CHAPTER 6

TARIFFS AND PREFERENCES

BEFORE negotiations were undertaken at Geneva in 1947, two methods of reducing tariffs through international agreement had been explored. The first called for simultaneous action by many countries, the second for separate negotiations between pairs of countries. The method of multilateral agreement held out the hope of speedy and widespread accomplishment. Unfortunately, this hope was never realized. No formula for simultaneous action could be agreed upon. Establishment of a maximum limit on all duties was held, by states whose tariffs were high, to discriminate in favor of those whose tariffs were low. Reduction of all duties by a fixed percentage was held, by states whose tariffs were low, to discriminate in favor of those whose tariffs were high. Negotiations conducted on a product-by-product basis were believed to be impossible unless confined to pairs of states. The multilateral method failed because of its inflexibility.

In the decade that followed the passage of the Reciprocal Trade Agreements Act, bilateral negotiations were carried on between the United States and twenty-nine other governments. This method of action proved to possess the great advantage of flexibility. Negotiations were conducted on a selective basis; flat cuts across the board were never made. Some rates were cut substantially, others moderately, and others not at all. This method, however, has two serious limitations. The process of bargaining for reductions in foreign tariffs, country by country, in successive negotiations, is necessarily slow. And in the meantime the tariffs of countries not included in such negotiations are unlikely to be cut. Bilateral negotiations, moreover, do not offer assurance of action by enough countries to induce

participants to accept binding commitments as to other aspects of commercial policy.

Where it was applied, the method produced results. Concessions were obtained on 55 per cent of the exports of the United States to the countries concerned. Three-fifths of the duties imposed on such exports were cut more than 25 per cent; one-fourth, more than 50 per cent. Duties were cut on 64 per cent of dutiable imports into the United States and bound against increase on another 5 per cent. The weighted average rate of duty on such imports was cut from 48 per cent to 32 per cent, a reduction of about one-third.* Concessions granted in these agreements were generalized through the operation of the most-favored-nation clause.

Procedures were developed, in this country, to safeguard the established interests of producing groups. Before negotiations began, an Interdepartmental Committee on Trade Agreements set up country committees to study all aspects of the trade with the other countries concerned and to outline the concessions that might be offered and those that might be asked; the Tariff Commission made a thorough study of the competitive strength of each industry involved. An interdepartmental Committee on Reciprocity Information then issued a notice of public hearings and the Secretary of State published a list of all the products on which concessions might be made. In the course of the following months, the Committee received written briefs from any industry that was concerned and held extensive hearings where representatives of such industries might appear to argue for or against particular tariff cuts. The Committee on Trade Agreements then analyzed the studies made by the Tariff Commission and the country committees, the statements presented to the CRI, and other relevant materials and, on the basis of all the evidence, made its recommendations to the President. The President's decisions established the limits beyond which the United States was not permitted to go in using tariff cuts at home to obtain tariff cuts abroad. It was not until this procedure was completed that negotiations with other countries could begin.

In formulating its program for trade expansion at the end of the Second World War, the United States drew on this experience. It

* U.S. Tariff Commission, *Operation of the Trade Agreements Program* (Washington, 1948).

sought action that would be rapid in tempo and broad in scope. It also sought to preserve the flexibility that had been obtained and to maintain the safeguards that had been developed under the operation of the Trade Agreements Act. For the first purpose, a multilateral agreement was needed. For the second, bilateral negotiations were required. In the American program, the two approaches were combined. A multilateral conference was planned for the reduction of barriers to trade. Rates of duty were to be reduced, at this conference, through simultaneous negotiations, on a selective basis, initially between pairs of states and in the final stages among all of the participants. The results of these negotiations, together with provisions of general applicability, were to be incorporated in a multilateral document.

This procedure, adopted at Geneva, led to the conclusion of the *General Agreement on Tariffs and Trade*. In this agreement, concessions were obtained by the United States on two-thirds of its exports to the twenty-two other countries in the group. Half of the duties imposed on such exports were cut by more than 25 per cent; one-third, by more than 35 per cent. Many preferences were eliminated and many of the remaining preferential margins were substantially reduced. The average rate of duty on all dutiable imports into the United States was cut from 32 per cent to 25 per cent, a reduction of one-fifth.*

The negotiations at Geneva included most of the major trading nations and covered the bulk of the world's trade. A major part of the contribution that the United States can offer for the restoration of multilateralism has now been made. There are still, however, some forty countries that remain outside the *General Agreement on Tariffs and Trade*. It is important that these countries, also, should reduce their tariffs and that they should accept the commitments embodied in the *GATT*. This is the purpose of the provisions of the *Charter* relating to tariffs and preferences.

NEGOTIATING THE TARIFF PROVISIONS

In its *Suggested Charter,* the United States proposed that each member of the ITO should be required to enter into negotiations directed toward the substantial reduction of tariffs and the elimina-

* *Op. cit.*

tion of preferences. It laid down two rules to govern these negotiations: prior commitments should not be permitted to stand in the way of action on preferences; reductions in duties should operate automatically to reduce or eliminate margins of preference. Save for such existing preferences as might survive negotiation, extension of equal treatment to all members of the Organization was to be required. To enforce the obligation to negotiate, it was proposed that an autonomous Tariff Committee, consisting of the parties to the *GATT,* be established within the ITO. This Committee would have been entitled to receive, from members of the Organization, complaints that other members had failed, within a reasonable time, to enter into the negotiations required or to offer concessions comparable in scope and effect to those already made by the parties to the *GATT.* If it found such a complaint to be justified, the Committee would have been empowered to waive the rule prohibiting discrimination and to authorize these parties to withhold from the offending member the tariff concessions that they had made to one another. Through the operation of this sanction, comparable concessions were to be obtained from the other members of the ITO. It was proposed, finally, that an escape clause be adopted to permit the modification or withdrawal of concessions whenever increasing imports should cause or threaten serious injury to domestic producers. Such a clause had been written into trade agreements by the United States; its inclusion in future agreements was required by an *Executive Order* issued by the President in 1947.

These proposals were accepted by the Preparatory Committee and, with no significant changes, were written into the drafts of the *Charter* adopted at London and Geneva. At the Havana conference, however, they were vigorously attacked. Certain countries of Latin America sought to eliminate or qualify the commitment to negotiate for the reduction of tariffs and so to amend the rules governing such negotiations as to favor countries in an early stage of economic development. It was proposed, for instance, that industrial countries and creditor countries be required to make concessions to undeveloped countries and debtor countries; that the necessity of maintaining protection in the latter countries be recognized; that increases in specific tariffs be authorized in the negotiations; and that countries

relying on tariffs for revenue be excused from making concessions or relieved of the obligation to negotiate. The Tariff Committee was attacked as a device designed to enable parties to the *GATT* unreasonably to exact disproportionate concessions from the other members of the ITO. It was proposed that this committee be stripped of its authority and an autonomous Economic Development Committee set up within the Organization to function as a counterweight. The last of these proposals raised one of the critical issues of the conference.

None of the proposals was accepted. The commitment to negotiate was retained with a minor change in wording to make it clear that the negotiations required were to involve selective action rather than horizontal cuts. The rules governing such negotiations were spelled out in greater detail; the present text carries out the intention of the American *Proposals,* outlines the procedure followed at Geneva, and conforms to the provisions of the Trade Agreements Act. In the final compromise, the Tariff Committee and the Economic Development Committee were both dropped. The function assigned to the Tariff Committee reverted to the parties to the *GATT*. Protection against arbitrary action was provided by granting other members the right to appeal from their decisions to the ITO. But the assurance of most-favored-nation treatment, provided in earlier drafts of the *Charter,* was no longer given to countries that fail to become parties to the *GATT*.

TARIFFS IN THE CHARTER

The *Charter* now requires each member of the ITO, upon request, to "enter into and carry out . . . negotiations directed to the substantial reduction of the general level of tariffs and other charges on imports and exports and to the elimination of . . . preferences . . ." (17–1). Such negotiations are to be conducted "on a selective product-by-product basis which will afford adequate opportunity to take into account the needs of individual countries and individual industries." Particular products may be withheld from negotiation and particular duties may either be reduced or bound against increase. No member may be required "to grant concessions to other Members without receiving adequate concessions in re-

turn." The reductions made at Geneva are to be counted as concessions in future negotiations and the binding of low duties or of duty-free treatment is to be recognized, in principle, "as a concession equivalent in value to the reduction of high duties." Prior international obligations are not to be invoked to prevent the reduction or elimination of preferences. Reductions in tariffs are to operate automatically to reduce or eliminate margins of preference and no such margin is to be increased (17–2).

The commitment to negotiate is to be enforced by the parties to the *GATT*. For two years after another member joins the ITO, these parties must extend to it the tariff concessions that they have already made. During this period of grace, it will be afforded an opportunity to bargain its way into the *General Agreement*. But after the period has expired, most-favored-nation treatment will no longer be required. The parties to the *GATT* may then withhold such treatment from any member who fails to offer adequate concessions or refuses to negotiate. Such a member may then appeal this action to the ITO. If it has not entered into negotiations, it will be unable to make out a case. If it has negotiated, it must prove that the concessions it has offered are equivalent to those already made by the parties to the *GATT*. The burden of proof has thus been shifted, since the earlier versions of the *Charter,* from those who withhold most-favored-nation treatment to those who seek to obtain it. If a case can be established, the ITO may require the restoration of such treatment to the member who has complained. If its complaint is rejected, a member may withdraw from the Organization within sixty days (17–3).

The *Charter* retains the escape clause proposed by the United States. Whenever, as a result of unforeseen developments, imports of a product have so increased "as to cause or threaten serious injury to domestic producers," a member may modify or withdraw concessions made or obligations assumed with respect to that product "to the extent and for such time as may be necessary to prevent or remedy such injury." It may thus restore higher duties, impose quotas, or curtail imports in other ways. A member taking such action is required to consult with the other members affected, but it may proceed without their consent. In order to restore the balance

of an agreement which has thus been modified, parties deprived of concessions may withdraw equivalent concessions; the extent of such withdrawals is subject, however, to the approval of the ITO (40). In adopting this article, the Havana conference gave world-wide recognition to a provision developed exclusively by the United States in the administration of the Trade Agreements Act.

PREFERENCES

Under the terms of the American *Proposals,* tariffs and other restrictions affecting imports and exports were to be so designed and administered as to afford equal treatment to all the members of the ITO. No new preferences were to be created; no old preferences were to be increased. Existing preferences were subject to reduction or elimination through negotiation. But those surviving such negotiations were excepted from the most-favored-nation rule. The most important of these preferences were those among the members of the British Commonwealth and those between the United States and its territories, the Philippines, and Cuba.

During the negotiations, this list was extended, on the same principle, to include existing preferences among certain neighboring states in the Near East, Central America, and northern and southern South America. It was argued, however, that the distinction drawn in the *Charter* between old and new preferences was grossly unfair and amendments were introduced, at Havana, both to abolish old preferential systems and to establish new ones.

Peru proposed the abolition of preferences between Cuba and the United States; Haiti and the Dominican Republic proposed their extension to the neighboring island. One amendment would have exempted from the most-favored-nation rule all countries in the same economic region; another would have exempted countries with complementary economies. New preferential arrangements were proposed for each of the following groups: the countries of Central America, those of northern South America, those of southern South America, those formerly belonging to the Ottoman Empire, members of the Arab League, nine countries of the Near and Middle East, and all the countries of South East Asia.

The *reductio ad absurdum* of this movement was contained in a

Burmese note accompanying the last of these proposals: "The tendency of the countries represented in this conference being to favor groupings on a regional basis and the manifestation of such tendencies being such that the whole world except South East Asia has been covered in such regional groupings, it is felt that countries of South East Asia should not lose by default and should have the right to form such groups if they desire to do so."

All of these proposals were withdrawn or defeated. The general rules and the exceptions proposed by the United States were retained: new preferences are not to be created; old preferences are not to be increased; existing preferences are to be eliminated through negotiation; permission is given for existing preferences surviving such negotiations (16), for those required to facilitate frontier traffic, and for those extended to the Free Territory of Trieste (43). In two new articles, however, possible exceptions of greater importance were introduced. Under the first, members may seek the approval of the ITO for new preferential arrangements required to promote economic development. Conditions are laid down, criteria established, and procedures prescribed to limit the scope of this exception and prevent its abuse (15). These provisions are described in Chapter 14. Nominal recognition is also accorded to the creation of new preferences among former members of the Ottoman Empire, but no such preferences can be established unless all of the requirements of the foregoing article are fulfilled (16–3). The second article covers interim arrangements leading to the formation of customs unions and free trade areas.

CUSTOMS UNIONS AND FREE TRADE AREAS

Preferences have been opposed and customs unions favored, in principle, by the United States. This position may obviously be criticized as lacking in logical consistency. In preferential arrangements, discrimination against the outer world is partial; in customs unions, it is complete. But the distinction is none the less defensible. A customs union creates a wider trading area, removes obstacles to competition, makes possible a more economic allocation of resources, and thus operates to increase production and raise planes of living. A preferential system, on the other hand, retains internal barriers,

obstructs economy in production, and restrains the growth of income and demand. It is set up for the purpose of conferring a privilege on producers within the system and imposing a handicap on external competitors. A customs union is conducive to the expansion of trade on a basis of multilateralism and non-discrimination; a preferential system is not.

In the formation of a customs union, established interests may be threatened and substantial readjustments required. It is therefore desirable that the transition to such an arrangement be gradual rather than precipitate. For this purpose, duties within the union may be reduced, step by step, over a considerable period of time. While this process is going on, however, preferences will be established and increased. An exception to the general rule of non-discrimination will therefore be required. But such an exception may be dangerous. Progress toward the complete elimination of internal barriers may stop short of its appointed goal. And, if this happens, a preferential system will survive. If this outcome is to be avoided, the exception must be so framed as to insure its proper use.

An exception to permit the formation of customs unions was envisaged in the American *Proposals*. At Geneva, following upon the consideration of plans for the increasing economic unification of western Europe, in connection with the European Recovery Program, the terms of this exception were amplified and various safeguards were introduced. At Havana, proposals that would have weakened these safeguards were defeated or withdrawn. Only one important change was made: upon the motion of Lebanon and Syria, the exception was extended to cover arrangements in which, though common external tariffs and customs administrations are not established, internal restrictions are removed. To distinguish them from customs unions, such arrangements were designated as free trade areas.

The *Charter* now exempts, from the general rule of non-discrimination, customs unions, free trade areas, and interim arrangements required for their establishment. Members entering into such arrangements must proceed by reducing duties to insiders, not by raising duties to outsiders. They must move toward the ultimate elimination of restrictions on substantially all of their internal trade.

In the case of a customs union, they must move toward the establishment of a common tariff. In the case of any interim arrangement, they must present to the ITO a plan and schedule which provides for the completion of the customs union or free trade area within a reasonable period of time. If the ITO is convinced that the plan and schedule will, in fact, result in the completion of such an arrangement within a reasonable period, they may proceed with the project. Otherwise, they must modify or abandon their plans. If any change is subsequently contemplated in the program, they may be required to enter into consultation with the ITO. If any member of the group has previously accorded preferences to other countries, these may be modified or eliminated through negotiations with the governments concerned. An arrangement including countries not belonging to the Organization may not be entered into unless approved by a two-thirds vote (44).

THE CHARTER AND THE "GATT"

The *General Agreement on Tariffs and Trade* will formally enter into force when instruments of acceptance have been deposited with the United Nations by governments representing 85 per cent of the trade included within its scope. Under a *Protocol of Provisional Application*, however, the tariff rates contained in the *GATT* had been put into effect, provisionally, by June 30, 1948, by twenty-two countries; with the exception of Chile, by all the members of the Geneva group.

According to the terms of the *GATT,* each of these countries receives all the concessions made in that agreement as a matter of right. Any of them may extend these concessions to other countries; they are not required to do so; this policy has been followed, however, by the United States. The application of the *Protocol* may be suspended, on sixty days' notice, by any of its signatories. The *GATT* itself will run to January 1951, three years from the date of its provisional application by the United States. At any time thereafter, on sixty days' notice, any party may withdraw and the *Agreement* may be terminated if such withdrawals are important or widespread. Failing such action, its duration is indefinite. The operation of previous trade agreements between the United States and other parties

to the *GATT* has been suspended for the period during which the *GATT* is in effect.

In addition to its tariff schedules, the *General Agreement* contains provisions paralleling certain articles of the *Charter* relating to questions of commercial policy and required to protect the concessions it contains. In general, these provisions follow the wording of the Geneva draft; they were amended by the parties to the *GATT,* during 1948, to substitute the Havana articles relating to internal taxes and regulations, antidumping and countervailing duties, and exceptions for economic development, customs unions, and nondiscrimination in the administration of quota systems. The other Geneva articles are to be superseded by the comparable articles of the *Havana Charter* when that document enters into force. Until then, it is unlikely that the instruments of acceptance required to bring the *GATT* itself formally into force will be deposited. In the meantime, under the *Protocol,* its general provisions are to be made effective only to the extent not inconsistent with existing legislation. Provisions inconsistent with the laws of the United States will not become effective until Congress acts.

As envisaged by the two documents, the relations between the *GATT* and the *Charter* will be close. The commitment to negotiate, contained in the *Charter,* is to be enforced by the parties to the *GATT* and the results of such negotiations are to be embodied in the *GATT*. Enforcement of the general rules of commercial policy, however, will be taken over, on its establishment, by the ITO. In the meantime, this task is to be performed by the parties to the *GATT*.

Despite this close relationship, the two documents are legally separate. If the *Charter* should not be adopted, the *GATT* might be amended and maintained. In further negotiations, other countries might be brought within its scope. But the rules of commercial policy would not be rapidly extended, the problems of employment, economic development, international investment, restrictive business practices, and intergovernmental commodity agreements would not be covered, and the ITO would not be brought to life. If these things are to be accomplished, the *Charter* must be ratified.