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AFTER THE "KENNEDY ROUND": THE REGIONAL BLOCS CONSOLIDATE

THE MAIN EFFORT in international economic policy by the government of the United States during the 1960s—with loud Canadian support of the principle despite practical exceptions—has been a tariff-cutting program. To this its promoters attached the name of the late President John F. Kennedy, seeking an aura of international liberalism and goodwill. Tariff-cutting is, however, not synonymous with trade liberalization. National governments have learned how to interfere with business in too many other ways, and there are now too many national governments, for example, the successors of what was the world's widest free-trade area, the British Empire. Very few governments, old or new, have actually adopted the U.S. international economic policy, despite the reported participation of a total of 52 countries in the Geneva negotiations. The policy is too theoretical in principle for less-developed and developing countries, which include most of the world. Furthermore, the theory is regarded as false and misleading by economists who have looked up from their algebra long enough to see what is going on in the world they are supposed to be trying to describe.

An outstanding improvement in the theoretical discussion of international trade has recently been made by Professor Staffan B. Linder of Stockholm (*Trade and Trade Policy for Development,* New York: Praeger, 1967). Catching up with practical experience, Professor Linder constructs a new model for the trade between developing countries and advanced countries, showing how full employment of resources may require protection. He relegates the Ricardian comparative-advantage model to trade among advanced countries.

A similar change in trade policy has been that Britain and Sweden, evidencing disillusionment with the prospects afforded by the Geneva negotiations as well as with the results of their own European Free Trade Association, accepted the necessity of becoming integrated into the European Economic

Community. The beginning of a change of policy in Washington may also have been signalled by U.S. support for a Latin American common market at the Punta del Este conference in April, 1967.

The international policy of business corporations (as distinct from governments) has already recognized that the second half of the twentieth century is a new economic world. Elemental world-wide demand for secure jobs and accompanying self-respect has turned to nationalism because it has not been accommodated in the grand design for trade based on international specialization. Policies of leading companies have been adjusted to changes such as this rising nationalism, but not the international policies of advanced-country governments, though all governments pursue domestic policies of full employment. These corporations, through their new capabilities of systematic innovation and technological education, have been instrumental themselves in this development. By experiment and observation, companies and managers have discovered that marketing efficiency warrants the same attention as production efficiency, that prospective customers can be found all over the world, that local employees can learn to handle power-tools, and that customers' value-scales include many considerations besides price.

The changed and changing characteristics of the pursuit of goods and services and satisfying work by the world's peoples call for changes in the international economic policies of governments. The Board of Directors of the Chamber of Commerce of the United States drew attention, in February, 1967, while the Kennedy Round was still on, to "major transitions taking place in the world economy and forces of change in traditional trade relationships" and recommended "that Congress authorize appointment of a high-level joint U.S. Government-Business Commission to study long-range U.S. foreign trade policy in an international context" (news release June 13, 1967). William Roth, U.S. Ambassador at the Geneva trade negotiations, confirmed at a "National Conference on the Kennedy Round" sponsored by the Chamber of Commerce of the U.S. on July 7, 1967, that he had received a Presidential assignment to organize a new major trade initiative. International economic policy is a live subject. All concerned should consider, first, the transformation that has taken place in international trade since the Second World War, then the possibilities opened up at Geneva, along with the situations ignored or evaded at Geneva, and the new influences that Geneva did not seem even aware of, and finally, new forms of international trade and of trade negotiation and trade assistance.

The Modern Dimensions of International Trade

Assessment of the situation following the "Kennedy Round" of tariff negotiations requires consideration of several aspects of modern trade that were underplayed at Geneva.

International trade is apt to be conceived as the physical movement of material goods—the poet Masefield's "road-rails, pig-lead,/Firewood, iron-ware, and cheap tin trays". The increasing importance of the service industries has, however, become recognized in domestic trade. Similar developments are occurring internationally. Economists claim that they have made provision for these, through their item "invisibles" in the international accounts used in balance-of-payments studies. The invisibles understood have been, however, mainly traditional shipping expenses and marine insurance charges. There have also, of course, been emigrants' remittances in the case of Italy, and service on debt, interest on bonds, paid to Britain for half a century from all over the world for the loan of surveyors and construction crews to build railways. But an unprecedented amount and variety of international trade in services have developed in our second half of the twentieth century. Included are such esoteric sales/purchases as the extensions of human thinking power provided by IBM systems for computers, and the emotional experience of pilgrimages to Rome, Jerusalem, or Mecca by air. Payments for know-how and expenditures by tourists are now among the most important international transfers, and their omission from some reckonings of international trade is faulty arithmetic. Research by Talal A. Bisat of Lebanon at The American University in Washington, D.C., shows that inclusion of the very important category of royalties and fees that subsidiaries are required to pay for know-how, but that are omitted in U.S. government totals, brings foreign receipts up to 23 per cent of the total 1962 after-tax income of all U.S. corporations in the over $50 million assets class (*International Intercompany Transactions,* 1967, Table III, p. 21). Sales of affiliates abroad, which also have to be projected because the government has stopped publication of oil figures, are conservatively estimated by Bisat to have reached, by 1965, a total of $81.3 billion, representing a ratio of 3 to 1 over physical exports (*ibid,* p. 27). A still more dramatic estimate has been given to the Joint Economic Committee of Congress by Judd Polk of the U.S. Council of the International Chamber of Commerce (I.C.C., Aug. 11, 1967). This gives $150 billion for the total production abroad of U.S.-controlled companies in 1966, against $30 billion of exports, a ratio of 5 to 1.

International trade is also seen to take on a new dimension when scrutiny is given to the distinction between so-called "secondary" industries and those which the economists call "primary", implying that they come first, in time or in importance. Steel is called primary, cans for food and beverages are secondary, and processing the ingredients and putting them into cans are presumably tertiary. But without demand for products in cans, for trucks to haul them, and for supermarket shelves to hold them, or for parallel applications of steel to serve consumers in other ways, there is no use for a steel industry. The demand for steel is *derived* demand.

Internationally, so-called primary products were prominent in the imports of Britain (to which so many of the concepts still used in economics are traceable). They were needed to feed British people and factories, which had exhausted or outgrown their own small-island resources. But the United States and Russia, alike, have industrialized with comparatively little use of imported commodities. The United States is now the world's largest trader because of successful marketing of exports, *not* need for imports. The annual U.S. surplus in trade runs as high as $6 billion. The products are those of factories, rather than of mines, and though there are substantial exports from farm and forest, they are produced by industrial methods and they are often highly processed, e.g. frozen breast of chicken. The materials developed in the industrialized countries, particularly the United States, to displace imported commodities—substitutes for cotton, wool, leather, wood, rubber, soapery fats, and even traditional internationally-traded perfumes and flavourings, frankincense and myrrh—provide qualities that make them wanted imports in countries whose exports they have displaced.

Briefly, it can be said that international trade is a buyers' market for commodities, a sellers' market for manufactures. My own reasoning for why this situation has arisen, and why it persists, is that there is more scope for Schumpeterian innovation in rising levels of processing than in producing standardized commodities (Howe Martyn, *International Business*, New York: Free Press; [Toronto and London: (Collier)-Macmillan], 1964, p. 179). The exception that proves this explanation is the highly differentiated production of industrialized U.S. agriculture.

A steep rise in the levels of processing of products on their way to consumption is a feature of modern economic activity. Ready-to-use products, the doctor's injection as well as the housewife's cakemix, require packaging. Labels and directions need to be in local languages. Many items require expert maintenance. Increased varieties crowd distribution centres, forcing manufacturers to provide quick delivery from local stocks. By the time these needs are met, many companies find themselves, irrespective of tariff levels, well on the way to decentralizing their manufacturing so as to be close to local markets, both at home and abroad.

One more dimension: the relation of foreign trade to national income. In the United States, physical foreign trade stays at five per cent, despite increasing totals—a fringe benefit. At the opposite extreme is Japan. In 1957, the foreign trade of Japan represented 24.8 per cent of GNP, according to figures supplied by Mr. T. Adachi, Washington Representative of the Japan Development Bank. The growth of Japanese GNP since 1957 has been phenomenal. The foreign trade contribution has, however, actually declined to 22.1 per cent in 1965—a decline of more than 10 per cent in less than 10 years. Development is not a function of foreign trade. Prosperity begins at home.

Openings Afforded by the Geneva Negotiations

Within these modern dimensions of trade, the possibilities afforded by tariff-cuts are narrow. The Geneva accords want analysis as to actual results—in amount, in extent, in time, in effects direct and indirect.

The reductions publicized as of 50 per cent, for example, are not price reductions, as many newspaper readers and television viewers may have believed, but merely reductions in only one fraction of landed cost of imports—the duty. Even if the duty were 33⅓ per cent on the c.i.f. cost, reducing this by 50 per cent, i.e. cutting it in half, would yield only 8⅓ per cent reduction of the final selling price, if a markup of 50 per cent on cost or one-third off selling is required for internal distribution and profit, which is not unusual, and if the reduction passed on is net duty, which is reasonable because the distributor cannot be expected to work on the same percentage applied to a reduced buying price when he is handling the same amount of trucking weight and distance, paperwork, and other expense. The Geneva reductions shrink in the light of the facts of trade. (Example: to a $12 c.i.f. item, add duty 33⅓ per cent or $4, making $16, then add for distribution one-third off selling or 50 per cent on cost, $8, making $24; cut duty 50 per cent, $2, reduce selling price only from $24 to $22, i.e. one-twelfth or 8⅓ per cent).

The Geneva accords also include in the fine print a time schedule which gradualizes their effect. A cut of 50 per cent in a tariff rate of 10 per cent is spread over 5 years, giving an annual reduction of only one per cent. The Kennedy Round moves in slow, old-fashioned waltz-time.

Another limitation of the Geneva accords is that they change only possibilities for trade. They do not create trade changes. Any action will have to come from individual businessmen and government purchasing officers. Will these people see worth-while opportunities, and follow them up?

The theory of the Geneva affair was that an overall increase of efficiency and therfore of public benefits would result from re-allocation of resources into more international specialization. The sage Professor Ohlin of the Stockholm College of Business has warned, however, that "the only satisfactory method for an analysis of the effects of reduced international obstacles is to consider both the changes in the price system that would occur if the other basic elements were unaffected and the changes due to the actual reactions of these elements" (Bertil Ohlin, *Interregional and International Trade,* rev. ed., Cambridge, Mass.: Harvard University Press, 1967, p. 186). The American or Canadian industrialist is expected to find that his customers can buy their other requirements cheaper, and do so. Thereby they will have more to spend on his specialty, or they can sell more of their products through lower prices and thus buy more from him. Two questions are raised by this theory. First, what savings are buyers actually being offered? Second, to what extent will this formula work among modern buyers, i.e. will they switch to cheaper suppliers and reduce their prices and get sales increases? Also, are there any differences on these two questions between domestic customers and those sought internationally?

As to the question of the responsiveness of customers to price, it can be doubted that many of them will take advantage of possible savings through tariff cuts. Except at the discount-house level (cheap clothes) or on steel reinforcing rods that are going to be buried in concrete, there are too many values besides price involved in purchases today. Americans, and other people too, have learned the importance of dependability and service. The supplier's reputation is as important to purchasing agents as the "brand image" is to ultimate consumers. The increasingly processed products of modern industry, e.g. tailor-made chemicals, as well as the ready-to-use products that fill the housewife's market basket, ask for more than the government grades that have served for quality control on many exports.

As to the overall influence, the United States is reported to have made tariff cuts on products which were imported to an amount of $8 billion in 1966 (*Wall Street Journal,* June 30, 1967, p. 3). This would be roundly one-third of the total imports. But the amount affected represents only one per cent in an $800 billion economy. The effect on that amount of trade is reported to average not quite 35 per cent (*ibid*) but this is, of course, off the duty collected, not off the price. If the duty averaged 15 per cent, the saving would be 5 per cent of the import portion of the total price of a product, but starting with only one per cent the first year because of the time schedule. This does not seem likely to provide any great stimulus for the U.S. economy.

It may be asserted that a greater stimulus will be felt by customers outside the United States because the influence of international trade is greater in their countries. The most optimistic reactions to the Geneva accords have occurred in Canada, which has "one-fifth of her total output moving into export channels" (*New York Times,* June 30, 1967, p. 47). Canadians have stopped taxing the imports of machinery that their industry needs, and imports of fruits and vegetables during their long cold off-season, in return for easier entry to the United States for fish, forest products, and a few manufacturing specialties that they have developed. These may exert a buoyant influence on the Canadian economy, though certainly not greater than the recent several successive sales of wheat from stockpile to Russia and China.

The European Economic Community has become, like the United States, much more influenced by internal conditions than by foreign trade for economic growth and profitability. There can be increasing trade with other countries in mutual specialties, e.g. German Volkswagens for American Cadillacs, but the amount of this trade is more likely to be a result than a cause of internal prosperity.

In the storybook days of Britain, international tariff reductions might have been responded to by world-wide increases in sales of Harris tweeds, Bradford broadcloth, Manchester cottons, Belfast linens, Sheffield cutlery, ships from the Clyde, and Scotch whisky. The whisky still seems indispensable to the writer, but a new generation is said to be getting its kicks from marijuana, which Britain must import. British specialties are now subject to substitution.

If Britain, Sweden, and the other former free-trade members of the "Outer Seven" are admitted to the European Economic Community, a new supernational market will be created. Its trade with outsiders is likely to decline proportionately, though the original "Inner Six" traded so successfully among one another that they generated new products for export and needed more imports.

The applications of Britain, Sweden, and the other members of the former European Free Trade Association to join the more protectionist EEC write a subtle, penetrating commentary on negotiations for cutting the Geneva Tariff. As the EFTA name signified, the seven member countries had tried to operate under the same theory that dominated the Geneva negotiations. It was a loose association. There have been suggestions that an underlying purpose of the "Kennedy Round" was to slow down the tighter integration of Community Europe in order to keep it open to American exports of goods and service and accompanying cultural and political influences (the Washington "Grand Design"). Failure both politically and commercially is implied by the conclusion of Britain and Sweden that Geneva has not relieved them of the necessity of integrating with a regional bloc. New influences have superseded free trade theory.

The Japanese concessions may have considerable effect. The Japanese import up to the limit of their international purchasing power, and will spend anything they can gain through most-favoured-nation treatment on their exports of sewing machines, steel, or photographic equipment. Their exports are, however, already so competitive that they have provoked other kinds of restrictions besides tariffs. These barriers have not been lowered by the Geneva agreements, except for the administration of anti-dumping laws.

The underdeveloped countries generally import to their economic limits, and as far beyond as grants and loans and supplier credit will allow. Mexican fresh fruits and vegetables appear likely to enter the United States more easily, as does West African cocoa but few other farm products. Mine and forest products receive reductions, but they were not heavily taxed before. Until there is more action than Geneva produced, trade with the less-developed countries is a credit-and-collection problem as before.

Errors and Omissions

The fundamental error of the General Agreement on Tariffs and Trade (GATT), the Kennedy Round, and postwar U.S. international economic policy has been failure to acknowledge the built-in advantage for the big and advanced countries in free trade theory, and the even greater advantage in the practice of so-called liberal trade policies which conceal exemptions for agriculture, chemicals, textiles, defence industries, and anything that is politically sensitive. The second error, almost as great, is imagining that the first error will not be detected in the countries disadvantaged by steam-roller competition from the advanced countries. Even the theoretical cover for this has been removed by the latest Swedish contribution of Professor Linder (*op. cit.*). These policy errors would be enough to make the Geneva negotiations abortive. There were, moreover, failures with regard to agriculture, East-West trade, non-tariff barriers, the less-developed countries, and direct investment. These have been indicated already in this paper but can gain emphasis from closer examination.

Any general application to agriculture of the principles of international specialization, comparative advantage, and free trade at Geneva proved impossible, but the significance of this for international trade generally does not seem to have been grasped. The extraordinary fact blinked by the theorists is that highly protected U.S. agriculture has made tremendous surges in efficiency. Agriculture can hardly be called an infant industry. It is truly a primary industry. National security depends on food supply. Every government must assure quantity and close proximity first, and then only, price. This is a good reason for Britain to join Germany in drawing supplies from the wheatfields of France, now that colonies have broken away and sea transport has become vulnerable to disruption by air attack. On the U.S. example, French agriculture may gain in efficiency.

The position of agriculture in national economic policy was spotlighted when President Lyndon Johnson announced new quota restrictions to protect the U.S. dairy industry, on the same day that results of the Geneva negotiations were published (Roy Reed, *New York Times*, July 1, 1967, p. 1).

The Communist countries generally do not participate in GATT because of disparities between the structure of centrally planned economies and that of free-enterprise economies, as well as because of political differences. The exporting of all Soviet exports has at times been regarded as dumping, because they are priced, not *ex* free domestic market, which does not exist, but in order to obtain specific quantities of foreign currency. The gap between East and West with respect to trade has not mattered much thus far, because the Communists have aimed openly at security through self-sufficiency. They do not seem to be abandoning this policy, and therefore the prospects for East-West trade remain limited.

There are, however, three developments which demand approaches of concept as well as policy that go beyond GATT. Firstly, the Communists are increasingly producing temporary and occasional surpluses which they could advantageously export. Secondly, they are also encountering accidental shortages in the more intricate planning of their domestic supplies that can advantageously be met by imports. The West needs a new basis for discussing possible mutual benefits of trade in these situations, to take the place of the free-market concept which does not apply. The third development is the widening applicability given to this requirement for a new trading system by the extent to which national planning is being adopted outside the Communist bloc. The Indian and French examples have been most publicized, but practically all governments are trying to guide their economies. Even the United States has its guidelines. Moreover, U.S. agricultural price supports, acreage allotments, technical assistance, and Cooley Law exports, show that this sector is under comprehensive national planning, while at the same time it is showing tremendous increases in productivity.

Governmental interference with international trade by other means beside tariffs caused rising concern at Geneva during the four-year negotiations. An unusual contribution to public education on this subject is a booklet written by Noel Hemmendinger and published by the United States-Japan Trade Council (*Non-Tariff Barriers of the United States,* Washington, D.C., 1964). The popular opinion is that Japan is restrictive in the extreme toward imports and that the United States is comparatively open. This booklet shows, however, the variety and the strength of the obstacles that a Japanese exporter can encounter in the United States. These include State and city building and health codes, and handling of bids so as to suit the specifications to local suppliers, as well as Federal regulations. To Hemmendinger's list needs to be added the strong and prevalent preference for buying from people you know —a relationship that American companies have become adept at synthesizing through advertising of brand and corporate images. Ironically, this skill is now providing a subsidy for American exports through U.S. government market research, sales prospecting, and Trade Center and trade fair sales promotion and advertising.

There is an aspect of non-tariff barriers that goes beyond the Geneva attitude that they are simply unfinished business, to be dealt with along the lines of the abolition of European road taxes that discriminated against American cars, and the adoption of proof of injury as a requirement for anti-dumping surcharges. Recognition needs to be given to the management of foreign trade that is integral in national economic planning. Governments dare not allow their programs for investment, employment, population relocation, and the like, to be thrown out of gear just because lower money-cost imports unexpectedly become available. This aspect heavily clouds the outlook for increasing trade on the free market price basis. Interior Secretary Stewart Udall of the U.S. is reported to have barred foreign bids on Grand Coulee dam turbines because "it was important that U.S. firms develop the competence to produce such units" (*Washington Post,* July 15, 1967, p. 14).

These countries want imports, and in humanity and the interests of peace, they need and deserve them. They also want particularly the machinery and the specialized components for industrialization produced mainly in the advanced countries. It is all too well known, however, that they cannot pay. They have been quite liberally allowed grants and loans, though partly for wrong priorities as between "primary" and "secondary" industries. They complain, however, that they are suffering from an increasing spread between the earnings of their exports and the rising costs of modern equipment. This complaint has been made familiar by farmers regarding their implements, fertilizers, and insecticides. Unfortunately there is no "purchasing power parity" machinery in international trade.

The suggestion has been made by the United Nations Conference on Trade and Development (UNCTAD), and included on the GATT agenda for the future, that special unrequited concessions should be given by advanced countries to imports from the infant manufacturing of the developing countries. The situation is so serious that any action is good, but is this realistic? Professor Linder shrewdly points out (*op. cit.*) that many of the products a developing country will make are no longer wanted, at any price, in the advanced countries.

It seems clear that the underdeveloped countries must continue to receive unrequited exports such as have been represented by foreign aid. The public contribution can be supplemented, however, and the effectiveness improved, by more "direct private investment". This phrase is bankers' language for the establishment of foreign subsidiaries. The bankers' terminology can be quite misleading as to the amount of actual out-of-pocket expense for the company or of balance-of-payments drain for the country. Local land and buildings can be obtained with local money on mortgage. The exports are machinery and know-how. There need be no cost to the country that subsidiaries help develop until they earn dividends, which at most are a small fraction of their local contribution to production. An even greater advantage for the less-developed countries is the direction of practical knowledge and skill towards the real needs and wants of the local market, e.g. canning factories rather than steel mills.

This factor in world production and distribution was ignored at Geneva. It often requires more tariffs and subsidies rather than the so-called trade "liberalization". Adapting to national economic policies and plans is one of the activities of rapid progress in international business. Reference has been made to the size to which this new kind of trade has already grown.

Opportunities Among the Blocs

A discussion of trade should conclude by pointing to possible new opportunities, especially if businessmen are to be interested. The only place where any real buoyancy seems to be resulting from the Geneva accords is Canada. This is mainly, however, from the promise of easier access to the U.S. market for processed commodities and specialized manufactures. This is an increase in regional integration. Marginal increases in trade flow may also occur in existing channels between the United States and Europe, and between the United States and Japan. Any large trade changes and consequently greater opportunities for alert innovators seem more likely to arise from reactions against the GATT approach than from the Geneva accords. The "Kennedy Round" year 1967 is already looking historic in the annals of international trade. The reason is, however, not trade liberalization or any far-reaching tariff cuts, but rather the triumph of regional bloc integration. New dedication to achieving a Latin American common market was made by the Organization for American States at the Punta del Este "summit" conference in April, 1967. New applications for membership were received by the European Economic Community from Britain, Sweden, Norway, and others. The Geneva agreements themselves tighten the already close and special relation of the United States with its adjoining neighbours, Canada and Mexico.

While regional integration is compatible with and even conducive to growth in total export/import trade in the long run, immediate opportunities are obtained by getting inside the blocs. Adapting to this situation is an elementary requirement of modern trade policy for governments as well as companies. Governments should encourage so-called "direct foreign investment". Developing-country blocs need subsidiaries even where and when only capital gains are possible for the companies because of difficulties of host countries in earning foreign exchange by exports. Advanced countries could encourage their companies by bridging this gap. Funding the dollars, francs, marks, sterling, and yen required for dividends from subsidiaries in developing countries could be less expensive and less wasteful than direct grants and loans to foreign governments. One more new policy requirement is to find ways to handle trade with planned economies and among sectors such as agriculture that are under government planning in most countries. Original thinking on these subjects is essential for any successful new initiative toward world economic development.