Chapter 8

STATE TRADING

The basic principles of the General Agreement are incompatible with complete state trading. When trade is completely in government hands, the treaties to lower trade barriers may be rendered useless if the state deliberately does not buy and sell more. In countries practising state trading, imports and exports are determined by public policy and the existence or absence of trade barriers exerts little influence. Lowering of trade barriers will expand trade when it is conducted by private traders. Similarly, an undertaking by any government not to indulge in discrimination will be meaningful only where trade is in private hands. Such an undertaking can be evaded without much difficulty if the trade is in state hands. Countries with state trading can practise discrimination against particular countries just by administrative actions without the need for discriminatory tariffs or discriminatory quantitative restrictions. Where production is in private hands and trade in state hands, the state may provide protection to domestic industries by selling similar imported products at artificially high prices. Similarly, it may sell the imported raw materials at artificially low prices by incurring a loss and thereby enhance the competitive strength of domestic producers in domestic and foreign markets.

The state trading can be fitted into the framework of the General Agreement only where it embraces a small portion of the total foreign trade of a country. This can be done by subjecting the state trading operations to rules paralleling to those which
limit the freedom of states to interfere with private trade. (1)
This is what Article XVII aims at.

The contracting parties, establishing or maintaining a state enterprise, whether at home or abroad, or granting exclusive or special privileges to any enterprise, undertake that such enterprise shall act, in its purchases or sales involving imports or exports, on the principles of non-discrimination prescribed in the Agreement for governmental measures affecting imports or exports by private traders. (2) State trading enterprises shall make purchases and sales solely in accordance with commercial considerations, including price, quality, availability, marketability, transportation and other conditions of purchase or sale. The enterprises of other contracting parties should be given adequate opportunity to compete in its purchases or sales in accordance with the customary principles of business. No contracting party should prevent any enterprise, whether state or privately owned, from acting in accordance with these rules. These provisions do not apply to the import of products which are meant for governmental use and not for re-sale or use in the production of goods for sale. (3) Regarding such imports, the trade of other contracting parties should be given fair and equitable treatment.

Discrimination is often practised by private traders for commercial purposes in cases in which the elasticity of demand for

(2) Article XVII, 1.
(3) Article XVII, 2.
the product differs in different markets. To deny the right of similar discrimination to state enterprises will involve discrimination against these. To avoid this, state enterprises are permitted to charge different prices for the sale of a product in different markets provided the differences in prices are purely for commercial reasons e.g. to meet the conditions of demand and supply in the export markets. (4) Private enterprises may, and sometimes do, practise discrimination not only for commercial purposes but also for other non-economic purposes. German private enterprises often indulged in discrimination for non-economic purposes. When there is no provision preventing private enterprises from practising discrimination for non-commercial purposes, prohibiting public enterprises from practising such discrimination is nothing short of discrimination against these. (5) It may, however, be pointed out that discrimination for non-commercial purposes is very rare in case of private enterprises because the basic motive of these is the maximisation of profits. The capacity of the individual private enterprises to indulge in discrimination for non-commercial purposes is strictly limited. It is doubtful if the discriminatory action of an individual private enterprise can significantly affect a foreign country. Further the institution of state trading increases the scope for discrimination. Discrimination can be practised only under monopolistic or monopsonistic conditions. In the absence of state trading, monopsony for the import of a

(4) Ad. Article XVII, para 1.

(5) W. A. Brown, Jr., The United States and the Restoration of World Trade (Washington, D.C., 1950) 111-12.
commodity or monopoly for the export of a commodity will not be very common. For these reasons, special restrictions on the right of state enterprises to practise discrimination even for commercial purposes are not unjustified. If the public enterprises are not prohibited from practising discrimination for non-commercial purposes, these are likely to practise such discrimination on a large scale.

State trading agencies should be further obligated to be guided in their transactions solely by 'competitive considerations.' There is, of course, no objective and unambiguous criterion for determining whether or not the state trading monopoly has been guided in its purchases solely by competitive considerations.

Once there is monopoly power, however, there does not seem to be available any general formula, capable of practical application and not somewhat arbitrary, which would restrain the use of that power for economic advantage. When monopoly power is present, its use tends to some extent to be automatic and undeliberate. The existence of the power, even without conscious will, to exploit it, is sufficient to yield some monopolistic fruits. Even if an agency with some degree of monopoly power were willing to subject itself to a self-denying ordinance, it would probably encounter great difficulty in drafting such an ordinance and in applying it to its operations. By deciding to buy at uniform prices regardless of the source of supply of its purchases, it could keep itself from practising discriminating monopoly. But unlike a private competitive buyer, it could not prevent the size of its purchases from influencing the price it had to pay, and it could not very well be expected to refrain from being influenced in the determination of the volume of its purchases by the effect on the sale of its purchases.

There arise some difficulties in the application of the rule of non-discrimination in case of bulk purchases. The difficulties

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(6) League of Nations, *Trade Relations Between Free Market and Controlled Economies* (Geneva, 1943) 81.
are particularly marked when the bulk contracts are of a somewhat long-term nature, say, for five or ten years. If the comparative supply prices of different exporting countries change during the contract period, discrimination will be involved against the countries whose prices have fallen below those at which the contract is made. Similarly, if the contracts are for large bulks, the discrimination will be involved against countries whose prices are lower than those at which the contracts are made but can supply only small quantities. Discrimination will be involved also against those exporting countries which do not want to tie their hands by entering into contracts.

Discrimination is permitted under special circumstances by certain articles of the Agreement e.g. Article XIV, Article XII, paragraphs 2 and 3 of Article I. State trading enterprises should be permitted to practise discrimination under such circumstances.

The most difficult problems arise in effectively enforcing the rule of non-discrimination in actual practice in case of state trading enterprises. Determination of discrimination requires a detailed analysis of cost accounts. The Agreement does not obligate the contracting parties to provide this information. Even if the cost accounts are made available, these can be differently interpreted by the parties having different interests and whether or not the situation involves discrimination will remain a matter of dispute. Discrimination can be avoided only if the state trading enterprises work in good faith.

The Contracting Parties recognise that the operations of the state trading enterprises might create serious obstacles to
trade. (7) Negotiations on a reciprocal and mutually advantageous basis for reducing such obstacles, therefore, are very essential for the expansion of world trade. Contracting parties are required to notify the Contracting Parties of the products which are imported into or exported from their territories by the state trading enterprises. (8) A contracting party establishing, maintaining or authorising a monopoly for the importation of a product, on which no concession has been negotiated under Article II, is required, on the request of another contracting party having a substantial trade in the product concerned, to inform the Contracting Parties of the import make-up on the product during a recent representative period. In case it is not possible to give this information, it will inform of the price charged on the resale of the product. The Contracting Parties may, at the request of a contracting party which has reason to believe that its interests under the Agreement are being adversely affected by the operations of a state trading enterprise, request the contracting party establishing, maintaining or authorising such enterprise to supply information about its operations regarding the carrying out of the provisions of the Agreement. No contracting party, however, will be required, under this provision, to disclose any confidential information which would hinder the enforcement of law or otherwise be contrary to the public interest or would prejudice the legitimate commercial interests of particular enterprises.

(7) Article XVII, 3.

(8) Article XVII, 4.
Trade between Private Enterprise and Centrally Planned Economies

As seen above, the existing GATT rules are intended to regulate state trading only where it embraces a small portion of the total foreign trade of a country. They do not provide an adequate framework for regulating trade between private enterprise economies and centrally planned economies where trade is conducted by the state.

If a free enterprise country enters into the General Agreement, it undertakes a number of important obligations with regard to the level of tariffs, use of quantitative restrictions, subsidies, dumping, customs administration etc. These obligations assure exporters a greater access to the markets of the importing countries. Most of such obligations are meaningless in the case of centrally planned economies. In a centrally planned economy, price mechanism does not operate in its genuine form. Prices are determined not by the forces of demand and supply but by state policy. In the absence of the knowledge of true costs of production, it is not possible to determine as to whether or not the goods are being dumped. Imports might be discouraged by artificially lowering the domestic prices of similar goods. The whole economy is shaped by political considerations. It is not possible to forecast the trend of markets or that of competition because there is always involved the risk that a change in state policy will falsify the forecasts. In some centrally planned economies (e.g. USSR, China etc.) foreign traders do not enjoy facilities for promoting their exports through advertisement, personal contacts with consumers and importers, and other means. Imports and exports
are determined by public policy and the tariffs, quantitative restrictions, subsidies and customs administration have little effect on these. Centrally planned economies can restrict total imports or exports and practise discrimination against any particular country just by administrative actions without the use of tariffs, quantitative restrictions, subsidies etc. If these countries are to be admitted into the GATT, certain special obligations will have to be imposed on them to put them on an equal footing with the free enterprise economies in regard to their obligations. The problem of devising these special obligations is a very difficult one. Some of the pessimist writers believe that the problem is insoluble. "As a matter of logic, it must be recognised that the fundamental problem is insoluble: complete collectivism does not fit into the pattern of free markets and multilateral trade." (9) This kind of pessimistic attitude, however, is not very healthy and we must look out for some workable solution. The importance of co-existence in trade relations between the free enterprise and centrally planned economies cannot be overemphasized for the maintenance of world peace and for increasing the world prosperity. Hitherto the planned economies had very little trade. Further, whatever trade they had was on a bilateral basis. But things are changing very rapidly. Centrally planned economies have recognised the importance of foreign trade and are rapidly expanding their trade. They have shown an earnest desire to expand their trade with the private enterprise economies on mutually advantageous basis.

(9) Wilcox, n. 1, 97.
In addition the sphere of planned economies is increasing very rapidly. More and more countries, particularly the developing countries, have recognised the need for rigid economic planning supplanting the free price mechanism in varying degrees. With the increasing sphere of the centrally planned economies and their earnest desire to expand trade, the problem of finding some course for expanding trade between the free-enterprise and the collectivist economies can no longer be postponed.

One suggested solution of the problem is that centrally planned economies should conclude bilateral agreements with the contracting parties undertaking to import in aggregate goods of a minimum value in exchange for the benefits flowing to them from the obligations undertaken by the contracting parties under the General Agreement. Bilateral agreements, however, might lead to discrimination against third parties. In addition, there is the risk that "Gresham's Law might assert itself and bilateralism drive out multilateralism." (10) It will be better, therefore, if the centrally planned economy concludes a multilateral agreement with all the contracting parties undertaking to import in aggregate goods of a minimum value from all contracting parties taken together. The aggregate value of goods to be imported by the centrally planned economy shall be subject to periodic adjustment according to changed conditions. (11) Some arrangement will have to be made for the distribution of the minimum aggregate among the contracting parties. The best way of distributing this minimum value will be a mutual


agreement among the contracting parties. In case, mutual agreement is not possible, the allocation may be made according to some set formula. One such formula will be the allocation according to the share of each contracting party during a representative base period taking into consideration the changes affecting the trade that have occurred since the base period. An objection that can be raised against this solution is that commitments on the part of centrally planned economies to buy various goods in certain quantities will be tantamount to disclosing their economic plans to other countries. The provisions of the Agreement impose no such obligations on the private enterprise contracting parties. (12)

In spite of the difficulties discussed above, the GATT has continuously made efforts to associate the centrally planned countries with its activities. A flexible use of waiver procedures, consultations and procedural interpretation has enabled Czechoslovakia to maintain its membership in the GATT. (13) In accordance with paragraph 4 of Article II, Czechoslovakia has assured that the establishment of state trading did not imply an increase of protection on items on which it had originally granted concessions.

While dealing with charges of dumping or export subsidization by Czechoslovakia, the contracting parties have accepted consultative procedures based on comparison of Czechoslovak prices with those of other exporters in the same market. It has been felt that the


(13) Czechoslovakia is the only centrally planned economy which is a full member of GATT. It became a member, as one of the original signatories, before the present system of virtual complete state ownership and control of the means of production and trade was established.
criterion requiring comparison of export prices with domestic prices or costs cannot be applied in the case of an economy like that of Czechoslovakia. It may be pointed out that out of 17 investigations of dumping by Czechoslovak trading enterprises in Western markets during 1960-63, 11 have been amicably settled and only 3 have resulted in a finding of dumping.

In accordance with a waiver, Czechoslovakia has given an assurance that, in regard to foreign exchange matters, it will act in conformity with the principles enunciated in special agreements concluded between the Contracting Parties and non-members of the International Monetary Fund. The Czechoslovak Government regularly supplies the contracting parties with information on the growth of trade, role of foreign trade monopoly in national economic planning, the character of the foreign trade plan, the scope and activities of foreign trade agencies etc. While Czechoslovakia has generally benefitted from most favoured nation treatment in respect of tariffs, several countries have refused to accord Czechoslovakia non-discriminatory treatment in the field of quantitative restrictions.

Yugoslavia and Poland are also associated with GATT. For three years Yugoslavia was associated with GATT under the terms of Declaration of 25 May 1959. (14) She was granted a provisional status in accordance with the terms of the Declaration of 13 November 1962, (15) which provides for the application of the


General Agreement in relations with the contracting parties to the fullest extent not inconsistent with Yugoslavia's legislation existing at the time of the Declaration. She receives most favoured nation treatment from countries which have accepted the Declaration. Yugoslavia has expressed readiness to endeavour in the development of its commercial policy arrangements to move progressively towards a position in which it can give full effect to the provisions of the Agreement.

Poland is associated with GAIT under the terms of Declaration of 9 November 1959. (16) In this Declaration Poland, being guided by the objectives set out in the Preamble to the General Agreement, expressed its desire to expand trade with other contracting parties to this declaration on the basis of mutual advantage. She agreed to give sympathetic consideration to, and enter into consultations regarding, any representation made by the countries which are parties to the Declaration. She accepted to make public promptly, in a manner as to enable governments and traders to become acquainted with them, laws, regulations, judicial decisions, administrative rulings and agreements of general application as well as statistics pertaining to trade.

(16) GAIT, n. 14, 12-14.