

## Transatlantic Differences on Trade and Tariff Policy (\*)

The purpose of this paper is to evaluate the significance of existing and potential future conflicts between the United States and Western Europe on matters of trade and tariff policy, and to suggest ways in which these conflicts might possibly be resolved. To put the issues in proper historical perspective, Section I contains a brief review of the evolution of trade policy since the 1930's and its current status as codified and implemented by means of the General Agreement on Tariffs and Trade (GATT). For additional background purposes, some facts are given in Section II concerning the commodity structure and geographic distribution of the trade of the U.S. and Western Europe and the import duties and other restrictions used by these regions to protect domestic producers.

In Section III, we discuss the issues, outcome, and unresolved problems of the Kennedy Round of GATT tariff negotiations that was concluded in mid-1967. A number of issues that were on the whole bypassed during the Kennedy Round and that are potentially disruptive to trade relations are examined in Section IV. These issues include nontariff barriers, trade in agricultural products, preferences for less-developed-country exports, and East-West trade.

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In Section V we consider the various alternative methods by which further trade liberalization can be pursued and focus in particular on the efficacy of a North Atlantic Free Trade Area which would exclude the European Economic Community (EEC). Finally, in Section VI, we offer our views on future foreign trade policy for the U.S. and Western Europe. Our preference in this regard is for a new round of multilateral negotiations under GATT.

## I.

The international trading system which evolved in the late nineteenth and early twentieth centuries contained two important principles of trade policy for individual nations (1). The first was that the use of trade barriers for protective purposes be confined to tariffs, the heights of which were clearly evident to foreign producers and could be overcome by virtue of efficiency in production. The second was the principle of nondiscrimination in trade among different foreign nations which was codified by the inclusion of a most-favored-nation (MFN) clause in commercial treaties.

Both principles served well on the whole prior to the 1930's when world production and trade were greatly expanding. However, with the onset of the Great Depression and the attendant disorder in financial markets and widespread unemployment, governments resorted frequently to nontariff restrictions and direct controls over international trade and payments. These actions were clearly antithetical to long-accepted principles. It was to help reverse this tide towards severe protectionism and beggar-thy-neighbor policies and to restore the principles of reliance on tariffs and nondiscrimination that the United States initiated its Trade Agreements Acts beginning in 1934. These acts are noteworthy because they marked the introduction of a new principle — that of reciprocity — into trade policy relations (2).

(1) An excellent discussion of the evolution of international trading arrangements and their embodiment in GATT after World War II and of the problems outstanding at present is to be found in H. G. JOHNSON, *The World Economy at the Crossroads* (New York: Oxford University Press, 1965), esp. pp. 36-67.

(2) J. W. EVANS, *U.S. Trade Policy: New Legislation for the Next Round* (New York: Harper & Row, 1967), p. 30, has likened the principle of reciprocity to Janus because it has two faces. The forward-looking face is that of cooperation insofar as tariff reductions by one nation will induce other nations to do likewise. This face lacks precision, however, and thus

The foregoing principles were of central importance in the planning of a "charter" for world trade following World War II, and they later became embodied in GATT following the demise in the U.S. Congress of the proposed International Trade Organization. The purposes of GATT were essentially to set forth "a series of rules and conventions governing the relations among parties to the Agreement with respect to their commercial policies" within a framework of "general principles for the conduct of international trade" (3). The first and most important multilateral tariff negotiation took place under GATT auspices in 1947. This was followed by a number of additional negotiations in the 1950's. These were generally rather laborious exercises in which negotiations were carried out on an item-by-item basis primarily for manufactured goods. Some concessions were made on agricultural products. However, the beneficial effects were often vitiated by nontariff barriers inasmuch as the major trading countries were unwilling to compromise their domestic agricultural interests. This was true above all for the U.S. which applied for and received in the early 1950's a waiver from GATT with regard to its agricultural policies.

provides no guidance to the negotiator. The second face of reciprocity is seen accordingly in the process of actual tariff bargaining in which the participants seek tariff concessions to obtain as large an increase in exports as the increase in imports which may result from the concession. Thus, as Evans points out (p. 32), the logic of reciprocity in practice does not differ in effect "from the value judgments of a primitive mercantilist". B. BALASSA, *Trade Liberalization Among Industrial Countries: Objectives and Alternatives* (New York: McGraw-Hill, 1967), esp. pp. 69-73, makes much the same point.

(3) Thus, as JOHNSON, *op. cit.*, pp. 42-44, has put it:

"... GATT establishes the rule of law and consultation in international trading relations: one basic principle is that the relations of the parties to one another should be embodied in binding legal instruments, the interpretation of which generates a body of rules and precedents for the resolution of conflicts; another is that any actual or proposed policy change by a party to the Agreement should occasion consultation aimed at avoiding or minimizing damage to the trading interests of other contracting parties; a third is that members pledge themselves to work steadily towards the reduction of barriers to international trade through negotiation within the GATT framework.

As regards the principles of international trade, the central one is the principle of non-discrimination. The contracting parties oblige themselves to extend most-favored-nation treatment to one another; they also oblige themselves to reduce existing preferential arrangements gradually, through negotiation, and ultimately to eliminate them, and to introduce no new preferences. There is, however, an important exception to these obligations, which has proved crucial in subsequent developments: countries are free to establish free trade areas and customs unions. ... A second major principle is that protection to existing industries should be provided exclusively through tariffs, not through other commercial measures, especially not by import quotas".

By the end of the 1950's, U.S. initiative towards further tariff reductions was flagging under the weight of protectionist sentiment at home. This was reflected in the rather limited scope for tariff reductions provided in the 1958 extension of the Trade Agreements Act. It so happened that it was about at this time that the EEC came officially into existence. The impetus for economic cooperation in Western Europe had actually begun much earlier under the Marshall Plan via the creation of the Organization for European Economic Cooperation (OEEC). The OEEC's task was to foster cooperation among member countries in order to accelerate reconstruction and growth and liberalize international trade. It was clearly understood that this cooperation was to be sought without interfering with the traditional sovereignty of the member countries. There began at this same time a movement to bind the continental West European countries together both economically and politically in order to mollify the longstanding Franco-German animosity and to solidify the North Atlantic alliance militarily vis-à-vis the Soviet Bloc. This movement which culminated in the formation of the EEC was given strong backing by the U.S. in the belief that it would accomplish the aforementioned ends more effectively than a looser OEEC type of arrangement.

The impact of the EEC on trade and tariff policy was noticeable immediately because of the planned implementation of the common external tariff (CXT) and the fact that the EEC member countries were now to be represented in GATT as a bloc rather than individually (4). This change became clear in the "Dillon Round" of tariff negotiations under GATT in 1961 when the U.S. had very little negotiating authority and the EEC suggested a 20 per cent across-the-board reduction in its CXT provided reciprocity was attained. While it turned out that more was accomplished during the Dillon Round than had initially seemed possible, it became very clear that the EEC would henceforth be in a strong position to affect future negotiations under GATT. It was obvious by the same token that the U.S. would no longer be able to act unilaterally on

(4) The formation at this time of the European Free Trade Association (EFTA) was looked upon as a temporary expedient which would afford its members the benefits of lower tariffs on their mutual trade until such time as an accommodation could be reached to permit an enlarged membership in the EEC. Since EFTA members individually retained sovereignty over their tariffs vis-à-vis the rest of the world, their representation in GATT continued on an individual-country basis.

tariff matters. This was brought home in the spring of 1962 when in response to the U.S. removal of previous tariff concessions on imported carpets and sheet glass, the EEC retaliated by raising its tariffs on a number of U.S. products (5).

The Kennedy Administration was deeply concerned lest the EEC turn out to be highly protective with regard to trade both in agricultural and industrial products and discriminatory with regard to imports from less developed countries (LDC's) that were not associated with the EEC (6). There was concern also about the growing importance of the EEC and its possible rivalry with the U.S. in international economic and political affairs (7). In order to meet the challenges in international trade posed by the EEC, President Kennedy asked Congress for and obtained in the form of the Trade Expansion Act of 1962 the most liberal authority which Congress has ever granted for tariff negotiations. It was on the basis of this authority that the U.S. sought the sixth round of tariff negotiations under GATT which came to be known as the "Kennedy Round".

Before reviewing the specific issues posed by the Kennedy Round and the outcome of these negotiations, it may be useful as a backdrop to provide a few facts about the foreign-trade characteristics of the U.S. and Western Europe.

(5) These events are described briefly in L. B. KRAUSE, *European Economic Integration and the United States* (Washington: The Brookings Institution, 1968), pp. 211-12.

(6) A note of discord was struck in mid-1963 when the EEC introduced measures which virtually curtailed all imports of American chickens into Germany. The U.S. had the choice of directly retaliating against EEC goods or seeking to demonstrate injury to its interests via GATT arbitration. As KRAUSE, *op. cit.*, p. 213, put it, the U.S. chose not to "escalate the chicken war" and opted for the arbitration alternative. They were permitted subsequently by GATT to withdraw previous concessions on an equivalent amount of imports from the EEC. This episode clearly presaged the difficulties that were to emerge during the Kennedy Round negotiations on agricultural products.

(7) JOHNSON, *op. cit.*, p. 52, has made the following observation in this regard:

"It is one of the major ironies of post-war economic policy history that the United States should have devoted so much effort to the creation of a European supereconomy, whose existence and policies now constitute the most serious threat to the attainment of the foreign economic (and military) policy objectives the United States intended to serve by creating it. The obvious analogy with the tale of Frankenstein's monster requires no elaboration".

## II.

Some indication is given in Table 1 of the commodity composition and geographic distribution of the merchandise exports and imports of the U.S., EEC, and EFTA for 1966. These three regions, of course, occupy a position of prominence in world trade, accounting for more than 50 per cent of total trade in 1966 (8). But what is noteworthy when we examine the figures more closely is that a substantial proportion of this trade was intraregional in character between the U.S. and Canada and within and between both the EEC and EFTA (9). Looking at the export data in the top of Table 1, it can be seen that the value of U.S. exports was about one-third primary products and two-thirds manufactured goods, and that about 28 per cent of total U.S. exports went to EEC and EFTA in 1966. Both EEC and EFTA are in contrast relatively more specialized in the exports of manufactures than the U.S., and they export considerably less to the U.S. than they do to each other and to the remaining regions. U.S. exports are apparently oriented more towards the Developing Areas than is the case for both EEC and EFTA. It is evident finally that none of the three regions exports very much to the Soviet Bloc.

On the import side, the value of U.S. imports in 1966 was about 40 per cent primary products and 60 per cent manufactures. The bulk of U.S. imports of primary products came from Canada and the Developing Areas. The EEC and EFTA were important sources of U.S. imports of manufactures as were the Other Industrial Areas, chiefly Canada and Japan. Somewhat less than half the imports of the EEC and EFTA consisted of primary products obtained in large measure especially from the Developing Areas. The greatest proportion of EEC imports of manufactures came from within Europe. Although less pronounced, this was the case also for EFTA. As was true for exports, imports from the Soviet Bloc were not of great importance in any of the regions indicated.

The data recorded in Table 1 are interesting and important because they tell us something about the nature of international

(8) According to GATT, *International Trade, 1966* (Geneva, 1967), p. 300, total world trade amounted to \$200.7 billion in 1966.

(9) Canada is included in the data for Other Industrial Areas in Table 1. The same is true of Japan.

specialization and the exchange of goods by source and destination for the U.S. and Western Europe. U.S. trade is evidently directed much more to Canada, Japan, and the Developing Areas than to Western Europe, while a substantial proportion of Western Europe's trade is intraregional and otherwise oriented more to regions other than the U.S. These facts suggest a number of implications for policy that we shall have occasion to examine later.

It is also of interest to consider briefly the tariff protection which exists in the U.S. and Western Europe. Tariff comparisons are notoriously difficult to make because the rates themselves are not an accurate indication of restrictiveness and there is no unambiguous method by which the individual rates can be weighted to obtain an overall average (10). Some idea of the height of tariffs may nevertheless be obtained from the data in Table 2. It will be noted that the averages refer to nominal tariffs and effective tariffs. The former reflect the rates taken from the official tariff schedules. While these rates may be relevant for analyzing consumer choice between imported and domestically produced goods, they do not afford a satisfactory indication of protectiveness because they fail to take into account the structure of rates with reference to domestic value added in the process of production. That is, the tariff rates in the U.S. and in the other industrial countries are typically escalated according to the stage of production, rising from raw materials to semimanufactures to finished goods, with consumer goods generally bearing much higher rates than capital goods. The successive stages of the production processes will thus be accorded greater *effective* protection at rates which may be substantially in excess of the nominal rates listed in the official tariff schedules (11).

(10) That is, without knowledge of the home and foreign demand and supply schedules for particular goods, we cannot determine how restrictive a 5 per cent or 50 per cent tariff may be. It is common, moreover, to weight individual tariffs by the value of imports, thus in effect assigning a weight of zero to prohibitively high tariffs.

(11) A simple example may help to illustrate this point. Let us define the effective rate of protection of a production process  $j$  as  $T_j = (t_j - \sum a_{ij}t_i) / v_j$ , where  $t_j$  represents the actual tariff rate on the commodity at the last stage of production;  $t_i$ , the tariff rate on commodity  $i$  (with  $i = 1 \dots n$ ) which represents inputs into the production process;  $a_{ij}$ , the cost per unit value of output of  $j$  of the input of commodity  $i$  which is used in process  $j$ ; and  $v_j$ , the value added in process  $j$  per unit value of output. Suppose that for a given production process, imported materials account for half the world-market price of the final product and that such materials are dutiable at 10 per cent while the duty on the final product is 20 per cent. The effective rate of protection on value added in the given production process will,

PERCENTAGE DISTRIBUTION OF U.S., EEC, AND EFTA EXPORTS AND IMPORTS OF PRIMARY PRODUCTS AND MANUFACTURES BY DESTINATION AND SOURCE, 1966

TABLE I

Destination of Exports	United States Exports			EEC Exports			EFTA Exports		
	Primary Products %	Manufactures %	Total %	Primary Products %	Manufactures %	Total %	Primary Products %	Manufactures %	Total %
1. United States . . . . .	—	—	—	0.8	7.0	7.8	2.1	8.4	10.5
2. EEC . . . . .	7.9	10.5	18.4	10.6	33.5	44.1	7.1	18.2	25.3
3. EFTA . . . . .	3.5	6.4	9.8	3.9	15.1	19.0	6.2	16.3	22.5
4. Other Industrial Areas . . . . .	11.7	27.2	38.9	1.3	8.7	10.1	1.9	17.2	19.1
5. Developing Areas . . . . .	9.9	22.3	32.2	1.9	13.3	15.2	2.0	16.2	18.2
6. Soviet Bloc . . . . .	0.5	0.2	0.7	0.6	3.2	3.8	0.7	3.8	4.4
7. Total . . . . .	33.5	66.5	100.0	19.1	80.9	100.0	20.0	80.0	100.0
8. Value in \$ (billions) . . . . .	9.59	19.05	28.64	10.04	42.59	52.63	5.58	22.34	27.92

  

Source of Imports	United States Imports (f.o.b.)			EEC Imports (c.i.f.)			EFTA Imports (c.i.f.)		
	Primary Products %	Manufactures %	Total %	Primary Products %	Manufactures %	Total %	Primary Products %	Manufactures %	Total %
1. United States . . . . .	—	—	—	4.6	6.2	10.8	3.2	5.9	9.1
2. EEC . . . . .	1.7	14.5	16.2	10.3	32.4	42.7	7.1	23.9	31.0
3. EFTA . . . . .	2.3	9.2	11.5	3.7	9.8	13.5	5.7	13.9	19.7
4. Other Industrial Areas . . . . .	13.2	28.0	41.2	5.1	2.9	8.1	10.7	6.7	17.5
5. Developing Areas . . . . .	22.3	8.0	30.4	17.9	3.1	21.0	14.0	4.1	18.1
6. Soviet Bloc . . . . .	0.3	0.4	0.7	2.8	1.0	3.8	2.8	1.8	4.6
7. Total . . . . .	39.9	60.1	100.0	44.6	55.4	100.0	43.6	56.4	100.0
8. Value in \$ (billions) . . . . .	10.11	15.26	25.37	23.91	29.72	53.63	14.78	19.11	33.89

Notes: Figures may not add exactly due to rounding. Primary products include food, raw materials, and fuels; manufactures include base metals, chemicals, capital goods, textiles, passenger cars, and other manufactures. Other Industrial Areas include Australia, Canada, Finland, Greece, Iceland, Ireland, Japan, New Zealand, South Africa, Spain, Turkey, and Yugoslavia; the percentages shown were derived as residuals

since the group of countries was not separately identified. EEC and EFTA imports from the United States were taken from United States exports to these regions with an adjustment of 10 per cent to allow for insurance and freight charges.

Source: Adapted from GATT, *International Trade*, 1966 (Geneva, 1967), pp. 168, 184, and 200.

The conclusion that effective rates of protection will be higher than nominal rates is clearly evident in Table 2 (12). There is apparently not a great deal of difference in effective protection between the U.S. and EEC, whereas the structure of U.K. rates is more highly protective. Even Sweden, which has always been considered a low-tariff country, has high effective protection on some categories of goods. The data in Table 2 thus suggest that there was substantial scope for tariff reductions via the Kennedy Round even though nominal tariffs were comparatively low in many instances. It should also be borne in mind that the rates in question apply to trade with the less developed countries (LDC's) as well as to trade among the industrialized countries themselves. What is important here according to the more detailed calculations that have been made on an individual-industry basis is that effective tariff rates

TABLE 2

AVERAGES OF NOMINAL AND EFFECTIVE TARIFFS FOR FOUR COMMODITY CATEGORIES FOR THE U.S., EEC, U.K., AND SWEDEN, 1962  
(Per cent)

Category	U.S.		EEC		U.K.		Sweden	
	Nominal	Effective	Nominal	Effective	Nominal	Effective	Nominal	Effective
Intermediate Products (a) . . .	8.8	17.6	7.6	12.0	11.1	23.1	3.0	5.3
Intermediate Products (b) . . .	15.2	28.6	13.3	28.3	17.2	34.3	8.5	20.8
Consumer Goods . . .	17.5	25.9	17.8	30.9	23.8	40.4	12.4	23.9
Investment Goods . . .	10.3	13.9	11.7	15.0	17.0	23.0	8.5	12.1
All Commodities . . .	11.6	20.0	11.9	18.6	15.5	27.8	6.8	12.5

(a) Manufactures whose main inputs are natural raw materials.

(b) Intermediate goods at higher levels of fabrication.

Source: B. BALASSA, "Tariff Protection in Industrial Countries: An Evaluation", *Journal of Political Economy*, Vol. LXXIII (December 1965), p. 591.

therefore, be 30 per cent ( $T_1 = (.20 - .50 \times .10) / .50 = .30$ ), as compared with the nominal rate of 20 per cent applicable to the final product itself. To put this in another way, the domestic value of the labor and capital used in the given production process receives protection on the order of 30 per cent in excess of what this value would be if the services of these factors were purchased at world-market prices.

(12) The composition of total trade for the countries included in Table 2 plus Japan has been used to weight each country's tariffs. This avoids some of the weighting difficulty mentioned earlier except in cases where rates may be uniformly prohibitive.

in the industrialized countries are particularly high on goods in which the LDC's may have a special interest for export purposes (13). As we shall see, the case for trade preferences for LDC exports rests importantly on this fact.

Tariffs are, of course, neither the only nor necessarily the most important impediment to international trade. This is particularly the case with regard to primary products that are covered by some domestic price support or control program. Nontariff barriers (NTB's) also, of course, affect trade in manufactured goods, although it is often very difficult to document their existence and to determine precisely what their effects may be (14).

So much for background. Let us turn now to the Kennedy Round.

### III.

The Sixth Round of Trade Negotiations, better known as the Kennedy Round, held under the auspices of GATT and completed in Geneva on June 30, 1967, has been called "... the most comprehensive assault on barriers to trade that has ever taken place" (15).

(13) Effective rates of protection in the industrialized countries are also substantial on the processing of many agricultural products. See, for example, H. G. JOHNSON, *Economic Policies Toward Less Developed Countries* (Washington: The Brookings Institution, 1967), p. 91.

(14) A convenient list of NTB's is given in *ibid.*, pp. 204-5. The various NTB's are classified there according to whether they fall under foreign trade policies; administrative practices; internal economic policies affecting imports; and internal health and safety regulations affecting imports. An alternative grouping can be found in W. B. KELLY, "Nontariff Barriers", in B. BALASSA and Associates, *Studies in Trade Liberalization: Problems and Prospects for the Industrial Countries* (Baltimore: Johns Hopkins, 1967), p. 266, and in R. E. BALDWIN, "Nontariff Barriers: A Brief Survey", in U.S. Senate, Committee on Finance, *Compendium of Papers on Legislative Oversight Review of U.S. Trade Policies* (Washington: Government Printing Office, 1968), p. 338. The following groupings are used by Kelly and Baldwin: quantitative controls and state trading; government procurement policy; customs valuation and practices; antidumping legislation and practices; border tax adjustments; and other internal measures that restrict trade (e.g., differential road-use taxes, differential taxes on spirits, etc.).

(15) Office of the Special Representative for Trade Negotiations, "The Kennedy Round Agreement", contained in Joint Economic Committee, *The Future of U.S. Foreign Trade Policy, Hearings before the Subcommittee on Foreign Economic Policy*, Vol. 1 (Washington: Government Printing Office, 1967), p. 11. This statement provides a good summary of the Kennedy Round agreements and is the principle source of the factual information used in this paper.

The agreements reached will apply to an estimated total of \$40 billion of world trade, with cuts on industrial products averaging about 35 per cent. Measured in terms of 1966 trade, the U.S. is reducing tariffs on approximately \$7.5 to \$8 billion of imports and obtaining tariff concessions on about the same amount of U.S. exports. This sounds like an impressive achievement.

However, before deciding whether or not this in fact is the case, it may be useful to examine the original goals of the Kennedy Round and to see how they were altered in what turned out to be an arduous set of negotiations. When President Kennedy first proposed the Trade Expansion Act (TEA) in January 1962, it was aimed primarily at mitigating the burdens on U.S. trade from what appeared to be potentially ominous developments stemming from formation of the EEC. More generally, the TEA was considered to be in line with the broad policy of furthering a spirit of cooperation between the U.S. and Western Europe. The EEC had passed through its initial stages and was moving ahead of schedule towards its objective of internal free trade. Moreover, it was expected that the Community would soon expand to include the U.K. and other EFTA members. Finally, developments after 1957 had provided ample evidence that the era of the chronic "dollar shortage" had passed. Thus, concern over persistent U.S. balance-of-payments deficits added urgency to the need to negotiate reductions in the EEC's common external tariff.

The TEA, which was passed by Congress on October 11, 1962, granted to the President negotiating authority that far exceeded any that had previously been given. Authority was included for the reduction of most industrial tariffs by 50 per cent, reduction of tariffs on agricultural products to zero in connection with maintaining or expanding exports to the EEC, reduction of tariffs on specified tropical products to zero, and reduction to zero of very low nuisance tariffs. The TEA also contained some quite radical departures from traditional U.S. tariff negotiating policy. One sharp break with precedent was the "dominant supplier" provision which authorized the President to remove tariffs entirely on any product in which combined EEC and U.S. trade accounted for 80 per cent of the free world total. It was anticipated here that the U.K. would shortly become a member of the EEC. Another provision, which granted authority to provide adjustment assistance to industries and labor groups who were adversely affected by imports, was designed

to supplant the traditional approach of granting tariff relief in such situations.

A further important innovation in the TEA related to bargaining methods and was not specifically mentioned in the TEA at all. As Evans put it, "... the Congress had tacitly consented to the President's expressed intention of negotiating an agreement to cut tariffs across the board, thus breaking the shackles imposed by the traditional item-by-item negotiations" (16). In referring to the TEA, Evans noted that full utilization of the impressive grant of authority would have resulted in an average reduction of well over 50 per cent in the U.S. tariff (17). Thus, it can be seen that the U.S. entered into the Kennedy Round with its sights set extremely high. However, disappointments were not long in coming. The rejection of Britain's bid for membership in the EEC effectively nullified the "dominant supplier" authority. Further, it soon became painfully apparent that the EEC intended to pursue a protectionist agricultural policy rendering U.S. negotiating authority in that area virtually useless. The authority for removing tariffs on tropical products was thwarted by the EEC's unwillingness to disturb existing preferential arrangements with a number of African countries. In sum, the sweeping U.S. initiative that had been expected to usher in a new era of cooperation among the nations of the "Atlantic Community" was getting a rather unenthusiastic reception.

It was clear from the start that there were important issues in dispute and the EEC intended to drive a hard bargain. The Economist expressed it pungently as the Kennedy Round was nearing completion: "Instead of producing a 'grand design' for an Atlantic partnership as it was supposed to do, the Trade Expansion Act has led only to the most squalid and interminable negotiations over such Byzantine points as tariff disparities" (18). Tariff disparities were, in fact, one of the contentious issues that arose early and stayed late (19). This insistence by the EEC that higher U.S. tariffs necessitated some adjustments in the straight linear-cut formula delayed

(16) J. W. EVANS, *op. cit.*, p. 8. Note that the discussion of the TEA draws on Chapter 1 of this book.

(17) *Ibid.*, p. 8.

(18) *The Economist*, "Round and Round to Disillusion", April 15, 1967, p. 249.

(19) For a discussion of these issues, see R. E. BALDWIN, "Tariff-Cutting Techniques in the Kennedy Round", in *Trade, Growth, and the Balance of Payments: Essays in Honor of Gottfried Haberler* (Chicago: Rand McNally & Co., 1965).

and embittered the negotiations, but in the end was not allowed to block their success. Other principal issues in dispute included: the American selling price (ASP) method of customs valuations which applied to certain chemical products, providing an extremely high level of protection; the U.S. practice of withholding customs valuation during antidumping investigations which hampered trade by creating uncertainties regarding the duty that would finally have to be paid; and the cereals problem which centered on assuring reasonable access to the EEC market for North American grain growers.

Looking at the actual results achieved by the Kennedy Round, it is clear that the major area of progress was in industrial goods. The full 50 per cent tariff cut was achieved on a broad range of manufactured products. Cuts of between 30 to 50 per cent were made on many more (20).

The chemical-sector bargaining was complicated by the ASP issue. It was resolved only in the very last stages of the negotiations when the EEC shifted its previous stand and agreed to a two-part deal on chemicals. The unconditional part of the package called for a weighted average duty reduction of 43 per cent by the U.S. on an estimated \$325 million of dutiable imports from the EEC, U.K., Japan and Switzerland. Those countries in turn agreed to tariff reductions averaging 26 per cent on nearly \$900 million of U.S. chemical exports. The second part of the chemicals package was made contingent on elimination by the U.S. of the ASP valuation system, which can only be accomplished through the passage of further U.S. legislation (21).

(20) The principal negotiating countries made reductions averaging over 35 per cent on the following product categories: machinery both electrical and nonelectrical; photographic equipment and supplies; automobile and other transport equipment; optical, scientific and professional instruments and equipment; paper and paper products; books and other printed material; fabricated metal products; and lumber and wood products including furniture.

The steel sector was a special situation in which the U.S., a net importer of steel products, had a schedule of tariff rates generally lower than the other participants. Through bilateral and multilateral negotiations, the tariffs of the major steel-producing countries were brought much closer together. Practically all the peaks in steel tariffs were eliminated, so that almost all rates will be bound at 15 per cent or less, with most well below 10 per cent.

(21) If the Congress concurs, the U.S. will eliminate the ASP method of valuing benzenoid chemical imports and establish ad valorem tariffs calculated to provide a comparable degree of protection. Those concerted rates, with certain exceptions, would then be reduced in stages by 50 per cent or to an ad valorem rate of 20 per cent, whichever is lower. (The main exceptions are dyes, which would be reduced to 30 per cent, and sulfa drugs which would be reduced to 25 per cent). The European side of the ASP package would include

In the increasingly important field of NTB's, the major accomplishment was the negotiation of an antidumping code. The code specifies rules and procedures to be followed in antidumping actions similar to those in existing U.S. legislation and regulations on the determination of sales at less than fair value and injury to domestic industries. Of particular importance is the fact that under the code, U.S. exporters will have a chance to defend their interests in foreign antidumping actions. The principal U.S. concession was an agreement to revise existing Treasury Department regulations to limit the time that appraisement is withheld in connection with antidumping actions to a maximum of 90 days, and to assure that investigations will not be initiated unless there is evidence of injury. As mentioned earlier, there were also certain concessions on NTB's contingent upon Congressional concurrence in the ASP bargain.

In agriculture there was little that was negotiable. The EEC, which was in the process of formulating its Common Agricultural Policy (CAP), was unwilling to accept substantial reductions in its level of protection. It was not possible to negotiate a reduction in the highly restrictive effects of the EEC's variable levy system (22). The EEC tariff cuts on agricultural items of interest to the U.S. affected a total volume of U.S. trade valued at only slightly more than \$200 million (23).

Although guaranteed access to the EEC market proved unobtainable, a World Grains Agreement was negotiated which established a minimum price for wheat some 21.5 cents per bushel above that contained in the present International Wheat Agreement and

substantial further tariff reductions on chemicals imported from the U.S. In addition, significant nontariff concessions have been offered as part of the ASP deal: Belgium, France, and Italy would modify road-use taxes to eliminate discrimination against U.S. automobiles, and Switzerland agreed to remove limitations on imports of canned fruit preserved with corn syrup.

In the textile sector, tariff reductions were selective and well below the average cuts. A result of the negotiations in this sector was the extension of the Long-Term Cotton Textiles Arrangement (LTA) which provides for a system of limitations on cotton textile exports by the LDC's to the advanced industrial countries. The latter countries agreed to enlarged import quotas and certain tariff reductions (U.S. reductions on cotton textiles amounted to a weighted average of 21 per cent) as concessions to the exporting countries for obtaining an extension of the LTA until September 30, 1970.

(22) See footnote 41 below for a brief comment on the EEC's variable import levies.

(23) The U.S. was also able, however, to obtain some agricultural concessions from Japan, Canada, the U.K., the Nordic countries and Switzerland. The concessions received will enhance the export opportunities for a number of products including: soybeans, tallow, tobacco, poultry, and horticultural products, such as citrus and canned fruit.



somewhat below current market prices. The new agreement also provided that the participating countries, including both exporters and importers, will contribute 4.5 million tons of wheat to a multi-lateral food aid program. This was a much smaller program than the U.S. wanted. The U.S. share of the program will amount to 42 per cent of the total.

The LDC's benefited less from the Kennedy Round than had been anticipated when those negotiations began. The hoped-for generalized preferences for the exports of such countries and removal of duties on tropical agricultural products did not materialize. However, the developed countries did agree on the principle that full reciprocity was not to be expected in tariff negotiations with the LDC's and, in fact, some concessions of interest to them were granted. The United States, for example, made concessions benefiting LDC's covering over \$900 million of their exports, including the elimination of the duty on \$325 million of that total.

But, such concessions were significantly lower than those made with respect to manufactured products traded chiefly among the industrialized countries. It appears, therefore, that even after taking the Kennedy Round reductions into account, the levels of both nominal and effective tariffs on manufactured products of interest to the LDC's are still relatively high and greater on the average than tariffs on products traded mainly among the industrial countries themselves (24). The extension of the Long-Term Cotton Textiles Arrangement implied, moreover, that there would be little improvement in the ease of access of LDC products into the industrial countries.

#### IV.

The successes and failures of the Kennedy Round serve to identify a number of principal trade policy issues of the future. In a wide range of manufactured products, tariffs have been reduced to a point where they are a much less important barrier to trade than formerly. As a result, nontariff barriers to trade have become

(24) For information on the effects of Kennedy Round tariff reductions on the rates applicable to the LDC's, see UNCTAD, *The Kennedy Round: Preliminary Evaluation of Results with Special Reference to Developing Countries*, TD/6 and Supplements 1-3 (4 September 1967). For an analysis reaching different conclusions pointing to greater benefits from the Kennedy Round to the LDC's, see the special study by the GATT Secretariat (1967).

relatively more important than in the past. Substantial liberalization of trade in agricultural products was not accomplished so that the problem of assuring reasonable growth of trade in that sector remains. The needs of the LDC's for expanding exports through significantly improved access to developed country markets were not met, and this continues to be a major policy issue. Finally, an issue that was raised but not pursued in depth in the Kennedy Round is what the policy of the U.S. and Western Europe should be with respect to East-West trade. In general, the issue of broad tariff liberalization is perhaps now less pressing and problems related to particular commodities and to the relationships between groups of countries stand out in sharper relief. Let us now examine some of these problems in greater detail.

#### Nontariff Barriers

We have already pointed out that the Kennedy Round contributed relatively little to the reduction of NTB's, except for the agreement among GATT members on an antidumping code and the EEC chemical package that was made conditional on U.S. elimination of the ASP method of valuing, in particular, imports of benzenoid chemicals. As tariffs have been reduced significantly in the periodic GATT negotiations, more attention has become focused on the impediments to trade represented by NTB's. As noted earlier, the NTB's that have attracted the most attention are quantitative controls and state trading; government procurement policy; customs valuations and practices; antidumping legislation and practices; border tax adjustments; and a variety of other internal measures that restrict trade. NTB's are particularly troublesome not only because they involve outright trade restrictions as in the case of import controls, but also because of the uncertainty which their administration may create (25).

(25) In comparison with tariffs, quantitative restrictions on imports have the effect of severing the relation between domestic and foreign prices. Such restrictions give rise, moreover, to "quota" profits equal to the aforementioned price difference times the quantity imported. These profits will accrue either to importers or exporters and ordinarily not to the government, as in the case of a tariff. At least with a tariff, if the foreign producer increases his efficiency, he may be able to overcome the tariff. Improvements in efficiency are of little use, however, in overcoming quantitative controls on imports.

It is difficult to negotiate the reduction or elimination of NTB's because they have so often historically been introduced as an adjunct of some particular domestic policy. Unless the domestic policy in question is changed, therefore, little can be done concerning the NTB's involved (26). In some cases, however, the domestic conditions that led to the imposition of the NTB's may no longer exist, although it may be difficult to convince the vested interests that this is so. In order to pin-point some of the problems posed by NTB's in the U.S. and Western Europe, it may be useful to discuss briefly the different types of NTB's that have been mentioned.

*Quantitative Controls and State Trading.* - We have already indicated that import quotas on agricultural products are commonplace in both the U.S. and Western Europe in instances where farm prices are supported domestically at levels in excess of world prices. There seems little likelihood that such quotas will be removed or liberalized significantly in the near future. As far as nonagricultural products are concerned in trade between the U.S. and Western Europe, the most important restrictions are those affecting the import of U.S. coal into Western Europe. Since protection of coal mining has many of the same characteristics as protection of agriculture, it will be similarly difficult to effect much in the way of liberalization. There is, in addition here, the larger question of the relation of coal to other forms and sources of energy which must be considered in the context of energy policy in individual nations and in the EEC as a whole (27).

There are in contrast comparatively few quantitative restrictions affecting industrial products traded between the two regions since most of these restrictions in Western Europe, especially, which dated from the 1930's and the early post-war dollar shortage, were removed under OEEC auspices (28). Both regions, however, retain significant

(26) Thus, for example, we could hardly expect countries to do away with import quotas on agricultural products that are covered by domestic price supports. If a different type of domestic agricultural program were adopted, say one in which deficiency payments were made directly to farmers, the import quotas would no longer be needed.

(27) See W. B. KELLY, *op. cit.*, p. 308, for a discussion of these points. It should also be mentioned that the U.S. has import quotas on petroleum and petroleum products. These quotas do not affect Western Europe directly, however.

(28) The few remaining restrictions on imports of U.S. industrial products into the Western European countries are noted in *ibid.*, pp. 270-71.

restrictions affecting imports of manufactured goods from Japan, and Japan in turn has many restrictions of its own (29).

State trading is not of much importance in the U.S. and Western Europe (30). This issue is likely to grow in importance, however, as East-West trade expands in the future.

*Government Procurement Policy.* - On the surface, at least, the U.S. appears to be especially vulnerable to criticism because of the "Buy American" Act which grants a 6 per cent price preference for domestic over foreign producers and an added 6 per cent for small firms or firms in depressed areas. The preference given to U.S. firms for defense procurement is 50 per cent, and a very substantial proportion of foreign aid is tied to the procurement of U.S. goods. The European countries are by no means liberal with respect to government procurement, however, for as Kelly points out, "the absence of legislation or regulations does not necessarily constitute liberality; it may afford the widest possible latitude for restricting trade" (31). To the extent that such formal and informal arrangements for government procurement restrict trade, there would appear to be some scope for reducing or eliminating the most obvious excesses through negotiations involving the affected parties.

*Customs Valuation and Practices* (32). - The treatment of imports for customs purposes is considerably more complicated in the U.S. (and Canada as well) than in Western Europe. This is because of the complexity of the U.S. tariff schedules and the different bases which exist for valuation of certain imported products. With regard to nomenclature, the U.S. schedule differs significantly from the comparatively more simple Brussels Tariff Nomenclature (BTN) in

(29) *Ibid.*, pp. 274-76.

(30) It is confined chiefly in the case of the U.S. to subsidized agricultural exports which go mainly to the LDC's, while in Western Europe state trading affects such goods as ethyl alcohol, alcoholic beverages, salt, manufactured tobacco, matches, and coal. See *ibid.*, pp. 276-78, for additional details.

(31) *Ibid.*, p. 278. Kelly goes on to say (pp. 279-80):

"Most industrial countries other than the United States are more subtle in granting preferences to domestic producers in government procurement. These preferences most often result from the exercise of broad administrative discretion because there are usually no specific 'buy national' laws or regulations. In addition to administrative discretion, practices that limit or deny the opportunity to compete for government contracts include little or no advance publicity, eligibility and other regulations that preclude foreign bidding, and closed lists of suppliers."

(32) See *ibid.*, pp. 284-95.

effect in most other industrialized countries. As far as special import-valuation problems are concerned, the most widely publicized instance is the ASP method of valuing benzenoid chemicals, which became a great bone of contention during the Kennedy Round. As we have already noted, at EEC insistence the elimination of ASP valuation was made a condition for further tariff reduction on chemicals. It also appears that the U.S. is relatively slow in adjudicating valuation disputes. These are things which the U.S. could correct unilaterally or on the basis of some quid pro quo vis-à-vis Western Europe. This is not to deny, of course, that significant short-run administrative difficulties might be experienced if the U.S. were in fact to adopt the BTN and otherwise attempt to simplify its customs procedures.

*Antidumping Legislation and Practices (33).* - Dumping refers to selling a good abroad at a lower price than at home. It may arise when firms have enough market power so that they can charge different prices in different markets. What is of concern to importing countries is not price discrimination per se. Rather it is the possibility that such discrimination may be used in a predatory fashion to stifle competing producers in the importing countries. By the same token, exporters are concerned that antidumping procedures may be used for protective purposes in the importing countries.

We noted earlier that an international antidumping code was agreed upon during the Kennedy Round. The impetus to obtain agreement came chiefly from the U.S. concern that restrictive antidumping measures might be introduced in Western Europe as tariffs on intra-EEC and EFTA trade were removed and the external tariffs of these regions lowered as a result of the Kennedy Round. This was the case especially since antidumping procedures were administratively determined in Western Europe and there were no clearcut criteria for determining injury.

The new international antidumping code is designed to encourage impartial and more rapid investigations and to offer criteria for determining injury. The effect in this regard may be not only to deter Western Europe from utilizing antidumping procedures to restrict trade. There may also be an improvement in the administra-

(33) See *ibid.*, pp. 295-300.

tion of the U.S. law which has been subject to criticism because of the uncertainties created with respect to valuation in alleged cases of dumping and the long delays in the settlement of claims.

*Border Tax Adjustments (34).* - The issue of border tax adjustments arises in connection with the indirect taxes (e.g., sales tax, turnover tax, excise tax) which are commonly used especially in Western Europe. Indirect taxes are typically levied upon consumption in contrast to direct taxes which are levied upon business profits and personal income. It is permissible under GATT rules for countries with an indirect tax system to levy an "import equalization tax" which is intended to subject imported goods to the same amount of indirect tax as will be reflected in the price of similar goods produced domestically. Under this system of taxing internationally-traded goods according to where they are consumed (i.e., the so-called destination principle), exporters will thus receive a rebate on the indirect taxes that are included in the price of the exported goods. World market prices are freed consequently from indirect taxation. The prices of imported goods will reflect then only the indirect taxes in the consuming country.

Direct taxes on income (e.g., the corporation income tax) cannot be rebated on exports or be imposed additionally on imports under GATT rules. The reason for this is that direct taxes are presumed to be borne by the factors of production in the country in which the goods originate. A border tax adjustment is held to be unnecessary, therefore, because direct taxes will not be reflected in the prices of final products. The theoretical rationale here is that under conditions of competition, where firms are assumed to be maximizing profits, a tax on profits will have no effect upon the determination of optimum firm output. That is, firms would be unable to pass the tax on to consumers by raising prices and restricting output without adversely affecting their profits. The question arises, however, as to whether this conclusion is applicable to situations of oligopoly where firms enjoy an important element of market power

(34) Good discussions of the issues of border-tax adjustments are to be found in D. DOSSER, "Fiscal and Social Barriers to Economic Integration in the Atlantic Area", in B. BALASSA and Associates, *Studies in Trade Liberalization*, esp. pp. 220-33, and H. JUNZ, "The Border Tax Issue Defined", in Joint Economic Committee, *Issues and Objectives of U.S. Foreign Trade Policy: A Compendium of Statements Submitted to the Subcommittee on Foreign Economic Policy* (Washington: Government Printing Office, 1967).

and thus may be in a position to shift the corporation income tax wholly or in part on to consumers in the form of higher prices. It may be, therefore, that since the U.S. relies extensively on a corporate profits tax, its exports of manufactured goods are placed at an unfair disadvantage vis-à-vis exports of countries where indirect taxes are rebated.

Whether or not this is so is primarily a factual question. It is noteworthy that the most authoritative recent study of the U.S. corporation income tax has concluded that there is no evidence that it is shifted forward to consumers in the form of higher prices in the short run (35). If this conclusion is indeed correct, there are no grounds accordingly for the U.S. to give a rebate on exports and impose an extra surcharge on imports. But suppose in any event that the U.S. adopted a system of indirect taxation in lieu of the corporation income tax in an effort to improve its export position. It has been estimated that under such circumstances the decline in U.S. export prices would not likely be more than 5 per cent and the decline relative to other countries' export prices could be as little as 1 or 2 per cent if they adopted measures which reduced their export prices as well (36). It does not appear, therefore, that U.S. exports are at much of a disadvantage because of the system of direct taxation employed.

This is not to say, however, that the existing tax systems in the U.S. and Western Europe are perfectly neutral with respect to foreign trade. There are many cases in which the distinction between direct and indirect taxes cannot be made clearly and in which export rebates in fact undercompensate or overcompensate for the effect of the taxes. It is important, therefore, to scrutinize the existing tax systems with great care and to remove present inequities in the treatment of foreign-traded goods as well as to keep new inequities from occurring (37).

(35) R. J. GORDON, "The Incidence of the Corporation Income Tax in U.S. Manufacturing, 1925-62", *American Economic Review*, Vol. LVII (September 1967).

(36) See R. Z. ALIBER and H. STEIN, "Price of U.S. Exports and the Mix of Direct and Indirect Taxes", *American Economic Review*, Vol. LIV (September 1964).

(37) There has been considerable discussion following President Johnson's balance-of-payments message in early 1968 of the desirability of the U.S. initiating border tax adjustments on its exports and imports. Unless it can be proven that these adjustments were necessary to offset "unfair" export rebates abroad, the EEC in particular might undertake retaliatory measures to negate the U.S. actions.

*Other Nontariff Barriers* (38). - There are a variety of other NTB's in addition to those already mentioned. These include annual automobile road-use taxes used especially in France, Belgium, Italy, and Austria. These taxes are imposed in such a way as to discriminate against U.S. automobiles. Another example is the excise tax and import-duty differential resulting from the method of wine-gallon assessment used by the U.S., which discriminates against imported spirits. Some countries impose quotas on imported motion picture films and television programs. Other examples include requirements of marks of origin on labelling that may involve undue expense, the imposition of needlessly restrictive standards of safety and health on imported goods, and restrictions on the contents of imports by specifying the precise references to be used in product advertising in such a way as to favor domestic goods.

We have already noted that not much can be done to modify the restrictiveness of particular NTB's without changing the underlying domestic policies at the same time (39). Perhaps some progress can be made nevertheless by tying the removal or reduction of NTB's to multilateral tariff reductions as was done during the Kennedy Round with regard to the chemical negotiations. Agreement may also be sought to standardize and harmonize various restrictions with the ultimate end in mind of eliminating them.

### Agricultural Products

As far as trade in agricultural products is concerned, there is evidence already that the EEC's common agricultural policy (CAP) has had an unfavorable effect upon U.S. agricultural exports, especially temperate zone foodstuffs (40). In view of the system of

(38) KELLY, *op. cit.*, pp. 301-7.

(39) No mention has been made of the other side of the NTB coin to take account of subsidies of various kinds which artificially encourage international trade. Among these may be mentioned: subsidies to domestic producers or factors of production; maritime subsidies; domestic transportation subsidies; research and development subsidies; and special tax benefits. We have also abstracted from the various forms of restrictive business practices which may affect trade. A number of these matters are discussed briefly in BALDWIN, "Nontariff Barriers: A Brief Survey", esp. pp. 342-44; see also DOSSER, *op. cit.*, esp. pp. 233-35.

(40) KRAUSE, *op. cit.*, pp. 99-100, has estimated an annual loss of \$150 to \$200 million for U.S. agricultural exports during 1958-65 as a result of EEC policies. This amount was equal to 3.4 per cent of total U.S. exports of agricultural products (p. 102). He estimated a loss in U.S. agricultural exports totalling \$2,050 million for the period 1958-70 (pp. 102-9 and 222).

variable import levies used in implementing the CAP (41), the chances are that U.S. exports will be even more adversely affected in the future. How serious this will be depends upon the height of domestic farm prices within the EEC and how production responds in France especially.

Some understanding of the direction of possible future developments may be obtained by examining briefly the French position that the world markets for temperate zone agricultural products should be "organized" in order to achieve higher prices in the markets of the industrial countries, with the excess supplies that may be generated by such a policy being diverted on a concessionary basis to the markets of the LDC's to accelerate economic development (42). It thus appears that the World Grains Agreement worked out during the Kennedy Round is quite consistent with France's views. That is, if prices in the EEC are set at sufficiently high levels, the expansion of French grain output especially could easily exceed total EEC needs. Hence, provision would have to be made to export surplus output and the World Grains Agreement provides such an outlet.

France's proposals for the organization of markets for temperate zone foodstuffs can be looked upon essentially, then, as a rationalization for a highly restrictive CAP. Such a policy is being pursued despite the obvious fact that the overseas suppliers can produce these temperate zone products much more cheaply than France or the other countries in the EEC. It is thus unfortunate that the CAP will most likely ramify the inadequacies of a system of high and inflexible farm prices which would cut off cheaper imports, encourage the expansion of higher cost output, and perhaps add to the world's agricultural surplus accumulations (43).

(41) The workings of the CAP are described in *ibid.*, p. 91 as follows:

"Target prices for individual products are set for the market as a whole, with some slight deviations. To ensure that these prices cannot be undermined by world market conditions, a system of variable import levies is provided. These levies are calculated to offset completely any price advantage that imported products may have over domestic products. Since these levies are easily adjusted, the EEC market is completely insulated from world price developments".

(42) Some indication of French views on the "organization" of commodity markets is given in the statement by V. G. D'ESTAIN in UN, *Proceedings of the United Nations Conference on Trade and Development, Policy Statements*, Vol. II (New York: United Nations, 1964), pp. 195-98.

(43) The comments by KRAUSE, *op. cit.*, pp. 117-18, are worth noting in this regard:

"The EEC is not the only factor distorting the world market mechanism for agricultural products. Most agricultural importers and many exporters — including the United

The World Grains Agreement which contemplates using agricultural surpluses to accelerate economic development is, of course, nothing really new. Surplus disposal has been an integral part of the U.S. foreign aid program since the mid-1950's and has to a limited extent been carried out also under United Nations auspices. Surplus commodity aid has been important to some LDC's in enabling them to restrain inflation, free additional foreign exchange for use in importing capital goods, and raise consumption and nutrition standards. Some of these benefits may have been offset, however, by the depressing effects of surplus disposal upon the domestic agricultural output in the recipient countries and upon supplies of the same or related goods produced and exported by other exporting countries, some of which were themselves underdeveloped. It is frequently overlooked, moreover, that agricultural surpluses may be a relatively inefficient way to transmit economic aid to the LDC's (44).

In summary then, the EEC's common agricultural policy promises to be a continuing source of conflict insofar as U.S. agricultural exports to the EEC may be severely restricted in the future. There may be some consolation to the extent that surplus commodity aid to the LDC's will be furnished by the EEC via the World Grains Agreement. The benefits of such aid to the LDC's are not altogether clear, however, and it should be borne in mind that there are other ways in which aid objectives can be more effectively accomplished.

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States — must share the blame. But in other countries the errors of this policy have been recognized in part, and in many countries — most noticeably the United States — policy changes have been introduced to reduce the degree of market distortion. The fact that such an important area as the EEC is moving in the opposite direction is disconcerting. Spokesmen for the EEC have pointed out that the Community is merely following the path of the United States in its agricultural policy. While this assertion is undoubtedly true, it is hardly a justification for repeating all the errors that have marked the U.S. experience".

(44) Once produced, surpluses may have no alternative use. But it does not follow that the production of future surpluses should be purposefully encouraged as a means of providing additional aid. If one adopts this line of reasoning, would it not be better to encourage, instead, the production of surplus machinery, vehicles, and other manufactured goods which are equally and perhaps more vitally needed for development? Or, to go one step further, would it not be better still to make outright financial grants to developing countries and leave the spending decisions up to them?

### Trade Preferences for LDC Exports

One of the most pressing trade policy issues facing the U.S. and Europe is clearly the formulation of some suitable response to the insistence by the LDC's that measures favoring their exports in the markets of the developed countries are long past due. Their argument is that they have received little benefit from the trade liberalization that has been achieved under the principles of reciprocity and MFN treatment which are embodied in the GATT. They view efforts to achieve generalized trade liberalization, such as the Kennedy Round, as inherently involving negotiations among rich countries affecting trade primarily of interest to the developed world. Moreover, it is agreed that in the absence of greatly increased levels of foreign aid, the dependence of development on increased foreign exchange earnings by the LDC's makes it urgently necessary that action favoring their exports be taken. This implies both an effort to maximize their receipts from traditional primary products, which constitute the bulk of their exports, and also a move to increase their production of manufactures for export purposes and for import substitution.

For a variety of reasons ranging from the protectionist agricultural policies of most developed countries to generally sluggish demand, the prospects, with certain exceptions, are not good for rapid and dynamic expansion of primary product exports (e.g., foods, fuels, mineral ores, and agricultural raw materials), which currently account for about 85 per cent of LDC export earnings (45). Thus, attention has shifted to the manufacturing sector where it is believed the outlook is more promising.

Here, however, it is argued that the obviously desirable development of manufacturing for export by the LDC's is being frustrated by what amounts to discrimination against them by the developed countries in the form of high effective duties on the kinds of products they can produce efficiently and special restrictions affecting their exports epitomized by the Long-Term-Arrangement on Cotton

(45) H. G. JOHNSON, *Economic Policies Toward Less Developed Countries*, esp. pp. 136-62, contains a good discussion of the various techniques, including international commodity agreements, that have been used or considered for maximizing and stabilizing LDC earnings from primary products exports. Also, a balanced consideration of commodity policies is interspersed in the testimony of various economists contained in Joint Economic Committee, *The Future of U.S. Foreign Trade Policy*, op. cit., pp. 219-68.

Textiles. Thus, the view has been taken, particularly in the United Nations Conference on Trade and Development (UNCTAD), that discrimination against the LDC's should be replaced with discrimination in their favor.

A consideration of how a system of preferences for LDC exports would work raises many thorny technical and substantive problems (46). To begin with, the selection of products and countries to be covered by the system would entail difficult decisions. Some manufactures produced by LDC's, such as cotton textiles, are already considered "too competitive" by many developed countries and would not be likely prospects for preferential treatment. A number of countries could be considered either among the most developed of the LDC's, or the least developed of the developed countries. Should they give preferences or receive them, and who decides? What arrangements should be made to protect domestic industries in developed countries that are injured by preferential imports? How long should a preferential system last in order both to give sufficient time for infant industries to reach maturity in LDC's and to avoid unduly perpetuating inefficient manufacturing? Should the preferences be terminated by raising the preferential rates or lowering the MFN rates? What, if anything, should be done about the great relative differences among LDC's in their ability to take advantage of export opportunities presented by preferences? How should pre-existing preferential arrangements like that between the EEC and certain associated African countries be handled? Simply raising some of the questions indicates the complexity of the issues involved.

In the original UNCTAD meeting in Geneva in the spring of 1964, the U.S. flatly opposed, on the grounds of its commitment to the MFN principle of nondiscrimination, the concerted recommendation of the LDC's that preferences be granted for their exports (47).

(46) The best reference for a straightforward and comprehensive presentation of the issues is UNCTAD, *The Question of the Granting and Extension of Preferences in Favour of Developing Countries*, TD/B/C.2/AC.1/7 (31 May 1967). See also the papers by J. PINCUS, "United States Trade with Less Developed Countries", and H. B. LARY, "Imports of Manufactures From Less Developed Countries", contained in Joint Economic Committee, *Issues and Objectives of U.S. Foreign Trade Policy*, op. cit., pp. 189-215 and pp. 216-44, for a fuller treatment of the subtleties of some of the arguments concerning preferences.

(47) At that meeting the U.S. was isolated in its opposition to virtually all the LDC proposals. See JOHNSON, *Economic Policies Toward Less Developed Countries*, pp. 251-54, for a list of the voting records of the major developed countries at the first UNCTAD meeting.

Europe was equivocal on the question of preferences, with the EEC countries abstaining from the vote on that proposal. The U.S. has since softened its attitude and agreed, together with the European countries, to explore the question of preferences at the second UNCTAD meeting in New Delhi in early 1968.

The U.S. insists, however, that any preferential system for LDC's must be a general one. It is firmly opposed to a proliferation of special preferential arrangements between particular developed countries and LDC's. Moreover, the indications are clear that the U.S. views the dismantling of reverse preferences that developed countries enjoy in the markets of LDC's as a necessary prerequisite to the establishment of a generalized system of preferences (48).

A number of European countries, most notably France, do not share the aversion to regional preferential arrangements and reverse preferences, and this constitutes a significant area of possible conflict in the trade policies of the Atlantic countries. The character and seriousness of that conflict may well be further defined and clarified as a result of the second UNCTAD meeting.

Quite aside from the difficult and complex issues associated with setting up a generalized system of preferences, there is the more basic question of whether such a system is the best and most efficient method of transferring resources needed for development in LDC's. A preference system most likely would be uneven and uncertain in its effect, benefitting some LDC's, generally the more advanced ones, much more than others. It is impossible to be sure in advance that the preference margins would be sufficient to stimulate significantly exports of manufactures and semi-manufactures from the LDC's. Some LDC's would waste resources establishing inefficient industries that would be unable to survive the removal of preferences.

In administering the preferences, the developed countries might feel compelled to institute a system to handle claims of damage from preferential imports. As the record on cotton textiles bears out, the industries that can most efficiently be established by LDC's are often the most vulnerable to damage in the advanced countries. There is the danger, therefore, that preferences might provide the occasion for heightened activity by protectionist interests in

(48) The chief instances of preferential arrangements, including reverse preferences, are in connection with the association of certain African countries with the EEC and in the British Commonwealth system.

the developed countries, a prospect that cannot be viewed with equanimity.

In sum, the case for preferences over multilateral tariff reductions is by no means clearcut. If it were possible to increase aid levels, that might well be the preferred alternative. Preferences can be viewed as a second best alternative, therefore, in the sense that they provide a method for transferring resources from developed countries to LDC's that otherwise might not be transferred at all.

### East-West Trade (49)

It will be recalled from Table 1 that East-West trade accounted for only a fraction of one per cent of U.S. exports and imports in 1966. A little under 4 per cent of EEC exports and imports was accounted for by the Soviet Bloc. The corresponding figure for EFTA was about 4.5 per cent. It is evident, therefore, that East-West trade is of only marginal importance to the West.

It has been official U.S. policy in most of the postwar period to keep East-West trade to a minimum in order to avoid enhancing the economic and, therefore, the political and military strength especially of the Soviet Union. This policy was adhered to by our allies in Western Europe in the early postwar years and during the Korean war period. Subsequently, however, as the political climate between East and West has become warmer and a rapprochement of sorts achieved among the major powers, there was a marked increase in interest in expanding trade between Western Europe and the Soviet Bloc. This was much less true, however, as far as the U.S. and the Soviet Union were concerned. Thus, the U.S. continued to maintain its highly restrictive laws and regulations governing East-West trade, and it was not until 1966 that an effort was made to introduce more permissive legislation in this regard. This legislative program has been stalled, however, in view of the Vietnam conflict.

In spite of this, some progress is indicated by the participation of Czechoslovakia and Poland in the Kennedy Round talks, and in the accession of Poland to the GATT in September 1967. The Polish

(49) For a review of many of these issues, see K. R. HANSEN, "East-West Trade: Dilemma or Delusion?" in Joint Economic Committee, *Issues and Objectives of U.S. Foreign Trade Policy*, *op. cit.*

accession may well become the prototype for other Eastern European countries desiring to expand their trade with the West. It will be interesting therefore to see how these arrangements are translated into practice.

The West Europeans are apparently much more cognizant of and ready to develop further trade opportunities with the Soviet Union and the countries in Eastern Europe than is the U.S. This difference in trade policy has caused some friction in the past and may constitute a further source of friction in the future. This will be the case especially the more the West Europeans take exception to U.S. policy in Asia and the more they feel it is in their own interests to seek closer relations with the Soviet Bloc.

If we were to assume a settlement of the Vietnam conflict and restoration of more harmonious relations between the U.S. and U.S.S.R., the question arises as to the directions in which policy should move with respect to East-West trade. If the Soviet Bloc countries decided to expand further their trade contacts with the West and to permit additional Western firms to undertake investment activities similar to those initiated by FIAT in the Soviet Union, East-West trade could very well increase significantly. This would be all the more likely particularly if the West were to extend equipment credits and other forms of export financing to Bloc countries. There are, of course, many problems that would have to be resolved if trade was expanded, particularly in connection with the state trading and planning control aspects of the Bloc countries and the marketing of Bloc goods in the West. Progress on these issues will depend fundamentally on the willingness at the highest political levels to seek cooperation and closer economic relations. It may not be too soon, therefore, to begin extending the groundwork in terms of the adaptations that will be necessary in trade policy in the West as a whole.

## V.

Having reviewed in the two preceding sections the accomplishments and unresolved problems of the Kennedy Round, the question arises as to where we go next as far as trade and tariff policy is concerned. There are a number of possible policy alternatives, but before discussing them there are two overriding considerations which deserve mention. The first has to do with the fact that the

1967 Kennedy Round tariff reductions are to be spread over a five-year period. What this raises is the question of the appropriate and politically most feasible timing of any new initiative in trade liberalization. The second consideration involves whether or not the split in Europe between the EEC and EFTA will be maintained in the future. Related to this is the question of the desirability of another round of multilateral negotiations under GATT.

Keeping the foregoing considerations in mind, the main available policy alternatives appear to be the following: 1) another round of multilateral negotiations under GATT, with the same or an expanded EEC membership, and broad negotiating authority which should include the possibility for across-the-board, staged tariff reductions and sectoral free trade; 2) a North Atlantic Free Trade Area (NAFTA) including the EEC; and 3) a NAFTA without the EEC (50). The idea of a NAFTA has attracted attention in recent years as doubts have grown about whether the GATT alternative is the best means of obtaining further trade liberalization. The third alternative of a NAFTA without the EEC came to the fore early in the Kennedy Round when the hard-line EEC position threatened to disrupt the negotiations. In view of the unfavorable outlook for early British entry into the EEC, this alternative continues to be very widely discussed. It thus deserves separate comment.

In our judgment, there are formidable difficulties which stand in the way of creating a NAFTA without participation of the EEC. It will be recalled from Table 1 that trade between the EEC and EFTA is much more important than their trade with other regions (51). It makes much more sense, therefore, to attempt to bridge the gap between EEC and EFTA than to expend a great deal of effort to form a NAFTA without the EEC. This would appear all the more true in light of the fact that the tariff effects

(50) B. BALASSA and Associates, *Studies in Trade Liberalization*, *op. cit.*, contains a series of valuable studies of the many intricate political and economic factors involved in the various approaches to trade liberalization from the standpoints of the U.S., U.K., EEC, Canada, Scandinavia, and Japan. See also MAXWELL STAMP Associates, *The Free Trade Area Option: Opportunity for Britain* (London: The Atlantic Trade Study, 1967); and T. GEIGER and S. LEA, "The Free Trade Area Concept as Applied to the United States", in Joint Economic Committee, *Issues and Objectives of U.S. Foreign Trade Policy*, *op. cit.*

(51) Thus, in 1966, EFTA accounted for 19.0 per cent of EEC exports and supplied 13.5 per cent of EEC imports. Correspondingly, the EEC accounted for 25.3 per cent of EFTA exports and supplied 31.0 per cent of EFTA imports.



of EEC and EFTA have been to divert a significant amount of trade to within each of the two blocs that would otherwise have occurred between them (52). It will be further recalled from Table 1 that the U.S. trades more with Canada and Japan (included in Other Industrial Areas) than with either the EEC or EFTA. There might be an even greater potential, therefore, for a Canadian-American free-trade area and some arrangement with Japan than for a NAFTA (53). Another consideration in questioning the efficacy of a NAFTA concerns the LDC's. They would hardly be in a position to assume the obligations of a free-trade area, although they might well be given nonreciprocal or even preferential access to NAFTA for their exports of manufactures. There is an immediate problem, however, for it would be necessary to distinguish between the LDC's with and without ties to the EEC.

It is particularly difficult from the U.S. standpoint to determine whether it would be most desirable politically to support efforts to unite the EEC and EFTA or alternatively to seek to maintain their separation. The worrisome aspects of an expanded EEC concern the powerful challenge and counterbalances to U.S. economic and political interests that might ensue. It would be especially undesirable, for example, if an expanded EEC were to move in an illiberal direction economically and extend preferential arrangements to particular LDC's that would further fragment the developing world. On the other hand, it can be argued that an expanded EEC which included the U.K. and the Scandinavian countries would be more conducive to representing U.S. views and interests in Europe and would strengthen the position of those present EEC members that are concerned about Franco-German domination of the EEC. Moreover, an expanded EEC might be considered a stabilizing force in Europe.

It is conceivable that an organization such as NAFTA could bring pressures of a liberalizing sort to bear upon the present EEC member countries. But there is a danger as well of creating antag-

(52) KRAUSE, *op. cit.*, p. 72, has estimated the loss of trade in manufactured products due to trade diversion as the result of the formation of the EEC and EFTA to be \$1,145 million in 1958 prices. The loss in trade by the EEC due to EFTA was estimated at \$279 million and by EFTA due to the EEC, \$378 million. Thus, half of the total estimated amount of trade diversion in manufactured goods occurred in the blocs vis-à-vis one another.

(53) This assumes, of course, that Canada could overcome its fears of U.S. economic domination, and that Japan would agree to reduce its protection of domestic manufacturing and alter its trading relationships especially with the LDC's in Asia.

onisms within Europe and of worsening relations between the U.S. and the EEC. On balance, it strikes us that the pursuit of trade liberalization via the NAFTA alternative excluding the EEC could very well prove to be divisive to the world economy. This alternative has merit primarily as a contingency plan which might be brought into play if the EEC balks at further trade liberalization and is intransigent in rejecting the membership applications of the U.K. and the other EFTA countries. If that happened, then some type of broad free or preferential trade grouping outside of the EEC might conceivably be the only viable way to gain the benefits of continued trade liberalization for those nations willing to engage in it (54). At this point in time, however, it is our view that the possibilities of progress along traditional lines have clearly not been exhausted. One cannot be certain, moreover, that the NAFTA alternative excluding the EEC would lead to more trade creation than trade diversion. There is much to be said accordingly for keeping alternatives such as NAFTA excluding the EEC on the "back burner" for the time being, and preparing instead for a new initiative under GATT auspices.

## VI.

Having expressed our view in favor of a new initiative under GATT, it must be recognized that since the implementation of the Kennedy Round has scarcely begun, sentiment may be strong for marking time for a while before a new initiative is undertaken. This is understandable particularly since the Kennedy Round proved to be so arduous. There is a serious danger of retrogression, however, insofar as the forces of protectionism might become stronger

(54) In such an event, the GATT rules would have to be modified to allow for trade groupings based on conditional MFN treatment. That is, GATT regulations presently do not permit preferential free trade groupings that are not aimed at complete internal free trade. This implies that conditional MFN, which means the granting of trade concessions to countries willing to reciprocate but not to others, is prohibited. In an article in *The Economist* entitled, "The Gap in GATT", February 16, 1963, p. 617, it was proposed that GATT regulations be modified to approve regional preferences under three conditions: (1) preferences are established by tariff reductions within the group, not by increases for outsiders; (2) tariff reductions must apply uniformly to all products of members; and (3) comparable facilities must be offered to any outsiders prepared to comply.

to fill whatever vacuum is created by inaction or hesitation in drafting new legislation (55).

If a seventh round of GATT multilateral negotiations is to be held in the near future, the question is how far the tariff cuts on industrial products should go and to what extent NTB's should be subjected to negotiation for the purpose of ameliorating or eliminating altogether their trade-restricting effects. By mid-1968, the EEC will have completely removed all tariffs affecting intra-community trade and solidified their common external tariff (CXT). Whether or not they can be persuaded to cut the CXT any further then becomes the main issue. It is fair to say that up to now the CXT has served as a force binding the EEC together. The EEC may look upon additional cuts in the CXT, therefore, as weakening member country ties. If, however, attempts could be made to foster ties other than the CXT which would promote the cohesiveness of the EEC, the effect could be to enhance the possibility of further multilateral trade liberalization (56). What this would mean inevitably is closer harmonization of other forms of economic policy, particularly monetary and fiscal policy, and the furtherance of common efforts in areas besides trade.

If the EEC is receptive to this line of thinking, what form then might the negotiations take? Of the various alternatives, the one which to us is most commendable is a series of staged tariff reductions following some prearranged timetable. This is the method which was employed for manufactured products in the formation of both the EEC and EFTA. In comparison with the long and drawn-out negotiations of the Kennedy Round which were based upon the principle of reciprocity, the success of EEC and EFTA in reducing tariffs has been remarkable. As far as the U.S. is con-

(55) As BALASSA, *Trade Liberalization Among Industrial Countries*, op. cit., p. 152, has put it:

"For lack of a better expression, we may speak of an 'instability effect', according to which economic and political relationships are hardly ever in a position of stable equilibrium but have the tendency to move in one direction or the other. Thus, in the absence of pressures for the liberalization of trade, protectionist counterpressures may gain force in the United States as well as abroad".

The spate of protectionist bills introduced in Congress since expiration of the Trade Expansion Act in mid-1967 would seem to bear out this view.

(56) A similar view is expressed in W. DIEBOLD, JR., "Future Negotiating Issues and Policies in Foreign Trade", in Joint Economic Committee, *Issues and Objectives of U.S. Foreign Trade Policy*, op. cit., p. 16.

cerned, there is some precedent for favoring general tariff reductions, which is to be found in the "dominant-supplier" authority in the Trade Expansion Act of 1962. This authority proved to be premature from the EEC standpoint and at the time was based upon an incorrect premise concerning the entry of the U.K. into the EEC. But conditions have changed, and it is possible that such authority could now be put to good use.

What we are suggesting, therefore, is a move under GATT auspices to freer trade and perhaps ultimately to free trade in industrial products. In light of the experiences of EEC and EFTA, the tariff cuts might be staged over a period of 10-20 years and no exceptions permitted. There is no reason why a similar plan for liberalization could not be applied to a number of NTB's, although admittedly this would be difficult because of the domestic policy changes entailed. In any event, problems of removing NTB's would be greatly simplified within a general framework of trade liberalization as compared with attacking the NTB's one by one.

In order to be certain that the effects of trade liberalization were not undone, agreement would have to be reached on acceptable policies to deal with import displacement. The most desirable policy here is one in which firms and workers affected unfavorably by imports would be eligible to receive special adjustment assistance (57). This would be preferable to an escape-clause system in which foreign producers were faced with the uncertainty of whether a tariff concession would be withdrawn in the event that displacement occurred.

A further attractive feature of staged tariff reductions on industrial products is the possibility of coordinating them with a system of general preferences for LDC manufactured-goods exports. Thus, for example, the LDC's might be granted complete or partial preference on their exports to the industrialized countries to take effect immediately. These preferences would then be reduced over time as the staged tariff cuts were made, and they would expire as of

(57) As mentioned earlier, the Trade Expansion Act (TEA) contained a provision for adjustment assistance. Unfortunately, the language of the provision was so strict as to render it virtually useless. Adjustment assistance is also provided for in the Canadian-American Automobile Pact. The experience to date under the Pact has been very favorable in contrast to the TEA since the criteria for labor displacement have been more broadly and liberally interpreted. It is to be hoped that new trade legislation will have liberal adjustment assistance provisions.

the date of the final cuts (58). While there is no way of foretelling how the LDC's would respond to preferences, surely a period of 10-20 years would be long enough to expect something to happen. If in fact the responses were limited to only a few countries or were not significant in general, it would indicate that the case for preferences had been exaggerated. Preferences aside, the LDC's might in any event benefit considerably from general tariff reductions by being assured access to the markets of the industrial countries. This is something which the LDC's have not been able to count on to date, as we have witnessed in the case of cotton textiles.

The preceding discussion has been predicated on the assumptions that the EEC would agree to reductions in its CXT and to a generalized system of tariff preferences vis-à-vis the LDC's. These are large assumptions in view of the role that the CXT has played to date in solidifying EEC ties and the French conception in particular of EEC relations with the associated African countries. If it turns out that the EEC is not receptive to additional tariff reductions and generalized preferences, alternatives such as NAFTA might then be considered more seriously. But for the time being at least, our predilection is to work through existing institutions and try in the process to make these institutions more liberal in outlook and behavior.

Our remarks to this point have related to the timing and form of a new initiative for liberalizing international trade in industrial products and at the same time fostering exports and growth in the LDC's. While much of our discussion is relevant also for agricultural products, trade liberalization will obviously be much more difficult to achieve here. Yet given the importance of U.S. exports especially of temperate-zone foodstuffs, it is certainly in this country's interest to seek expanding markets in Europe, particularly in the EEC. The EEC members are after all not indifferent to what it costs to obtain their food requirements. And as these countries continue to grow, their agricultural sectors will decline in relative importance. Pressures may develop therefore within the EEC to obtain agricultural products more cheaply through imports, and it may become easier

(58) Preferences for LDC exports need not be delayed until new tariff-reduction authority is obtained. A start could be made by providing advance implementation of Kennedy Round reductions on products of interest to the LDC's. This has been suggested by Ambassador W. M. ROHN, U.S. Special Trade Representative for Trade Negotiations, in a statement, "The Future Work of GATT", reprinted in the *Department of State Bulletin*, January 1, 1968, p. 13.

to effect changes in policy as the importance of the agricultural sector declines. There is no guarantee, of course, that this will happen, which means that the U.S. should continue to press the EEC to adopt a more liberal policy towards agricultural imports.

Finally with regard to East-West trade, it is evident that U.S. policy is still restrained by outmoded political considerations while policy in Western Europe is much more closely attuned to the tendencies for greater economic liberalism in the Soviet Union and Eastern Europe. The settlement of the Vietnam conflict will no doubt make it easier to effect a change in U.S. policy. It is difficult to gauge the market potential in the Soviet Bloc for Western goods because this potential is essentially politically determined via central planning. There is reason to believe, however, that if the Bloc countries oriented themselves more towards the West and if the West in turn was willing to extend medium- and long-term export credit financing, there might be a substantial increase in East-West trade (59).

In conclusion, there is evidently much that remains to be done in trade and tariff policy. While there are a number of particular questions concerning industrial products on which the U.S. and Western Europe may not see eye to eye, there are none which with concerted effort would fail to yield to some form of resolution in the near future. Questions concerning trade in agricultural products are unfortunately another matter. What is important in any case is that the momentum for trade liberalization be sustained. At the very least, this will serve to contain protectionist influences, and, more positively, to confer significant gains upon the industrialized countries and the LDC's alike.

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(59) HANSEN, *op. cit.*, p. 260, has suggested that a level of trade of \$1 billion annually between the U.S. and Soviet Bloc could be achieved if both regions were seriously interested in facilitating the necessary policies.