IJCRT.ORG ISSN : 2320-2882
INTERNATIONAL JOURNAL OF CREATIVE RESEARCH THOUGHTS (IJCRT)
An International Open Access, Peer-reviewed, Refereed Journal

Genesis of the Multilateral Trading System

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Introduction

Currently, the World Trade Organization (WTO) is an international organisation with the purpose of reducing tariffs and other trade barriers. Through agreements, it makes international trade predictable and smooth and prevents its members from using selfish protectionist policies that may harm both domestic and international economic prosperity. The WTO is a result of the evolution of the General Agreement on Trade and Tariffs. GATT also did not suddenly appear; it was a result of historical experience of the interwar period.
This paper discusses the inception and evolution of the multilateral trading system. The second section gives a historical context before the formation of GATT. The third section discusses the GATT and developing countries. The fourth section discusses the WTO, and the fifth section concludes this paper.

Historical Perspective

Before the First World War (1861–1913), international trade was based on a system of bilateral treaties that offered little trade discrimination. Apart from tariffs, this system had no other trade barriers, and trade thrived in this period. During World War 1, countries backed off from treaties, imposed higher tariffs, licencing requirements, import quotas, and foreign exchange controls. In the following years, attempts to remove these trade barriers failed. At the onset of the Great Depression (October, 1929), countries again started to adopt more protectionist policies. To protect its farmers and industries, the United States enacted the Smoot-Hawley Tariff Act in 1930, which raised the already high import tariff by 20%. In retaliation, other countries also raised their tariffs. In the period 1929–34, international trade contracted by 66%. To liberalise trade, the US passed the Reciprocal Trade Agreement Act in 1934, which allowed it to reduce Smoot-Hawley tariffs by 50% through bilateral agreements. In the period from 1934 to 1947, 32 agreements were signed with European and American countries.
To increase exports, employment, and economic growth through increasing international trade, the US was part of every major conference, agreement, declaration, and treaty that ushered in the liberalised trade era we live in today. In fact, the US and Britain were major players in all of those treaties.

The **Atlantic Charter (August 14, 1941)** was the first step towards the multilateral institutions and international order that we see today. It was a joint declaration consisting of eight clauses that resulted from a meeting between President Franklin D. Roosevelt and Winston Churchill in 1941, describing the two countries' intentions after World War 2. The fourth clause mentions that all countries, irrespective of their size, whether victorious or defeated, will have access to the trade and raw materials of the world on equal terms. The fifth clause announces That "they desire to bring about the fullest collaboration between all nations in the economic field with the object of securing, for all, improved labour standards, economic advancement, and social security." In exchange for lending leash assistance to Britain, President Franklin D. Roosevelt wanted Britain to remove the system of imperial preferences that encouraged trade within the empire by lowering tariffs while discriminating against others with high tariffs. Thus, this charter was a milestone towards a freer world trade.

After the outbreak of World War 1, the classical gold standard collapsed. Exchange rates were mostly floating in the interwar period. But this floating system had one major problem: countries' competitive devaluation. So, the delegates from 44 nations met at Bretton-Woods, New Hampshire on July 1–22, 1944 to agree upon a post-war international economic order, including an efficient exchange rate system that would prevent competitive devaluation. This **Bretton-Woods Conference** led to the creation of the **International Bank for Reconstruction and Development (World Bank)** and the **International Monetary Fund (IMF)**. The primary objective of the IMF's economic policy was to facilitate the expansion of international trade that would contribute to high levels of employment and income. To facilitate international trade, the IMF is charged with maintaining a stable exchange rate system and preventing competitive depreciation. The agreement in the IMF requires every country to fix the par value of their currency in terms of gold or US dollars; this par value can't be changed without the Fund's consultation. If a country faces a deficit in its balance of payments, the IMF would provide short-term financial assistance to give them an opportunity to correct the structural problems in their economy instead of taking immediate measures that would have adverse effects on both the international and national economy. The World Bank's purpose was to assist in the reconstruction of war-torn countries and the development of less developed countries by providing long-term capital investments. The first loan from the World Bank was to France. Another purpose was to support private investment. These investments were expected to create production capacity that would prevent or moderate disequilibrium in the balance of payment, ensuring the steady long-term growth of international trade.

The IMF and the World Bank were established to address currency and investment problems. To address trade-related problems, the United Nations Economic and Social Committee passed a resolution to draught a charter for the ITO (International Trade Organization) in February 1946. On March 24, 1948, 56 countries signed the **Havana Charter (**Final Act of the United Nations Conference on Trade and Employment), which gave a nod to the establishment of the ITO. However, this charter was not ratified by the United States Congress and, subsequently, other countries also didn't ratify it, as a result of which the ITO never came into action.

The General Agreement on Tariffs and Trade

On October 30, 1947, while the Havana charter was being drafted, 23 countries, including India, signed the **General Agreement on Tariffs and Trade (GATT)**. This was a multilateral trade agreement aimed at reducing customs tariffs and other trade barriers among themselves to achieve its final objectives of full employment, economic development, a higher standard of living, and increased production and trade of goods. The two basic principles of GATT were reciprocity and non-discrimination. Non-discrimination has two components: Most Favoured Nation and National Treatment.

Reciprocity ensures that something is given in exchange for some other thing. This means when a country negotiates with another country, they both lower their tariffs, benefiting each other. The **most-favoured-nation** clause requires a country to treat all other countries equally in trade. If a country gives a tariff cut on a good to another country, then the same tariff cut applies to goods from all other countries. **National Treatment** requires that after the imported product has passed through customs, the domestic product and the imported product should be treated equally. This clause prevents nullifying the benefits of tariff reduction by prohibiting the government from imposing relatively more taxes or regulations on imported products, which could eliminate the market access offered by tariff reduction. Exceptions to non-discrimination and reciprocity do exist. One example is GSP. Initiated in 1971, the Generalised System of Preferences (GSP) allows tariff preferences for goods from developing countries. And these tariff preferences were to be provided without any expectation of reciprocity from developing countries. Another exception was the grandfather clause, which allowed countries to continue already existing legislation that was contradictory to GATT's rules. Formation of free trade areas and custom unions is allowed, which are exceptions to the non-discrimination principle.

Tariff reduction is one of the major ways to achieve the goals of the agreement. However, if a tariff reduction causes or is expected to cause serious harm to domestic producers of similar or competitive products, the contracting party can suspend, modify, or withdraw the tariff agreement.

Under the General Agreement, the use of import restrictions is prohibited. but can be used to protect the balance of payments and monetary reserves. Low-development countries were allowed to use import restrictions in pursuit of development goals without using the balance of payment basis. Under specific conditions, import restrictions were allowed to be used in a discriminatory way.

Although protectionist policies are disfavoured, if a protectionist policy is used, Ad Valorem tariffs are preferred compared to other policies.

GATT and Developing Nations

Developing countries exported mostly primary products, and later they (in particular India and Pakistan) tended to specialise in textiles and clothing. However, trade liberalisation in agriculture, textiles, and clothing was exempted under GATT.

Domestic agriculture policy was directed by the Agricultural Adjustment Act of 1933 and the Farm Act of 1951, which allowed it to use export subsidies, tariffs, and import restrictions to protect domestic producers from low prices. Although these policies were in violation of GATT rules, in 1952, the United States, with its strong bargaining power, was able to get a waiver to use any policy in agriculture to support its producers even if it violated GATT rules.

The developed countries didn't reduce the protection for textiles and clothing; in fact, they increased it, violating the GATT rules. Until 1973, the textile and clothing exports from developing countries to developed countries were managed by quota restrictions, which allowed the export of cotton textiles only in the amount that would not hurt domestic producers in developed countries. The multi-fiber agreement of 1973 brought artificial and other fibres under a similar quota regime to protect domestic producers in developed countries.

Among the 23 founding contracting parties, 11 of them were underdeveloped countries. The initial GATT framework had no special provisions or exceptions for developing countries to promote their exports. It was a level playing field irrespective of their resource endowments. The policies that are beneficial for developed countries may not be beneficial for developing countries because of their different sectoral composition and economic structure. The **Haberler Committee** found that existing GATT rules are "relatively unfavourable to developing countries". After this, several changes were introduced to address the special needs of developing countries. Article XVIII allowed less developed countries to use quantitative restrictions and tariff protection to protect their infant industries and hasten their economic development. In 1971, the **generalized system of preferences** was introduced. Under which developed countries offered, on a voluntary basis, developing countries' preferential tariff treatment to increase market access for developing countries exports. To sum up, after the Haberler Committee, measures were taken to encourage developing country products and several exemptions from general principles were allowed for these contracting parties for economic growth and development.

The World Trade Organization (WTO)

Prior to the Uruguay Round, GATT did not cover agriculture, textiles and clothing, trade in services, intellectual property rights, and trade-related investments. The **Uruguay Round (1986–1994)** included negotiations on agriculture, textiles and clothing, trade in services, intellectual property rights, tariff, and non-tariff measures, and dispute settlement. This
The Marrakesh round stretched for 8 years and finally culminated in the Marrakesh agreement, which established the WTO. And the Uruguay Round Agreement is a part of the WTO.

Unlike GATT, **agriculture, textiles, and clothing** are covered by the WTO. And the Uruguay Round Agreement has significantly liberalized trade in agriculture, textiles, and clothing. No trade barrier other than a tariff can be used to control the import of agricultural products. And the tariff emerging from such a system has to be gradually reduced. The domestic price support, direct subsidies, and direct export subsidies were also to be reduced by a certain percentage and within a specific time period. In textiles and clothing, the Multi Fiber Agreement and non-MFA restrictions were to be removed completely by January 1, 2005.

Conclusion

Rules on international trade have evolved over time. Prior to the First World War, trade was relatively free and only tariffs were trade barriers (exceptions exist to this statement). In the interwar period, governments followed protectionist policies, which hampered recovery from the Great Depression. After WW2, GATT was founded in 1947, which remained the de facto authority dealing with issues of international trade till 1995. Its primary objective was to liberalise trade by reducing tariffs on a reciprocal basis. However, agriculture, textiles, and clothing were not covered by GATT. The eighth and last trade round of GATT, the Uruguay trade round, led to the creation of the WTO, which is an extended version of GATT. The WTO significantly liberalised the two above-mentioned sectors.

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