjudication by a third party, a step reinforced during the 1950s, when the practice of appointing panels of disinterested parties to make rulings on disputes began. For the individual countries, however, whether to invoke the procedure and whether to comply with any rulings were still matters of diplomatic judgment. It could not be said that in subscribing to the agreement, countries had agreed to submit themselves to a semijudicial procedure for the settlement of disputes.[5]

The Initial Tariff Cuts

The immediate practical outcome of the Geneva meetings was the successful negotiation of reductions in tariff barriers. The method was to negotiate reductions on an item-by-item basis. In preliminary wartime discussions between the Americans and the British, the latter had proposed that there should be a large, across-the-board percentage cut in tariffs. This was their counter-proposal to the American demand that Britain dismantle its system of Commonwealth preferences. In the American view, Commonwealth preferences were a particularly objectionable barrier to U.S. exports and exemplified the need for general adherence to the principle of nondiscrimination (although the United States had its own preferential trading arrangements with Cuba and the Philippines). In the British view, it was essential for the country to restore its export trade as quickly as possible after the war. Britain was not willing to give up its preferred access to Commonwealth markets unless it was compensated by much easier access to the American market. The British also observed that the United States was not able to bind its tariff reductions for more than three years and that, moreover, the United States reserved the right to withdraw tariff concessions in the event of serious injury to its industries (see Gardner 1969, 352).

In the end, the U.S. administration's concern not to provoke protectionist sentiment in Congress decided the method of tariff cutting. In opting for the item-by-item approach, the United States was more able to adapt its negotiations to accommodate particularist interests. This approach also sidestepped a major problem that had arisen in interwar proposals for across-the-board cuts, namely, whether both high-tariff and low-tariff countries should make the same percentage cuts. Using this approach meant, however, that negotiations had to be conducted on a bilateral basis between principal suppliers. That these bilateral negotiations took place simultaneously within a multilateral setting had a certain advantage; pairs of countries could draw other suppliers into the negotiations to ensure that the latter made other reciprocal concessions. But this advantage only underlined the fact that the item-by-item approach made for tight bargaining based on a narrow interpretation of reciprocity.[6]

The negotiations resulted in quite significant cuts in tariffs. While it began from a position of relatively high tariffs, the United States appears to have made the largest cuts. By 1950, in fact, the average level of duties imposed by the United States on manufactures was lower than that of most of the larger European countries.[7] Besides tariff reductions, countries also agreed to bind tariffs on a number of items carrying low or zero duties. In seeking to eliminate Commonwealth preferences, the United States made little immediate headway. While some preferential rates were reduced or eliminated, more than two-thirds of the preferences accorded to Britain by the Commonwealth countries remained unchanged (see Gardner 1969, 360). However, the point had been made, and in later years, no new preferences were added, while the margin of preference was gradually eroded as tariffs were progressively reduced.

A Notable Advance in Cooperation

As with most negotiated outcomes, the General Agreement on Tariffs and Trade was shot through with weaknesses. The rules and procedures that formed its core presumed that trade was taking place among largely industrialized, private enterprise economies in which the price mechanism operated freely. Actual conditions everywhere differed in varying degree from this model. One consequence was that the membership of GATT was far from universal. The then communist countries, with their centrally planned economies, were the extreme case; they remained outside the new regime. For the different reasons discussed shortly, many developing countries also remained nonparticipants. Only twenty-three countries participated in the initial negotiations—though, taken together, these countries accounted at the time for approximately 60 percent of world trade.[8] Even among the founding members of GATT, differences were substantial, as is reflected in the large qualifications and exceptions made to the rules.

Most countries had extensive systems of import controls in place at the time, and the only pragmatic solution that reconciled such controls with the underlying philosophy of GATT was to recognize their use as temporary and exceptional measures. In another awkward inconsistency, the industrially more established countries excluded trade in agricultural products from the rules because these countries—including the United States—pursued domestic price support programs that entailed import restrictions. There were, moreover, disagreements between the Americans and the Europeans on other issues, such as subsidies and safeguards. Indeed, for reasons just discussed, the rules and procedures often had to be drafted in vague and ambiguous language to win agreement at the time. But even with all its weaknesses, the General Agreement on Tariffs and Trade was a notable advance in multilateral cooperation; not the least of its contributions was that it created a vehicle for subsequent rounds of multilateral trade negotiations.

THE DEVELOPING COUNTRIES AS OUTSIDERS

No more than twelve of the original signatories of the General Agreement on Tariffs and Trade came from the developing world.[9] At the time, a significant number of developing countries, mainly those in Africa, were still colonial territories, but most of the developing countries in Asia and Latin America were independent nations and free to participate. The majority of the developing countries, however, saw little or no benefit in submitting themselves to the obligations of GATT membership. This position did not change in many countries until the 1970s or later.

A fundamental reason for the disinterest that most developing countries showed toward the General Agreement on Tariffs and Trade lay in the structure of their production and trade. They were still predominantly producers and exporters of primary products. Their trading interest was to protect their access or gain greater access to the markets of the industrially more established countries for their agricultural or mineral exports. For noncompeting agricultural products and for minerals, they generally faced few barriers in the industrially more established countries; the latter customarily placed few tariffs or other trade barriers on tropical foods and beverages or on the industrial raw materials coming from the developing world. In competing agricultural products, such as grains or sugar, the case was quite different. Developing countries faced an array of import restrictions in industrial countries, stemming from the latter's efforts, greatly intensified in the depressed 1930s, to support their farmers' incomes through programs to control domestic prices and production. But these programs, though having large effects on trade, were treated by the industrially more established countries as outside the purview of the General Agreement on Tariffs and Trade (and they remained so until the Uruguay Round).

Given the structure of their exports, it is not surprising that most developing countries did not find the General Agreement on Tariffs and Trade to have much relevance for them. Dominating their thinking was the history of severe instability that had characterized world trade in individual primary commodities, accentuated by the recent memory of the great distress experienced in primary commodity markets during the 1930s. In face of the tendencies toward overproduction and extreme price instability that appeared inherent in primary commodity markets (whether national or global), the focus of interest was on measures for stabilizing prices at remunerative levels. Just as the industrially more established countries sought to regulate agricultural production and prices at home, so the developing countries pressed for international commodity agreements to cover a range of both agricultural and mineral products.

In some competing agricultural products where the industrially more established countries already exercised extensive state control over domestic output and markets, international commodity agreements were, in effect, an extension of the regulatory activity through which the state allocated a share of the domestic market to developing country exporters. The idea of the state regulation of markets for individual products at the global level continued to attract many followers in subsequent decades—not only in developing countries. The state management of markets for internationally traded goods later came to be applied to certain industrial products, such as textiles and steel (as is discussed in chaps. 6 and 7). Such an approach to international trade had little in common with the freely competitive market principles that imbued GATT.

However, not only their export interests caused most developing countries to find GATT irrelevant to their needs. As states ambitious to develop economically, they generally valued the freedom to protect new domestic economic activities as they saw fit. Most countries, moreover, felt that they needed to exercise tight control over the use of scarce foreign exchange earnings;

they believed it was necessary to allocate these resources to the purchase of essential supplies of food, fuel, raw materials, and capital goods, rather than to allow the free market to buy imported consumer goods. Article 18 of GATT, which deals with infant industry protection and allows the use of import restrictions for balance-of-payments purposes, gave, in principle, no small latitude to developing countries. But for most developing countries, the question was whether it was worth submitting to any of the GATT disciplines in view of the virtual absence of clear benefits.