EDITED BY M. M. KOSTECKI

State Trading in International Markets

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Theory and Practice of Industrialized and Developing Countries

Edited by
M. M. Kostecki

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Abbreviations

CIF	Cost insurance freight
COMECON (CMEA)	Council of Mutual Economic Assistance
EEC	European Economic Community
EFTA	European Free Trade Association
FOB	Free on board
GATT	General Agreement on Tariffs and Trade
IBRD	International Bank for Reconstruction and Development
IMF	International Monetary Fund
ITC	International Tin Council
ITO	International Trade Organization
ITC	International Trade Commission
MFN	Most-favoured nation treatment
MMC	Multinational Mining Companies
OECD	Organization for Economic Cooperation and Development
OEEC	Organization for European Economic Cooperation
OPEC	Oganization of Petroleum Exporting Countries
PMB	Public Marketing Board
STO	State Trading Organization
UNCTAD	United Nations Conference on Trade and Development

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None of the persons mentioned above can be held accountable for any of the opinions and facts set forth in this study. That responsibility belongs to the authors, and to myself.

M. M. KOSTECKI

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Introduction

Raymond Vernon

Some thirty years ago, the governments representing the principal trading countries of that period were assembled in Havana to frame a charter for a global trade organization. Although the period was one of anxieties and uncertainties, the emphasis at the time was on building anew, on avoiding the errors and conflicts of the past. It was a time, therefore, that lent itself to hope, yet a period that could easily lead to error and to illusion.

As far as the leading countries of that period were concerned, the hope of the majority was to achieve an open trading system, in which barriers to trade would be low and in which those that existed would be applied without discrimination against any particular source or market. This view was not universal, any more than it is universal today; then, as now, there were governments that had misgivings about the desirability of such a system, on the grounds that it might produce a distribution of income and power – both within countries and between countries – which was socially undesirable. Despite such misgivings, however, the goal of the open trading system prevailed, and with it went the related assumption that the markets in the system would be created mainly by commercial buyers and sellers, each constrained by its costs and each striving for a profit.

The governments that were drafting and negotiating this new world order of course were aware – indeed, acutely aware – of the fact that much of the world's trade was being conducted on a different basis. Governments were deeply involved in international trade in numerous ways, including the imposition of discriminatory tariffs and quotas, the payment of subsidies, and the conduct of state trading. But tariffs and quotas, it was supposed, could be brought down to tolerable levels and applied on a non-discriminatory basis; subsidies could be held in

check; state traders could conceivably agree to act as if they were commercial traders, buying and selling in the same way as a profit-maximizing firm.

Some of the hopes of those negotiators of thirty years ago, as it turned out, came remarkably close to realization. Tariffs and quotas were greatly reduced, at least in trade in manufactured goods among the advanced industrialized countries, and a beginning was made on the control of subsidies. But the early hopes for some sort of agreement on the practices of state-trading firms went nowhere. In the light of thirty years' subsequent experience, the approach that was devised at the time for dealing with state-trading enterprises now appears unrealistic.

Perhaps the first major challenge to the hopes of those that would have reduced state trading to an ordinary commercial activity came from the agricultural programmes of the advanced industrialized states. Governments in many of these countries had developed programmes for stabilizing and supplementing the income of their farmers, and had created state-trading agencies to carry out some part of those programmes. These state traders in agricultural products usually exercised control over competing imports, acted as discriminating monopolists in the export of products, and drew on the support of the public treasury whenever their costs exceeded their revenues. Operating under an explicit mandate from their governments, these agencies as a rule had no great difficulty in resisting the application of the general trade principles to their situations.

The advanced industrialized countries were the source of a second challenge as well. Government procurement practices have rarely been altogether free of discrimination in favour of domestic interests; and until very recently, the agreements of governments have done little to alter that basic condition. Accordingly, wherever state-owned enterprises existed, they could be expected to tilt their purchases and sales in favour of national interests. This tendency was particularly apparent whenever the transactions were associated with high technology or with the national defence.

Yet another major challenge came from the developing countries. These countries, of course, saw many things in the new trade rules that seemed out of keeping with their stage of development. In particular, any undertaking to restrain their state-trading enterprises seemed especially inappropriate to their circumstances.

There were various reasons why the developing countries resisted any limitations on the powers of their state-trading firms. For one

thing, many developing countries had considerable misgivings about the general efficacy and superiority of a market economy, and many were prepared to experiment with the extensive use of controls. Many developing countries – emulating some of the more industrialized countries – established state-trading entities to perform some of the taxing and subsidizing and price-stabilizing functions that would otherwise have been assigned to the government ministries. Finally, even those countries that were prepared eventually to assign an important role to open markets and market prices in their national economies commonly had the feeling that a period of state trading might be needed before indigenous enterprises were in a position to be exposed to foreign competitors. In the meantime, governments had no desire to hamper their young enterprises with any agreed restraints.

Still another source of challenge came from the socialist centrally-directed economies. Some of these, in the interests of maintaining control, preferred to conduct their trade in balanced bilateral deals with their trading partners; in such cases, it was fruitless to require state-trading entities to choose their sources and markets on a non-discriminatory commercial basis. Moreover, practically all of these countries conducted their foreign trade through channels that insulated their internal price structure from the structure of world prices. In cases of this sort, efforts to constrain state traders by analogizing their trading mark-ups to tariffs had no operational meaning.

In the thirty years since this first abortive attempt to include state-trading firms in the rules of an international trading system, the international transactions conducted by such firms have expanded considerably. As the various articles in this volume demonstrate, state-trading enterprises are now to be found operating out of many countries in many different commodities. Moreover, as governments have expanded the number and variety of their enterprises in manufacturing, mining, and services, the international trade conducted by such firms has grown commensurately. The result is that, in some products, including wheat, copper, oil, and aircraft, state-owned enterprises are today a major factor in international markets.

The growth of such trade raises new questions about the adequacy of the existing rules of the game. Questions of this sort have been appearing for other reasons as well. Ironically, the very success of governments in promoting large increases in world trade over the past thirty years has been partly responsible for the new uncertainties. Some governments dare not open their economies any further, for fear of imposing unacceptable burdens of adjustment inside the

economy; but at the same time, most governments are loath to pull back for fear of losing foreign markets and adding to domestic costs. Practically all governments recognize that if international trade is to continue to widen the opportunities and reduce the costs of trading countries, the rules will have to accommodate more complex principles than have heretofore governed. Accordingly, governments seem to be edging into an era which will see a major reconsideration of the rules of the trading game.

In devising a new set of rules to govern the behaviour of state-trading enterprises, there is no flinching from one overwhelming fact. These enterprises are characteristically engaged in the kind of activities that straddle the line between domestic policies and foreign policies. The taxing function and the trading function for instance are often interrelated; efforts to redistribute national income through the internal price system also have their direct impact on international trade. The intertwining of sensitive domestic issues with foreign policy issues poses an especially difficult challenge for devising an acceptable set of international institutions and rules of the game.

To deal with this challenge effectively, the international community will have to know much more than it presently knows about motivations, behaviour, and consequences of the operations of state-trading enterprises. Moreover, much of what is available is easily subject to misinterpretation. Because such enterprises are commonly used by governments to dispense subsidies to some target group inside the national economy, the meaning of reported losses has not always been easy to interpret. Because others are tax collectors for their governments, the meaning of reported profits has sometimes been just as obscure. The fact that governments often use such enterprises in the execution of bilateral trade deals, or in programmes of domestic protection, has tended to confuse the trade policies of the governments with the predilections of the enterprises themselves. On the other hand, the fact that ambitious managers of state enterprises have sometimes struck off for themselves on highly independent entrepreneurial adventures has led some observers to believe that state traders if left to themselves would be indistinguishable from private traders.

When governments eventually turn to the problem of devising new rules of the game for state enterprises, their general positions will inevitably be affected by the way in which they look upon economic systems in the large, that is, by their economic ideology. The challenge will be to try to find a *modus vivendi* that accommodates a number of distinctively different ideologies, so that nations can continue to

benefit from some of the undisputed advantages of international exchange and so that those benefits can be equitably shared. To achieve that result will require at least two things: an extraordinary measure of mutual tolerance on the part of the negotiators; and an understanding in depth of the characteristics and consequences of the operations of state-trading firms. No single volume of essays will provide that understanding, but this volume represents a strong beginning.

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