CHAPTER 9

STATE TRADING

STATES have not only regulated private trade; they have entered into trade themselves, in many ways and for many purposes. In some cases, purchases and sales are made by the state itself; in others, they are made by public agencies; in still others, an exclusive right to buy or sell abroad may be conferred upon a private enterprise. Foreign purchases and sales by governments are sometimes incidental to the normal performance of public functions or to the preservation of national security: governments buy equipment and supplies for their departments and agencies; they accumulate stockpiles of strategic materials; they dispose of surpluses remaining at the end of a war. In many countries, state monopolies have long served as sources of public revenue. More recently, states have resorted to public purchasing as a means of reducing the cost of certain imports. And where the economy of a country is collectivized, foreign trade is conducted according to the requirements of a central plan.

The economic characteristics of state-trading operations differ from case to case. Governments may buy or sell in competition with private traders and their share in the imports or exports of particular commodities may be large or small. States may monopolize all purchases or sales of particular commodities, leaving foreign trade in other goods in private hands; the percentage of total trade that is nationalized may be high or low. Where collectivism is complete, however, everything that enters or leaves a country is bought or sold by agencies of government. As the economic characteristics of

state-trading operations differ, there are corresponding differences in the problems which they present.

Where purchases are made for public use, governments will usually favor domestic over foreign sources of supply. Aside from this, unless such purchases form a large fraction of the imports of a commodity, the issues presented by these operations are not likely to be serious. Where purchases or sales are made, for any purpose, in competition with private traders, the damage done to liberal trading principles will probably be small. If the state cuts imports by buying less or cuts exports by selling less, private traders can increase them by buying or selling more. If it discriminates in favor of one country against another, private traders can offset this discrimination by doing less business with the first country and more with the second. Where private trade is handicapped by regulations and public trade supported by subsidies, such competition will be curbed. But it is more likely that the state-trading enterprise will be granted a complete monopoly. And it is here that the real problems of policy arise.

STATE-TRADING MONOPOLIES

The *Charter* seeks to promote the expansion of imports and to eliminate discrimination among sources of supply by requiring governments to relax restraints on private trade. But this method will prove ineffective in the case of any product that is purchased by a state monopoly. Where trade is in private hands, imports will grow as governments, in conformity with their commitments, reduce tariffs, remove quotas, and abandon exchange controls. But where trade is in public hands, these commitments will be meaningless. Tariffs may be reduced, quotas removed, and exchange controls abandoned, but the government may simply fail to buy. Where trade is private, moreover, greater equality of treatment will be afforded as governments fulfill their obligations to move away from tariff preferences and discriminatory internal taxes, quotas, and exchange controls. But where trade is public, these obligations, too, will be meaningless. The state-trading agency, in the course of its daily operations, can discriminate by buying more in one country and less in another, paying more here and less there. If restriction

and discrimination are intended, no elaborate apparatus of tariffs, preferences, quotas, and exchange controls is required.

Discrimination, in fact, is not to be avoided. Wherever one large buyer deals with many small sellers, the buyer will discriminate. He will pay low prices where supplies are easily obtainable and high prices where they are not. He will get more goods for less money by buying, in each area, at the lowest price that sellers will agree to take. The larger the volume of his purchases, the greater will be his power to maximize his gain. And this is true, not only of private enterprises, but also of agencies operated by the state.

The motive for discrimination may thus be economic rather than political. Where trade is private, however, discrimination for economic purposes is not practiced by governments; it is only discrimination for political purposes that is required by public policy. But where trade is public, whatever the motive for discrimination, its practice is carried on by public agencies. It would be unreasonable to forbid such agencies to discriminate, as do private enterprises, for economic gain. It is reasonable, in so far as discrimination through the regulation of private trading is forbidden, to ask that states, as traders, do not use their powers of discrimination to serve political, rather than economic, ends. The principle is simple; its application is difficult. In the case of public regulation of private trade, discrimination is political if it occurs at all. In the case of public trade, its character depends upon its motivation and motivation is not easy to discover or to prove.

Where domestic production is carried on by private enterprise and imports are handled by a public agency, state trading may be employed as a means of affording an artificial advantage to domestic industry. If the state imports raw materials, it may sell them to fabricators at a loss, thus enabling these concerns to undersell their foreign competitors in the market for manufactured goods. If it imports goods that are also produced at home, it may sell at prices so high that domestic producers find it easy to compete. Such a policy would be quite as effective as tariffs, quotas, or exchange controls in curtailing the local market for foreign goods.

Where a state monopolizes the business of exporting a commodity, there are similar effects. Its agreement to reduce export taxes and

remove export quotas would have no meaning, for it could restrict exports simply by failing to sell. Its agreement to avoid discrimination in the use of export controls could likewise be robbed of its significance by favoring one country over another in making sales. The influence that a state monopoly can exert upon world markets will depend, of course, upon its relative importance as a supplier of the goods concerned. If its sales are a small part of the total, it can do little harm to the economies of other states. But if they bulk large, it can sell at high prices where demand is strong and at low prices where demand is weak, push prices up by withholding supplies, and invade markets by selling at a loss. In these respects, the state, as a seller, would behave as does any private monopolist. Unlike a private monopolist, however, it might also employ discriminatory pricing as a means of exerting political pressure, punishing its enemies, or rewarding its friends.

Where all imports and all exports are in the hands of government, as is the case in Russia, rules that are designed to expand trade and insure equality of treatment on the part of other nations do not apply. Purchases and sales can be expanded or contracted almost at will; they can be shifted from one market to another without warning; all decisions as to the volume and direction of trade become a matter of public policy. As a method of obtaining economic advantage, discrimination becomes inevitable; as a method of exerting political pressure, it is always readily at hand. And more than this, officials who buy and those who sell will not be strangers; where there is power on one side of the market it will be used to force advantageous terms on the other; collectivism thus makes for bilateralism in international trade.

EXPANSION OF TRADE

These are the issues that faced the framers of the state-trading provisions of the *Charter*. As a matter of logic, it must be recognized that the fundamental problem is insoluble: complete collectivism does not fit into the pattern of free markets and multilateral trade. But state-trading operations, at least where they are conducted on a more modest scale, can be brought under the general principles of fair dealing in international commerce by subject-

ing them to rules paralleling those that limit the freedom of states to interfere with private trade. And this is what the *Charter* seeks to do.

The rules that govern state trading apply to any trading enterprise that is established or maintained by the state, whether it is located at home or abroad. They also apply to any private enterprise that has been granted exclusive trading privileges. They do not apply to purchases for public use, if they are not made for commercial resale or for use in the production of goods for sale; here fair and equitable treatment is all that is required (29). The rules, moreover, do not apply to the rotation or liquidation of stock piles of strategic materials. In this case, each member of the ITO will agree so to conduct these operations as to avoid serious disturbance to world markets, to give advance notice of its intention to liquidate its holdings and, upon request, to consult with other members as to how such liquidation can be accomplished without serious injury to their trade (32).

As is the case where trade is entirely private, the *Charter* requires countries with state-trading monopolies to take part in negotiations directed toward the reduction of barriers to trade. Countries in the former group will fulfill their obligation by reducing the margin of protection to domestic industry that is afforded by their tariffs. Those in the latter group will fulfill it by reducing the margin of protection that may be represented either by a customs duty or by the markup that they add to the cost of imported goods in determining their resale price. Just as any other member of the ITO must publish its maximum import duties, a state monopolizing the imports of a commodity must declare the maximum protective margin afforded by its markup over costs. And such a member must negotiate the height of the protection provided by the markup just as other members negotiate the height of a duty. As defined in the *Charter,* a duty and a markup imposed by a state-trading country are identical in amount; agreement to reduce either one will require a corresponding reduction in the other and therefore in the price at which protected goods are sold. In this matter, the formal obligations assumed by both groups of countries will be the same (31).

When a country where trade is private has reduced its tariff and

abandoned other methods of restriction, the only limit to the quantity of imports will be the amount that domestic consumers will choose to take at the resulting price. But in a country where trade is public, barriers might be reduced and imports not increased. The *Charter* therefore provides that the obligations assumed in the two cases shall be equivalent not only in character but also in effect. At the price resulting from the established markup, the state-trading country must "import and offer for sale such quantities of the product as will be sufficient to satisfy the full domestic demand." But this obligation is seriously qualified: the principle is limited to cases where it "can be effectively applied" and account must be taken of domestic rationing (31–5).

In some cases, the method of negotiating a markup may prove to be impracticable. Where an imported material is further processed or where it is mixed with other materials, as is tobacco, it may not be possible to determine the margin between cost and selling price. In such cases and in others, where the parties prefer it, negotiations may be directed toward any other arrangement, consistent with the provisions of the *Charter,* that is mutually satisfactory (31–2*b*). Although the nature of such negotiations is not specified, they might, for instance, place a limit on the amount by which prices paid to domestic producers could exceed those paid for competing foreign goods. Or they might result in a guarantee to import a certain quantity of some commodity without discrimination among sources of supply.

The provisions relating to the expansion of exports by a state monopoly are similarly flexible. Here negotiations must be directed toward "arrangements designed to limit or reduce any protection that might be afforded through the operation of the monopoly to domestic users of the monopolized product, or designed to assure exports of the monopolized product in adequate quantities at reasonable prices" (31–1*b*).

NON-DISCRIMINATION

The parallelism between the provisions of the *Charter* that apply to public regulation of private trade and those that apply to the conduct of public trade is evident also in an article that brings state

trading under the general rule of non-discrimination. Here it is provided that each state-fostered enterprise, when it buys or sells abroad, shall "act in a manner consistent with the general principles of non-discriminatory treatment prescribed in this *Charter* for governmental measures affecting imports or exports by private traders." In order to prevent evasion of this requirement by agencies whose policies are said to be autonomous, the obligation to insure such conformity is placed upon the state itself. And members are also forbidden to prevent conformity on the part of private enterprise.

State traders will be held to have operated in accordance with the general principles of non-discrimination if they follow two rules. First, they must buy or sell abroad "solely in accordance with commercial considerations, including price, quality, availability, marketability, transportation, and other conditions of purchase or sale." And second, they must "afford the enterprises of the other Member countries adequate opportunity, in accordance with customary business practice, to compete for participation in such purchases or sales" (29). These rules, it should be noted, will not prevent discrimination on purely economic grounds, since such commercial considerations as price, availability, and marketability may well justify a pattern of purchases or sales in which one country is favored over another. And opportunity to compete does not insure that all purchases and all sales will be made on the same terms. But the rules, in so far as they are observed, should afford some assurance that discrimination will not be practiced on other than economic grounds. And in this, again, the formal obligations that will be assumed by private-enterprise countries and by state-trading countries are identical.

In the case of state-trading countries, however, it cannot be contended that these obligations can be effectively enforced. The *Charter* does require members to supply one another with whatever information may be needed to permit a full and fair appraisal of matters covered in direct consultations (41) and to provide the ITO with such statistical information as it may deem necessary to enable it to fulfill its functions (39–5). But the information that is provided on state-trading operations is unlikely to enable the Organization to determine with certainty, in any case, whether discrimina-

tion is to be justified on economic grounds. Proof of violation would require an analysis of cost accounts. The disclosure of such accounts is not asked of private enterprises; it would doubtless be refused by the directors of state-trading agencies. And even if cost accounts were to be made available, they would be open to conflicting interpretations; the motive for discrimination would continue to be a matter of dispute. Where trade is conducted by governments, reliance for observance of the rules of non-discrimination must be placed on their good faith.

TRADE WITH RUSSIA

Where all of a nation's trade is handled by public agencies, another nation can best obtain assurance that these agencies will import more of its goods if the two governments conclude a bilateral agreement under which the purchase of minimum quantities of these goods is guaranteed. But such an agreement would permit and might even compel discrimination against the exports of other countries. The only way in which imports could be assured without discrimination would be through the conclusion of a multilateral agreement in which the minimum quantities of goods to be purchased from all sources would be guaranteed. This solution of the problem of trade relations between free and collectivist economies was suggested by the United States in its original *Proposals*. "Members having a complete state monopoly of foreign trade," said the *Proposals,* "should undertake to purchase annually . . . products valued at not less than an aggregate amount to be agreed upon. This global purchase arrangement should be subject to periodic adjustment in consultation with the Organization."

When the Soviet Union failed to attend the London meeting of the Preparatory Committee, consideration of this proposal was postponed. When it failed to appear at the Geneva meeting, the proposal was dropped. Its value would have been questionable in any case. A commitment that made no provision for the allocation of Russian purchases among the other participants to the negotiations would afford no real insurance against discrimination. A global commitment on a product-by-product basis would require the Soviet Union to disclose to other nations the content of its economic plans;

the *Charter* imposes no such obligation upon the private-enterprise economies. A commitment as to the aggregate value of all imports would give other countries no indication as to the market prospects for particular goods. If it did not require Russia to buy more than she had intended to buy, it would not operate to expand trade. If it did require her to buy more than she wanted, it would be both inequitable and unenforceable. When other nations reduce restrictions on imports, they create conditions under which more goods may be purchased. But they do not guarantee that such purchases will be made. The proposal was therefore abandoned without regret.

If the Soviet Union were to join the ITO, it could conceivably be fitted into the pattern of multilateral trade negotiations under the rules of the *Charter* as they stand. In bilateral discussions with the principal suppliers of each of its imports, it could agree either to reduce its markups and satisfy the demands of its consumers at the resulting prices, or to purchase, from all sources, minimum quantities of the goods concerned. And the principle of non-discrimination would apply. The rules of the *Charter* governing state-trading operations would be no weaker here than in any other case.

If a major part of the world's trade were in the hands of governments, many of the rules laid down by the *Charter* would be unworkable. A different approach toward the problems of international trade relationships would be required. But the great bulk of world trade is still in private hands; the problems presented by state trading are more serious in their logical implications than in their practical effects. If a definitive solution of these problems is sought, the *Charter* does not contain it. But it does afford a legal basis for requiring that they be submitted to international discussion as they arise in practice. And it establishes a medium through which state-trading policies can be kept under continuous review. Out of the process of debate and the accumulation of decisions, it should be possible to establish a body of precedents that will bring state trading under increasingly effective control. In the absence of the ITO, no mechanism to serve this purpose would exist.