Chapter 2

OBJECTIVES OF GATT

The contracting parties to the General Agreement aim at contributing to the objectives, given below, by entering into reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade and to the elimination of discrimination in international trade. (1)

1) raising standard of living.

2) ensuring full employment and a large and steadily growing volume of real income and effective demand.

3) developing the full use of the resources of the world.

4) expansion of production and international trade.

The objectives are very general in nature. The arrangement aims at indirectly contributing towards these objectives through the promotion of free and multilateral trade. It does not aim at directly achieving these objectives. The articles of the Agreement, for instance, contain no provisions for the direct achievement of full employment. The contribution of GATT towards the achievement of full employment lies in so far as the promotion of trade expands employment. Many other domestic and international measures will be necessary for the achievement of full employment. Similarly, many measures, other than the expansion of trade, are necessary for raising the standard of living, developing the full use of the resources of the world and expansion of production.

The tariffs and trade restrictions are to be reduced

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(1) Preamble to the General Agreement on Tariffs and Trade.
substantially and not abolished. The framers of the Agreement recognised that trade barriers are essential under certain conditions. The Agreement provides full freedom of action in respect of tariffs with the reservation that the tariffs cannot be unilaterally raised in case of voluntarily bound items. It also permits quantitative restrictions under certain conditions mentioned in Articles XII, XVIII, XIX, XX and XXI. The word 'substantial,' however, is very vague. It may be taken to mean different levels by different parties.

It is, however, surprising that the adjective 'substantial' is not used in case of elimination of discrimination. If the absence of the word 'substantial' is interpreted to mean complete elimination, the following articles of the Agreement contradict the preamble because these Articles (e.g. Article XIV) envisage certain situations under which discrimination is permitted.

The reduction in tariffs and the elimination of discrimination is to be on a reciprocal and mutually advantageous basis. The idea of strict reciprocity is contrary to the principle, generally accepted by the developed countries, that advanced countries should help the less developed countries in their programme of economic development with a view to reducing the disparities in the distribution of the world wealth and income. The Articles of the General Agreement, however, do not insist on strict reciprocity. Article XVIII, for instance, provides some concessions for the less developed countries. The New Chapter, recently added to the General Agreement, explicitly states that the developed contracting parties should not expect reciprocity for commitments made by them in trade negotiations to reduce or remove tariffs and other barriers to the trade of less developed contracting parties.
It may be mentioned that concessions to underdeveloped countries in trade may, sometimes, be a very wasteful method of assisting these countries. Strictly speaking, trade should be used as an instrument of better allocation of world's productive resources and not as an instrument of better distribution of world income. Assistance to underdeveloped countries should be given through trade only where it can be given without adversely affecting the allocation of productive resources. In the actual world, there exists enough scope for assistance to underdeveloped countries through trade without adversely affecting the allocation of productive resources. In many cases, assistance through trade may even improve the allocation of productive resources. Removal of restrictions in developed countries on the import of primary products, in whose production underdeveloped countries possess a comparative advantage, will assist the underdeveloped countries and at the same time improve the allocation of productive resources. Similarly, breaking of the international trusts and cartels in developed countries will improve the terms of trade of the underdeveloped countries and improve the allocation of world resources.

The fundamental objective of GATT is the promotion of free and non-discriminatory trade. But trade restrictions are almost indispensable for the developing countries. The traditional case for free trade is based on the doctrine of comparative costs which, as discussed below, is not very valid in the context of the less developed countries.

The doctrine of comparative costs is static in nature. It seeks to maximise the aggregate output at a particular point of time irrespective of the rate of growth. Maximisation of current
output does not automatically lead to the maximum rate of growth. In a developing economy the acceleration of the rate of growth is more important than the maximisation of current output. Allocation of resources affects the rate of growth through its effects on the expansion of entrepreneurship, improvement in quality and increase in quantity of labour force, expansion of skills, saving habits which constitute an important factor in determining the future rate of investment, consumption pattern which is an important factor determining as to whether the consumption is simply on population maintenance or on the expansion of growth agents, rate of population growth which is an important factor determining the per capita output etc. It may be in the interest of an underdeveloped country to invest resources in certain industries which accelerate the rate of growth even if the same resources can produce a larger current output in some other lines without accelerating the rate of growth. Walter Galenson and Harvey Leibenstein suggest that resources should be allocated in a manner that the per capita output potential at some future point of time is maximised. This can be achieved by allocating the resources in a manner that the marginal per capita reinvestment quotient of capital is equalised in its various alternative uses. (2) By putting a higher value on future income than on present income, the Galenson-Leibenstein criterion errs on the other extreme. In fact an appropriate balance is required between the present and future output. One generation should not be overstrained to provide comforts to some other

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generation. One way of determining the appropriate time-pattern of growth is to maximise the present value of the output stream by applying some discounting procedure.

The doctrine suffers from myopia. In determining the appropriate place for the production of a commodity, it takes into account only the current cost of production in various countries. It does not pay due consideration to the long-term costs of production. In the beginning, the cost of production of certain industrial goods might be higher in underdeveloped countries than that in developed countries. In the long run, however, given protection in the initial stages, the cost of production of these commodities may be comparatively lower in underdeveloped countries because of the comparatively more favourable endowment of natural resources required for the production of these commodities. If we cast a glance on the present pattern of world trade and the endowment of natural resources in various countries, we find that the cost of production of industrial goods which are the main exports of developed countries is comparatively lower in developed countries not because these countries are more favourably endowed with natural resources required for the production of industrial goods but because of acquired favourable conditions viz. a large stock of capital, superior technology, skilled labour, managerial capacity, efficient means of transportation and communication, large markets and consequent economies of production etc. In this connection the observation made by J.S. Mill is very pertinent:

... the superiority of one country over another in a branch of production often arises only from having begun it sooner. There may be no inherent advantage on one part or disadvantage on the other,
but only a present superiority or acquired skill and experience. (3)

If all the facilities available to advanced countries are made available to the underdeveloped countries, they may be in a position to deliver many industrial goods at a cost lower than that of developed countries because of comparatively more favourable endowment of natural resources required for the production of these goods.

The question arises, are these acquired favourable conditions such as cannot be acquired by the underdeveloped countries? The doctrine of comparative costs assumes that factor endowments are fixed and unchangeable. There is no reason, however, to assume that the underdeveloped countries can not acquire these favourable conditions if genuine efforts are made by them. It, of course, requires a fairly long period and the industries must be protected from foreign competition during the transitional period. Capital can be acquired by gradual saving and investment; public utilities can be built up; skill and organisational ability automatically develops with the development of industry; technology can be imported, adapted and further developed at home. An important reason for the lower costs of production of industrial goods in advanced countries is the larger markets available to their industries which give rise to a number of internal and external economies; economies of scale are particularly important because the production of industrial goods is subject to law of increasing returns or decreasing costs. Many underdeveloped countries have

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got a population bigger than that of many advanced countries and thus possess a bigger potential market. The main reason for the present small size of the market in underdeveloped countries is the lower per capita income and consequently lower per capita expenditure. As industrialisation programme proceeds, per capita income will rise and consequently market will expand. Further, for many products a considerable portion of the market of advanced countries lies in underdeveloped countries which the latter countries can reserve for their own industries by restricting imports. Transfer of a part of the market from advanced to less developed countries will raise the cost of production in the former and lower the same in the latter countries and thus narrow the difference between the costs of production of the advanced and less developed countries. Further, the existing pattern of the endowment of factors of production is the result of past trade itself, (4) and it can be changed by further planned foreign trade. (5) A country deficient in capital and technology, for instance, can increase its stock of these through imports. From a long-term point of view, therefore, it is only the natural and unacquirable factor endowments which should be considered while determining the appropriate place for the production of a particular commodity. Thus if we take into consideration the long-term comparative advantage, we find that the present pattern of production and trade


is not the optimum one and the world may obtain a still higher level of production by making the countries specialise in the production and export of those commodities in which they possess a long-term comparative advantage.

An objection may be raised against specialisation according to long-term comparative advantage, that is, in a rapidly changing world, it may not be advantageous to forgo the benefits of specialisation according to current comparative advantage; for, before the world reaches the long-term production optimum, the comparative advantage of various countries might change owing to the discovery of new resources in certain countries or owing to changes in technology which change the raw material requirements for various products. In pursuit of this long-term optimum, the countries may go on incurring the transitional costs and losing the benefits from specialisation on the basis of current comparative advantage. This may be true in case of some commodities. On the whole, however, the advantages from specialisation on the basis of long-term comparative advantage are likely to heavily outweigh the transitional costs because the fundamental changes which alter the comparative advantage are not so rapid and so frequent.

The comparative costs theory takes into consideration only the production side; it tells us as to how the total world production can be maximised. It does not take into consideration the distribution side. In evaluating the effect of a policy on world economic welfare, its effect on the distribution of world income is no less important than on total world production. In the absence of any international agency regulating the distribution of world income,
policies which maximize world income without paying any consideration to its distribution cannot be acceptable to countries whose share is adversely affected by these. Generally speaking, per capita income is higher in industry than in agriculture. If the less developed countries want to appropriate a fair share of the world income, it is very essential for them to develop domestic industry even if it decreases the total world income to some extent. These should, however, be careful that their trade restrictions do not decrease the world income to such an extent that their absolute share in it falls even if they are able to get a much higher relative share, or in other words, from a purely nationalistic point of view, trade restrictions should not be carried beyond the point where the marginal increase in their absolute share is zero. From the point of view of world economic welfare, however, restrictions should stop much earlier; these should stop at the point where the increase in welfare from a less unequal distribution of world income is just equal to the decrease in welfare from a diminution in world income.

The doctrine of comparative costs assumes full employment of all the factors of production. There exists, however, vast unemployment and underemployment of manpower in underdeveloped countries. Marginal productivity of manpower in agriculture is almost zero (may even negative in certain cases). Opportunity cost of domestic production of import substitutes which can be produced with little capital and more manpower, therefore, is far lower than the cost of imports. The unemployed manpower can contribute something to the national dividend by producing import substitutes rather than remaining unemployed.
The doctrine of comparative costs assumes perfect competition which does not exist in the real world. In underdeveloped countries, recent emphasis on planning for rapid development has given a further blow to the freely working price mechanism. In a world of imperfect competition, prices are not equal to the marginal costs which are relevant to the doctrine of comparative costs. The discrepancy between prices and costs, of course, will impair the validity of the doctrine only where the degree of the discrepancy differs between the two industries which are being compared. There will exist a case for protection if the discrepancy between costs and prices is smaller in the export industry than that in the import-competitive industry. Underdeveloped countries specialise primarily in the export of agricultural products and import manufactured products in return. By its very nature, agriculture is more competitive than manufacturing. Consequently, the discrepancy between the costs and prices is smaller in agriculture than that in industry. There exists, therefore, a case for protecting manufacturing in the primary-producing countries.

If a country possesses a comparative advantage in industries subject to the law of increasing costs and a comparative disadvantage in industries subject to the law of decreasing costs, it may not be in its interest to specialise in accordance with the dictates of the doctrine of comparative costs. Underdeveloped countries are in this kind of situation. They possess a comparative advantage in agriculture which is subject to the law of increasing costs. Cost of production will, therefore, rise with the expansion of agricultural production. They possess a comparative disadvantage in industry which is subject to the law of decreasing costs.
Cost of production, therefore, will rise with the contraction of industrial production. Thus extension of specialisation in underdeveloped countries will raise the cost of production in both agriculture and industry. The increase in the cost of production in industry will further deteriorate the competitive position of underdeveloped countries in the world market for industrial products. Cumulative deterioration in the competitive position of underdeveloped countries for industrial products will handicap the exploitation of their development potentialities. Before concluding our discussion of the doctrine of comparative costs, we may mention the observation made by Singer:

All the circumstances which (according to our economic textbooks) put price mechanism out of action as an allocative force are present in underdeveloped countries: widespread unemployment, underemployment and underutilisation of resources (the problem is how to increase total investment and total resources not primarily how to allocate them to best use), rigidities, insurmountable, and non-competing groups. A considerable sector of the economy often lies outside the market mechanism altogether. Opportunities to secure external economies not only exist but the creation and utilisation of external economies is the very core of the process of economic development: not only are nearly all industries infants but the whole economy is an infant. The textbook exceptions to the effective operation of the price mechanism have become the rule in underdeveloped countries. (6)

The above discussion shows that the free trade policy is not in the best interests of the developing countries and that trade restrictions are very essential for their economic development. But their trade restrictions, as discussed below, are not inconsistent with the expansion in world trade.

The import restrictions in the developing countries are of a selective nature and do not restrict total world trade. Restrictions are imposed primarily to utilise the available foreign exchange earnings for the import of commodities essential for economic development rather than for that of consumer goods and luxuries. The only limitation on their imports is imposed by the amount of exports permitted by other countries i.e. the availabilities of foreign exchange earnings. If the advanced countries permit developing countries to expand their exports, the latter would be glad to increase their imports from advanced countries. It will enable these countries to import more capital goods, technical know-how and essential raw materials and thereby help in accelerating their rate of development.

On the other hand, trade restrictions of the developing countries expand world trade in the long run. They are of a transitional nature. Once the country has developed with the help of trade restrictions, its trade increases considerably. Trade is considerably influenced by the level of income. A major portion of the world trade is carried on among developed countries and not between developed and underdeveloped or within underdeveloped countries themselves.

In fact, trade restrictions of the developing countries are in the long-run interest of the developed countries, too. In addition to ultimately expanding world trade, they rectify the mal-allocation of world resources which is, primarily, due to historical reasons. Many countries have got a strong hold in some industries simply because they were the first to undertake these industries and not because they are better fitted for the production
of the concerned goods. Once a country gets a hold in an industry, it acquired additional advantages (viz. development of skill specific to that industry, economies of large scale, reputation in world market for the products of the industry etc.) and thus its competitive position grows stronger and stronger. Protection of infant industries, which have got some natural advantages in underdeveloped countries and can deliver goods at comparatively cheaper rates when fully developed, in the initial stages will benefit not only underdeveloped but also developed countries.

The above discussion, of course, should not be taken to mean belittling the importance of trade for economic development. Expanding trade is very helpful for the development of the underdeveloped countries. Haberler mentions four main ways in which trade helps the underdeveloped countries in accelerating their rate of economic development. (7)

Firstly, it enables the underdeveloped countries to obtain capital goods, machinery, essential raw materials etc. required for executing development programmes.

Secondly, trade enables the underdeveloped countries to import technical know-how, skills, managerial talents and entrepreneurship; these are even more important than the material means.

Thirdly, trade serves as the vehicle for the international movements of capital. No doubt capital movements can take place even in the absence of trade, but it cannot be denied that trade facilitates international movements of capital. The larger the

volume of trade, the easier is likely to be the transfer of capital and the retransfer of capital and the interest thereupon.

Fourthly, free trade promotes healthy competition and checks inefficient monopolies.

In underdeveloped countries, the incentives for investment are weak because of the small size of the market for most of the industries. Size of the market is limited even in countries of geographically large size because of low per capita income and hence low purchasing power. International trade widens the market and thus increases the incentives for investment. Large market gives rise to a number of internal and external economies and thereby lowers the cost of production. (8)

In fact, what is appropriate for developing countries is neither completely free trade nor completely closed economy but controlled, regulated and selective trade.

Keeping in view the objective of GATT as stated in the preamble - substantial reduction of tariffs and other barriers to trade and the elimination of discrimination in international trade - it may be argued that it is not in the interest of underdeveloped countries to participate in GATT because these countries require a considerable degree of control and regulation over their trade. But in its actual operation, GATT has not enforced the degree of free trade envisaged in the preamble of its text. In actual practice, trade restrictions have been liberally permitted. Trade restrictions have been permitted either under exceptions and escape clauses or through the grant of special waivers from the obligations

under the GATT. Underdeveloped countries have applied trade restrictions whenever they felt the necessity for these without experiencing any hindrance from their obligations under the GATT.

There is a marked divergence between GATT policy as laid down in the text of the General Agreement and as followed in actual practice. There is, thus, hardly any evidence to prove that the participation of underdeveloped countries in GATT, as it operates, has gone against the interests of the underdeveloped countries.