

ESSAYS IN INTERNATIONAL FINANCE

No. 29, March 1958

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TRADE POLICY IN CRISIS

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RAYMOND VERNON



INTERNATIONAL FINANCE SECTION

DEPARTMENT OF ECONOMICS AND SOCIOLOGY

PRINCETON UNIVERSITY

Princeton, New Jersey

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GARDNER PATTERSON, *Director*  
*International Finance Section*

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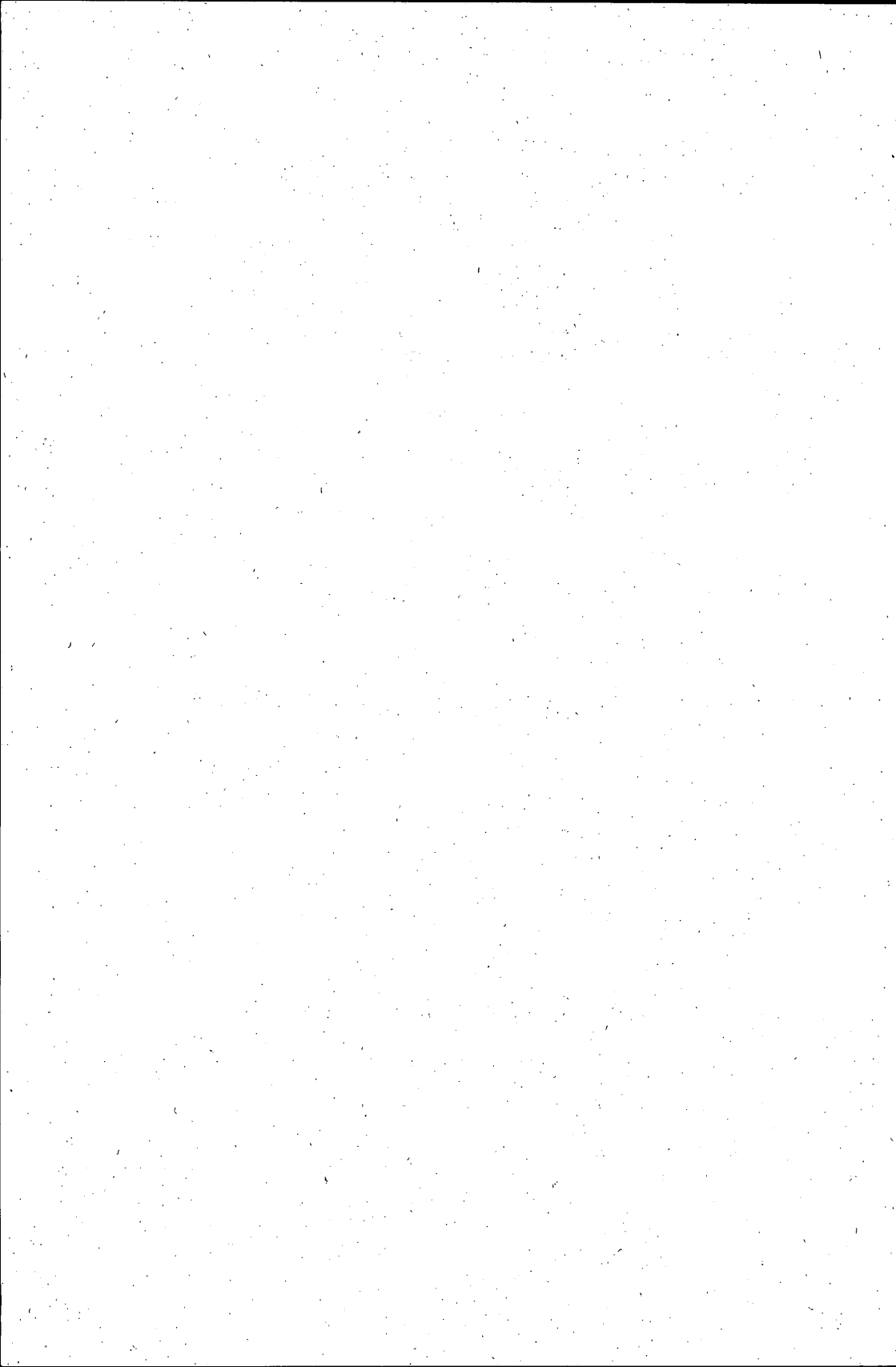


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# TRADE POLICY IN CRISIS

ONE has to go back to the days of Washington and Jefferson to find a period in which there was as much preoccupation in the United States with its position in international affairs. Since 1945, the political leaders of the United States have been engaged in an almost constant reappraisal of this nation's foreign relations. Yet within that period of 12 or 13 years, the basic premises have shifted. The American sense of leadership and control, a sense on which the plans and policies of the 1940's were implicitly based, has shifted to one of uncertainty and uneasiness.

In one way or another, all major United States policies toward the rest of the world are beginning to show the effects of this pervasive sense of change. Inevitably, as Congress turns to its reexamination of United States trade policies in this spring of 1958, this sense will color the debate and influence the outcome. The point of departure in any reappraisal of a United States trade policy, therefore, must be some understanding of the fundamental change in the larger role of the United States in world affairs.

## I. OUR SHIFTING POWER STATUS

From 1933 to 1939, we had been on the edge of the world scene, a world power in potential strength but not in actual performance. The signal political events of that period—Hitler's militarizing of the Rhineland, Japan's Co-prosperity Sphere, the Spanish Civil War, the Anschluss, the Munich Conference—had been only marginally affected by United States influence or United States views.

From 1941 to the end of the Korean War, we were the free world's undisputed leaders. Nothing of consequence could happen in the political structure of the free world in which our views were not a dominant factor and our cooperation was not crucial. In rapid succession, the United States crystallized its philosophy and its goals in the United Nations structure; the International Monetary Fund, the World Bank, and the General Agreement on Tariffs and Trade; the European Recovery Program; the peace treaties with Italy, Germany and Japan; and the North Atlantic Treaty Organization.

But since 1953 the United States position in world affairs has begun to take on another perspective. New forces in international politics,

some of which could be subordinated in prior years to the major goals of United States foreign policy, now have to be given greater weight. For one thing, the aggressive nationalism of many of the underdeveloped nations has to be recognized as a force so powerful as to condition any foreign trade or foreign aid program in which they participate. For another, the new role of the Soviet bloc in foreign trade and investment has to be acknowledged as a fresh threat, much larger in magnitude and more profound in significance than the sporadic economic sallies which Stalin had occasionally taken in the free world.

Beyond that, we have had to take account of the return of initiative and vitality among nations to which we are closely tied. This reviving initiative became evident to all when six countries in Europe developed a European Coal and Steel Community, then followed with a European Economic Community, exceeding in scope and objective anything which United States policy makers had previously proposed. The revival in the vitality of our friends also became evident as new foreign aid programs appeared. The Colombo Plan was launched in Asia; a similar arrangement began to function in Africa; the Italians in Iran, the Germans in India, the Israelis in Ghana, all began to assert their plans and ambitions as national entities bent on survival and expansion.

Our sense of being crowded in the driver's seat was dramatically heightened by scientific and military developments. The Sputniks' role was largely that of strengthening a view which had been developing in any case. For the moment, the principal impact of the satellite contest is to drive home the realization that the Soviet Union may have matched us or outdistanced us in critical branches of military science. But most of us sense larger implications in the Soviet performance. We are beginning to realize that we have persistently underestimated the capacity of the Soviet economy for material performance. The possibility of our being outdistanced in the race to produce goods, military or civilian, no longer seems so remote and unlikely.

These are possibilities whose implications need to be sorted out and assimilated into a new structure of international relations. This sorting-out process will take time. Clearly, however, the problem of the moment is explicitly to recognize the shift in our power relationships and to begin reshaping United States trade policy along lines which will take account of this new position in world affairs.

## II. TRADE POLICY IN RETROSPECT

Through a period of 24 turbulent years, the domestic symbols of our international trade policy seem scarcely to have changed. Ten times in

this period, a succession of Democratic and Republican administrations have importuned the Congress to renew the Trade Agreements Act, the Act authorizing the President to reduce United States tariffs in connection with trade agreements with other countries. The forces pro and con arrayed at each renewal have become traditional; the arguments adduced have had a sameness which defies the passage of time. The very stability of the performance raises uneasy issues in the mind of the observer. Do our regular renewals of the Trade Agreements Act suggest that we have devised a principle of international relations so enduring that it applies equally well in the 1950's as in the 1930's? Or can it be that the approach is obsolete and that we have been obliged to hang on to an outworn policy, *faute de mieux*—because no proposal for a significant variation would survive the hazardous course through a hostile and ill-informed Congress?

In answering the question, one has to recognize first of all that the seeming stability of United States policy is partly an illusion. The political forces which produced the Trade Agreements Act in 1934 were an amalgam of interests, peculiar to the 1930's. For one thing, the personalities and interests of Cordell Hull and Franklin D. Roosevelt were indispensable elements in the conditions which produced the Act. Another critical ingredient was the support of the agricultural exporters centered in our Southern states; in the 1930's, this group was grasping at straws, willing to try any measure which offered the hope of reopening foreign markets for Virginia's apples, the Carolinas' tobacco, and Georgia's cotton. Another group, a liberal element centered in the Northeast, saw the Act as a rallying point for those who wished to break down our traditional political and economic isolationism.

But the trade agreements program was much too frail an instrument to deal effectively with the turbulent international forces of the 1930's. The program had scarcely been placed on the statute books in 1934 when world events began to limit its relevance. The persistence of widespread unemployment throughout the world and the entry of Hjalmar Schacht's brand of aggressive economic warfare could hardly be countered by some puny powers to reduce tariffs through a reciprocal trade agreements program.

To be sure, one should not discount altogether the longer-run political impact of the score or more bilateral agreements negotiated by the United States in the ten-year period after 1934. These negotiations did have some marginal effect: The easy assumption of other nations that the United States was hopelessly protectionist was shaken somewhat; and the upward movement of our tariff rates was arrested and reversed.

But beyond this, larger events shaped the structure of international trade relations, pressing many nations further and further into the protectionist mold.

When the United States determined at the end of World War II to assume a position of international political and economic leadership, the trade program took its appropriate place as an element in this larger political structure. The President's powers to negotiate tariff levels under the Trade Agreements Act became much more than a vehicle for isolated bilateral agreements with a few other nations. It became a means by which the United States hoped to lead all nations into the formation of a multilateral trading structure, world-wide in scope—a structure which provided the essential rules of the game by which nations would be governed in their relations not only with the United States but also with one another. From the United States viewpoint, the main purpose of such a world trading structure was to hold in bounds the egregious interference of governments in international trade and gradually to return international trade to an open system which contained most of the elements of private enterprise and personal freedom prevailing in international trade during the early twentieth century.

To carry out these conceptions, the United States at first attempted to develop an International Trade Organization. Though a charter was drafted in 1948, the organization was stillborn for reasons which have been described in detail in another essay in this series.\* But an unaccountably vigorous GATT did emerge, embodying a series of principles which reasonably well reflect a consensus of the majority of trading nations in the free world.

After ten years of GATT operations and a full-scale revision of the instrument in 1955, it is apparent that the free world is now generally agreed on the desirability of a gradual reduction in high trade barriers and discrimination in international trade. It is recognized, however, that countries in an early stage of industrial development may be justified in pursuing trading policies basically different from those of the more mature nations, containing larger elements of protection. This is no longer a temporary concession, grudgingly extended by the industrial nations to the underdeveloped countries with various strings attached; it is wide-open release, to be exercised by the latter with only nominal restraints on their behavior. Furthermore, the world now has bowed to the view—a view pressed hardest by the United States, as events developed—that trade in agricultural commodities is in a class

\* See William Diebold, Jr., "The End of the I.T.O.," *Essays in International Finance*, No. 16, October 1952.



by itself; that numerous national schemes to guarantee the income of farm populations place such blocks in the way of open international trade in farm commodities as to require that nations retain a special measure of freedom to restrict such trade.

Finally, there has been a considerable movement away from the simple principle that most forms of trade discrimination by one country in favor of another are objectionable. This has given way to substantially more sophisticated appraisals of trade schemes involving discriminatory practices. Here again the United States has been a willing partner in the process. When the countries of Western Europe, as part of the European Recovery Program, undertook to relax restrictions on their trade with one another but not with the rest of the world, the United States winked at the fact that this involved increased discrimination; for it hoped—and hoped justifiably, as events proved—that the relaxation in trade restrictions among the countries of Western Europe was only an interim step in a relaxation of restrictions toward all the world. Later, when the European Coal and Steel Community was developed by six countries in Western Europe, the United States urged the world to accept the inherent discrimination which would ensue in the coal and steel trade of the six, arguing that the total economic effects had to be gauged by more complex standards than the simple one of the degree of discrimination involved. By the same token, the United States has taken a much more relaxed view toward the incipient European Economic Community among the six countries than have most other nations, even though increased discrimination against trade in United States products is inevitably involved.

The United States, therefore, has evidenced many of the characteristics of maturity and flexibility which the free world's trade leadership demanded in the post-war period. It has pressed for the continued reduction of the world's trade barriers; yet it has come to recognize that the trade problems of the underdeveloped areas are different in critical respects from those in the advanced countries. It has urged the reduction of protectionist barriers in the industrialized areas; yet it has tempered its pressure on nations with slim foreign exchange reserves, recognizing the precariousness of their situation and their limited capacities for risk taking. It has sought for the reduction of trade discrimination by other countries; yet it has recognized the possibility that increased trade discrimination by others could lead, in some cases, to lower trade barriers and greater trade.

Nevertheless, the United States position of trade leadership in the free world has gradually declined, assailed by various forces. Some of

these forces stemmed from developments at home, others from changing conditions overseas. At home, the nature of public support for a liberal United States trading policy had begun to change almost at the very moment that the United States began to assume its leadership position. Shortly after World War II, those who had previously supported the trade program as a vehicle for pushing United States exports of agricultural products into foreign markets began to look to other devices to produce this result. More and more strongly, the farm groups anchored their cause to foreign aid programs, carefully tailored to dispose of United States agricultural products. As these measures took hold, the farm groups' support of the trade program became more sporadic and uncertain.

Moreover, the traditional support from the agricultural export areas of the South was being weakened by still another force, namely, the progressive industrialization of its labor force. Many of the plants drawn to the South had been attracted to that area in the first instance because they required a low-wage situation in order to survive. This sector of Southern industry was therefore of a type particularly vulnerable to competition from the even lower-wage economies of some foreign countries. Hence, localities which had previously seen their interests as bound up in promoting cotton or tobacco exports now began to see their interests as linked to excluding textile imports.

Other post-war changes in domestic support for the reciprocal trade program also were taking place. The groups which before World War II had used reciprocal trade as the rallying point against American political isolation now had other programs of a more pressing nature demanding their support. At first, the United Nations, the European Recovery Program and NATO, later the annual battle for an adequate foreign aid program, commanded their attention. For 8 or 10 years after World War II, then, public interest in a liberal trade program steadily declined to low ebb.

Though public interest declined, the work of the groups with a stake in trade protection continued full tilt. Eventually, the shift in the balance of pressure began to appear in statutes affecting our foreign trade policies. In the field of agriculture, the Congress began to place increasing emphasis on the United States right and intent to ward off imports and subsidize exports. The Agricultural Adjustment Act was amended in 1951 in such a way as to place greater pressure on the President to restrict imports which threatened to interfere with agricultural price support programs. At the same time, export subsidy operations were broadened, culminating in the vast program of "dump-

ing" export surpluses which is now being pursued as part of our foreign aid operations. Cotton exports were subsidized despite the concern of Brazil, Peru, India, and Egypt. Dairy products were offered to the world through export subsidies despite objection from New Zealand, Australia, Denmark, and the Netherlands. Wheat was sold on the same basis, in the face of strong protests from Canada, New Zealand, and Australia. Citrus fruit was dumped in competition with South Africa and the nations of the Mediterranean basin.

In the same vein, the Trade Agreements Act was gradually weakened; with each renewal of the President's tariff-negotiating authority, amendments were added restricting his power to make new tariff concessions and to maintain existing ones in the face of increased imports. In 1955, a "defense production" amendment was added to the Trade Agreements Act—an amendment generally regarded as more responsive to the pressures of the independent oil producers and the electrical equipment industry than to the security needs of the nation.

Meanwhile, the changing economic position of the free world which became apparent in the early 1950's offered added challenges to our leadership position. By that time, the other principal trading nations had not only begun to recover their ability to export goods but had even begun to retrieve some of their lost gold reserves, giving them slightly greater freedom of economic action. By that time, too, our foreign aid program had begun to stress the military at the cost of the economic, underlining the fact that we were no less hostage to our allies than they were to us. On top of this, doubts about the realism of our military strategy began to emerge at home and abroad, raising queries among some of our allies whether there was any greater safety in military alliance than without it. In many countries, the possibility of pursuing a foreign policy embodying greater parity with the United States began to be considered. This was the atmosphere which contributed in part to the European Coal and Steel Community and, later, to the European Economic Community.

Inevitably, the visible changes in domestic support for the United States trade policies and the subtle shifts in the position of the United States abroad found their reflection in the President's administration of his trade powers. A self-imposed discipline which had previously led the Executive to avoid most trade measures which would undermine the United States position of leadership now began to soften. Increasingly, the President began to exercise his executive discretion on a pattern which assumed that the position of United States trade leadership in the free world was no longer quite so vital to its interests, and

that we could afford to expose that role to greater risks if domestic interests demanded it. This change in approach led to a series of measures restricting United States trade. The President raised the duty successively on watches and bicycles, on linen toweling and dried figs, on clover seed, clothespins, and woolen textiles. He importuned Japan and Italy to cut down the flow of textiles to the United States and he advised our own importers "voluntarily" to restrict their imports of oil. A few of these steps had significant trade impacts; most did not. But all were recognized as a sensitive barometer of the United States approach to international trade problems.

This shift in the position of the United States noticeably affected its role in international trade meetings. As the 1950 decade went on, control of the GATT proceedings slipped somewhat from United States hands and was more aggressively shared by others. The dominant voice of the United States in the trade deliberations of the Organization for European Economic Cooperation—already muted by the changing nature of our aid to Europe—was even further hushed. Whereas the United States had played a major role in shaping the trade provisions of the European Coal and Steel Community treaty in 1950 to 1952, its role in the much more significant European Economic Community negotiations of 1955 to 1957 was exclusively that of a half-informed observer.

Signs of United States backpedalling were visible in other international activities affecting world trade. In 1954, United States efforts to find a way of dealing with the harmful effects of international cartels were hastily arrested and reversed; instead of responding to the interest which we had aroused in Germany, Norway and other countries, we refused to consider further international measures in this direction. In the International Monetary Fund, the one international organization, other than the World Bank, in which the United States still had a major position by virtue of a weighted vote, trade discussions were slowed down to a desultory pace. In sum, the United States slipped back from a position of clear leadership in international trade matters to one of moderate participation or passive observation.

### III. THE NEXT DECADE

#### *The Political Background*

While the battle of the satellites has aroused United States public attention to the perils of missile warfare, it seems to have diverted that attention for the present from any other form of international