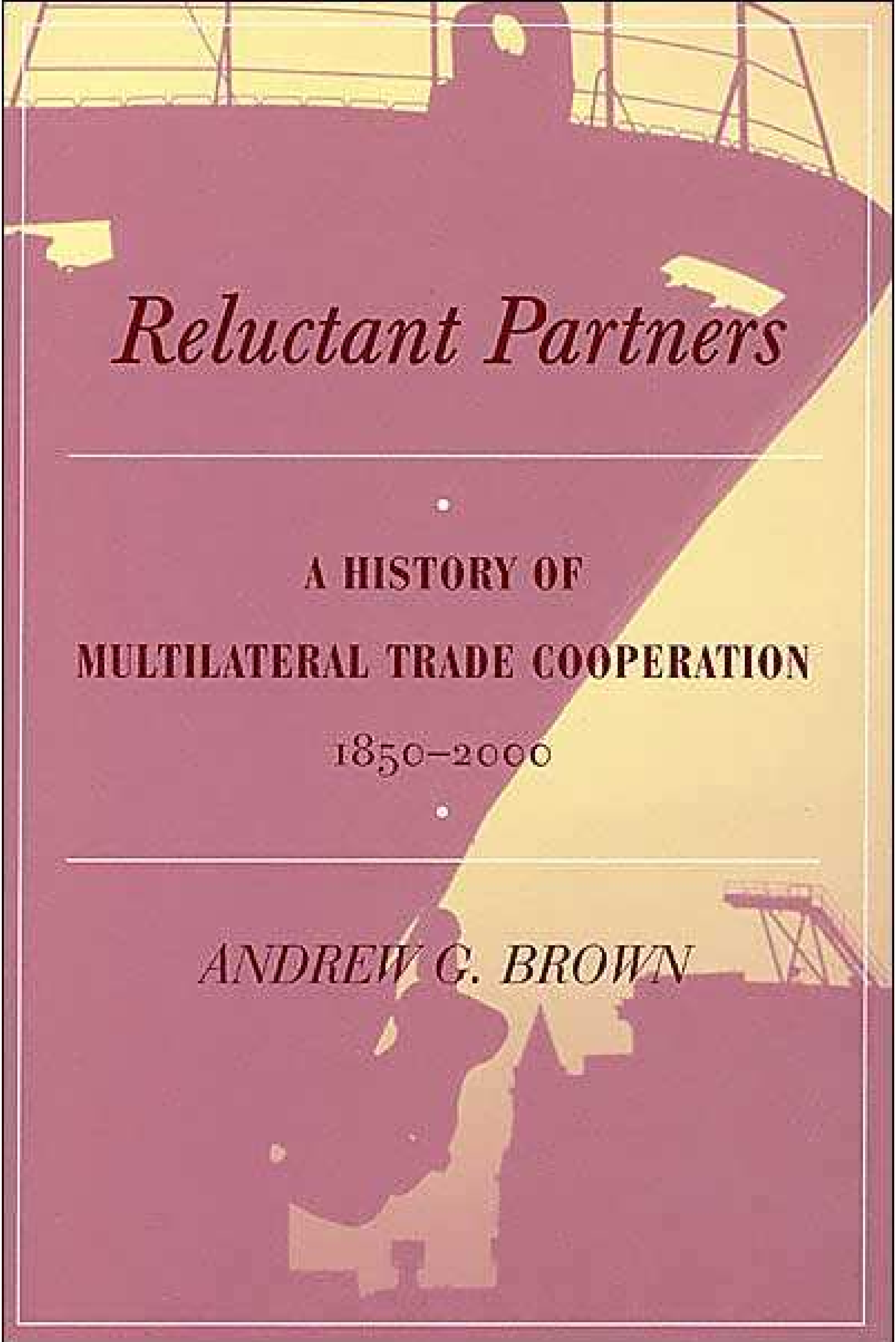

Reluctant Partners

A HISTORY OF MULTILATERAL TRADE COOPERATION

1850–2000

ANDREW G. BROWN

Reluctant Partners

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A HISTORY OF MULTILATERAL TRADE COOPERATION 1850–2000

ANDREW G. BROWN

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To Daniel, Jodie, James, and Thomas

All government, indeed every human benefit and enjoyment, every virtue and every prudent act, is founded on compromise and barter. We balance inconveniences; we give and take; we remit some rights, that we may enjoy others; and we choose rather to be happy citizens than subtle disputants. . . . But, in all fair dealings, the thing bought must bear some proportion to the price paid. None will barter away the immediate jewel of his soul.

–Edmund Burke, speech on the conciliation with America

Contents

Tables

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Anyone who writes a historical account is indebted to a great many others–both past and present–who have chronicled events, written biographies, or penned their own memoirs. In interpreting what has happened in multilateral trade, I have also benefited greatly from political scientists' contemporary theories about international relations and from the extensive economics literature analyzing trade policies. All those on whose work I have consciously drawn are acknowledged in the text. I am grateful to each and every one.

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Introduction

In a world where globalization is drawing nations ever closer together, most of us believe that international relations have to become more orderly and less anarchical. But attainment of this end is elusive. For those who see themselves as realists, it depends largely on the responsible exercise by the United States of its undisputed hegemonic power. For others, it rests with the development of more cooperative arrangements among states to manage world affairs in the common interest.

Experience with the formation of lasting global arrangements has been decidedly mixed. The system of multilateral trade relations stands out as one of the few instances on the positive side of the balance sheet. So, it is well worth exploring how and why nations have succeeded in assembling a body of multilateral rules and procedures to guide them in their trade relations. The primary interest of this study is thus in the conditions that have persuaded nations to overcome their mutual suspicions and to engage in trade cooperation.

The progression to the present-day order in trade relations stretches over many decades, even centuries. Its advance has been irregular and uncertain. Indeed, there have been periods in the history of trade cooperation when respect for the agreed disciplines has come close to disappearing entirely. This was true of the harsh world of the 1930s. Many people became concerned that the same was happening, though less dramatically and more insidiously, in the more recent decade of the 1980s. But since then, the multilateral trade regime has more than just survived. With the completion of the Uruguay Round of trade negotiations and the consequent establishment of the World Trade Organization in 1995, it has risen to a new level of cooperation.

It is striking that the advances in multilateral trade cooperation over the last 150 years or so have occurred in an era of vigorous and often virulent nationalism. Attempts to enlarge cooperation have had to contend with an almost absolute belief in the nation-state as an independent and sovereign entity, a belief that has come to be cautiously and quietly questioned only very recently. In international politics, external relations are still largely seen to be conducted in a Hobbesian world of near anarchy. States are deeply suspicious of each other, being either fearful of domination or, if powerful, ready to exercise their strength in order to impose their will. In such a world, multilateral cooperation has few successes.

Where national security has not been at stake, however, and where commercial interest or the promotion of material well-being has been at the forefront of national policy, countries have been readier to recognize that their own interests can sometimes be better advanced through cooperation with others. They have learned from experience—both good and bad—that the material benefit from cooperation can make it worthwhile to rein in their Hobbesian mistrust of other countries. The key has been the recognition of their mutuality of interest. Of course, suspicions have persisted, and if the powerful have refrained from the use of coercive or near coercive measures, they have nonetheless often used their power to shift the balance of advantage in their favor. But where cooperation has flourished, it is because all participants, whether powerful or weak, have seen a net advantage in doing so. The winding path of multilateral trade cooperation has thus been a story of how countries have come to equate their national interest with cooperation. It has been a story of the shifting interpretation within nations of where their national interest lies and of the circumstances in which these perceived interests have permitted mutual accommodations among countries.

Cooperation means not the absence of conflict but the resolution of conflicting interests in a mutually advantageous way.[1] Trade negotiators deal with conflicting interests and strive to gain as much advantage for their own side as they can, but they do so within an important constraint: the outcome of the negotiations must be seen by all parties to be reasonably fair. Over the centuries, trade negotiators have found certain operating principles—

for example, reciprocity, nondiscrimination, and national treatment—to be of immense value in meeting the requirement of fairness. Their work has led to the gradual emergence of abiding rules and conditions within which international business can be conducted. For those engaged in foreign trade and investment, the benefit has been immeasurable. To them, it is not only the level of trade barriers or the stringency of domestic regulations that matters; it is also the knowledge that the other nations with whom they deal will not apply their trade or investment regulations in ways that appear arbitrary and unpredictable.

The new trading environment emerging from the Uruguay Round has been greeted with acclaim by many economists, journalists, and corporate leaders, particularly in the United States. They have seen it, together with the remarkable developments now occurring in information and communications technology, as powering the globalization that they hail as the dawn of a new era in international economic relations. Others—mostly in industrially more established countries[2]—have reacted quite differently. They have found globalization to have many harmful consequences, both socially and environmentally, and they hold that the market-oriented rules of the World Trade Organization are at least partly to blame.

There is presently a large, fast-growing literature on the subject of globalization, and this book does not directly evaluate the many arguments for or against the expansion of world trade and investment (though these arguments are necessarily discussed as elements shaping present-day trade policies). But it may be helpful to the reader to know at the outset roughly where the author stands. As an economist believing in the efficiency of market capitalism in raising living standards, I see benefit in the expansion of international trade and investment and recognize the emergence and enlargement of a set of multilateral rules of conduct as a major achievement. But this is not a doctrinal position—there is no doubt that conflicts between the aim of economic efficiency and other social aims have to be addressed. Nor should my views be taken to imply a belief that the multilateral trade regime is or should be progressing inevitably toward universal free trade. A review of the history of trade relations reveals that pragmatism in reconciling conflicting interests and in searching for mutual advantage has been the outstanding characteristic of success in multilateral trade cooperation. The strength of national sensitivities everywhere and the great diversity that exists among nations—in their laws, their social institutions, and, even more important, their levels of development—ensure that this will remain true in the future.

Following current conventional usage, this book treats *trade policy* and *commercial policy* as interchangeable terms, though on a strict reading, *commercial policy* has a much broader meaning. Traditionally, in the days of largely bilateral trade relations, countries were wont to sign treaties of commerce with each other. These treaties usually dealt not only with measures affecting merchandise trade but also with many other matters affecting commercial relations in general, including, for example, foreign property rights or the recognition of patents. Today, however, most commercial issues arising between countries are lumped together under the heading of trade. Thus, we now have a World Trade Organization, which—though it may not trip off the tongue quite so lightly—should really be called the World Commerce Organization.

This book opens with a discussion of national trade policies. Chapter 1 takes countries' institutional settings into consideration as it explores the flux of interests and ideas that formed these policies. Chapter 2 moves on to the international plane; it analyzes how the international monetary system prevailing at different times has affected national trade policies, and it sets out, in general terms, the principles and practices that nations have collectively worked out, over time, to facilitate cooperation.

Chapter 3 begins the historical account in this book, with an exploration of trade cooperation before 1914; it discusses the British adoption of free trade and its limited effect on trade cooperation, and it traces the emergence of a continental European network of trade agreements linked together by the most-favored-nation clause. Chapter 4 describes the political and economic circumstances that accounted for the failure of attempts in the 1920s to restore the prewar pattern of trade relationships and to move toward multilateral trade cooperation; it also traces how the Great Depression brought about the near demise of any orderly trade regime in the 1930s. Chapter 5 explores why the trade regime established soon after the Second World War was, despite a false start with the Havana Charter, so successfully rooted in multilateral cooperation. Chapter 6 describes the first twenty-five years of the new multilateral trade regime, analyzing how national responses to changing economic circumstances led, in the Kennedy Round, both to a broadening interpretation of reciprocity and to the compromising of nondiscrimination. Chapter 7 seeks to identify the reasons for the international erosion of confidence in multilateral trade cooperation that took place in the 1970s and 1980s, and it traces the effect that the withdrawal into more nationalist policies had on cooperation.

Chapter 8 turns to the developing countries, exploring why their participation in multilateral trade cooperation, peripheral prior to the 1980s, changed markedly in the 1980s and 1990s. Chapter 9 takes up the Uruguay Round of trade negotiations initiated in the 1980s, examining how far its outcome can be deemed to mark a new era in multilateral trade cooperation. The 1980s and 1990s also saw a rising interest among many countries in regional trade arrangements, and chapter 10 discusses the nature of this development in relation to multilateral trade cooperation.

Chapter 11 outlines the progress of trade cooperation from the signing of the Uruguay Round agreement in Marrakech in 1994 to the aborted meeting of the World Trade Organization in Seattle in 1999, which was intended to launch a new round of negotiations; it thus identifies the main trade issues of concern to governments and discusses the chief criticisms and fears about the multilateral trade regime that are widely raised today against the background of globalization. Chapter 12 offers a brief assessment of the past and present evolution of multilateral trade cooperation.

1 What Shapes National Trade Policy

In the private enterprise economies of the world, the great driving force behind an expansive trade policy is and always has been the commercial search for access to foreign markets and sources of supply. It has forever been counterbalanced by hardly less powerful commercial interests–those of the domestic producers and workers who have to face competition from imported supplies. The balance of interest between groups influenced by these opposing forces has never been static. It is in endless flux as groups on both sides respond to economic growth and change at home and abroad. Trade policy, however, is not simply the outcome of the tug-of-war between these groups. Nations and the political elites or parties who govern them have other aims besides satisfying the wishes of commercial interests. Everywhere, national security takes precedence over commercial interest. For the more powerful nations, trade policy has often been a vehicle used in achieving the political aims of foreign policy. Most recently, many citizens in Western countries now push for the use of trade policy to advance human rights or to enforce environmental or labor standards.

Besides such political concerns, trade policy is profoundly influenced by prevailing ideas about what constitutes the national economic interest. The ascendant ideas and beliefs are usually consistent with the dominant commercial interests; but the intellectual rationale that they provide for national policies also has to be more broadly acceptable. Further, both current ideas and interests work within an established framework of domestic laws and institutions. Inherited from the past, the framework embodies other ideas and interests that are usually not easily dismissed.

WHAT SHAPES NATIONAL TRADE POLICY

SEARCHING FOR MARKETS: THE COMMERCIAL INTEREST

Throughout history, the primary commercial driving force behind the trade policies of countries has been the search by their traders and entrepreneurs for access to foreign markets and sources of supply. Both the trade merchants of medieval times and the heads of large corporations today have been assiduous in seeking the help of their princes or governments in gaining easier access to foreign markets and sources of supply. In generations past, one course of action often resorted to by the more powerful states was the use of force or the threat of force to create colonial empires or "spheres of influence" that assured their traders or manufacturers access, often on an exclusive basis. Indeed, such use of force was elevated by the Marxist-Leninists into a general explanation for the trade of the capitalist "imperialist" powers. As Stalin put it, with his usual bluntness, "countries which consider themselves inadequately provided with raw materials and export markets try usually to change the position in their favor by means of armed force" (quoted in Kissinger 1994, 440). While such an explanation of trade relations may seem mildly ludicrous to most of us today, ample support can be found for it in the history of earlier centuries, and many people in developing countries now subscribe to this imperialist interpretation. But even in the nineteenth century or earlier, it failed lamentably to provide an explanation for the evident and vigorous growth of trade among countries that were in no sense threatened by each other. In relations among states where military force was not a feasible or desirable means of gaining access to markets or supplies, the instruments that countries turned to were trade policy and trade diplomacy.

Industrial Development as the Driving Force

The commercial search for access to foreign markets and sources of supply has greatly intensified over the last two centuries as industrialization has taken root and spread throughout the world. The endless advance in technology, organization, and skills that raises productivity and drives economic growth has given a powerful impetus to foreign trade. The long and continuing decline in transport and communication costs, aided in the nineteenth century by such transforming innovations as the railroad and the steamship and symbolized today by the advent of the Internet, has greatly lessened the natural barriers that distance imposes on trade. At the same time, the opportunities for specialization have been vastly enhanced as markets have grown and as the introduction of new products has diversified output.

Such dynamics have caused world trade to rise faster than world output over most of the decades since the onset of the modern industrial era (see table 1). The upward trend in the share of world output that is traded was broken only during the interwar years, when the economic dislocations of the 1920s were succeeded by the Great Depression of the 1930s. It was sometime after the Second World War before the share of trade recovered to the level it had attained at the end of the belle epoque, but the share of output that is traded as merchandise exports today is almost double what it was in 1913. (It stood at over 22 percent of gross domestic product in 1998—a measure that takes no account of trade in services, which could raise the share to as much as 28 percent.)

Since the early nineteenth century, the composition of merchandise trade has gradually shifted in favor of manufactures. After industrialization first took off in Britain, a significant part of international trade became an exchange of factory-made manufactures for primary commodities. In the later nineteenth century, as other countries industrialized, some measure of interindustry specialization appeared, and the exchange of manufactures for manufactures started to grow. Only after the Second World War, however, did the value of trade in manufactures begin to overshadow that of primary commodities.

The core of postwar trade has been the exchange of manufactures and semimanufactures among the industrially more estab-

TABLE 1. World Merchandise Exports as Percentage of Gross Domestic Product

1850	1880	1913	1950	1973	1985	1993	1998
5.1[a]	9.8[a]	11.9[a]	7.1	11.7	14.5	17.1	22.4

Source: World Bank 1995. The 1998 estimate is based on data from World Trade Organization 1999.
[a]Data refer to OECD countries only.

lished countries of North America, Western Europe, and Japan. It has increasingly taken the form of an exchange of products coming from within the same industries and differentiated only in quality, price, or design. In the last two or three decades, the extent of specialization in world trade has taken another large step, appearing at the level of component parts traded within individual firms. Innumerable corporations have outsourced part or even all of their production to their affiliates in other countries. Many firms have gone further: their production is now broken down among different facilities located in several countries, with the assembly of the final product taking place close to the markets of yet other countries. According to estimates by the United Nations Conference on Trade and Development (UNCTAD), perhaps roughly one-third of world trade in goods and services during 1993 consisted of intrafirm trade between multinationals and their affiliates.[1]

When we look at the economic histories of most countries, it is evident that industrialization has been of underlying importance in bringing about shifts in national trade policies. Certainly, there is no simple and mechanical relation; as I will discuss later in this chapter, prevailing ideas about economic policy have also been influential in affecting the timing of the shift in policies. But a country's move toward greater trade cooperation has commonly occurred when manufactures have begun to account for a substantial share of its total exports.

There is a simple reason for this. As exporters of primary commodities, countries have generally faced low trade barriers. Certainly, this has generally been true for exporters of agricultural or mineral raw materials and of noncompeting foodstuffs; only for competing agricultural products have trade barriers been a major and persistent issue–especially in the latter part of the twentieth century. In manufactures, however, the case has been consistently different. As a consequence, governments wanting to satisfy their own manufacturing interests but faced with protectionist barriers abroad have been pressed into negotiating with other countries to gain access to the latter's markets.

The export history of the United States provides an instructive example. Total U.S. merchandise exports in 1969 actually comprised a smaller share of gross domestic product than was the case one hundred years earlier. Still, U.S. trade policy shifted dramatically over that period, from highly protectionist to relatively open. Matching this change was a rise in the share of manufactures in total U.S. exports (see table 2). Manufactures did not bulk larger than primary commodities in the United States until the interwar years, and as I shall discuss in chapter 4, a real change in attitude toward trade policy began to take place only then. A similar rise in the share of manufactures in total exports has been taking place over the last thirty years in a growing number of developing countries. As table 3 shows, manufactures now bulk large in the exports of a number of developing countries that have been industrializing fast. It is not surprising that the attitude of these countries toward trade cooperation has likewise been changing, as I will discuss in chapter 8.

In its later stages, industrialization has been accompanied by a search for foreign markets by service industries (paralleling the same search by manufacturing industries). While long present, this search by service industries gained a new impetus in the last quarter of the twentieth century, as broad economic policies within countries underwent significant changes. When countries began to deregulate and privatize major service industries, such as financial services or telecommunications, new opportunities for private capital opened up, and pressure for governments to gain access to foreign markets mounted. World trade in services

TABLE 2. Exports of Manufactures as Percentage of Total Merchandise Exports, United States

Year	Percent of Total Merchandise Exports
1869	22
1889	23
1909	41
1929	63
1949	66
1969	80
1989	79

Source: U.S. Bureau of the Census 1976; and U.S. Bureau of Economic Analysis 1991.

consequently burgeoned, outpacing the growth of trade in manufactures. This has been of especial importance in altering the content of the most recent international trade negotiations, extending them beyond trade barriers to include domestic laws and regulations that govern the operation of enterprises in specific service industries.

Foreign investment has likewise been influential in affecting the commercial interest of countries in each other's markets. Significant in the era before the First World War, then falling away in the interwar years, it has undergone a great expansion over recent decades. Some of the motives behind the recent expansion have been the same as in postwar decades. Direct investment, especially in developing countries, has continued to

TABLE 3. Exports of Manufactures as Percentage of Total Merchandise Exports, Selected Developing Countries

	Percent of Total Merchandise Exports		
Country	1965	1985	1998
Argentina	6	18	35
Brazil	9	41	54
Egypt	20	10	38
Hong Kong	89	95	93
India	49	49	75
Indonesia	4	11	44
Korea, Republic of	61	91	86
Malaysia[a]	6	27	79
Mauritius	–	30	70
Mexico[a]	16	28	85
Morocco	5	40	32
Pakistan	36	63	84
Philippines[a]	6	51	88
Singapore	34	58	85
Thailand	4	35	74
Tunisia	19	42	78
Zimbabwe	29	25	27

Source: World Bank 1987, table 12. World Trade Organization 1999, table IV, 31.

Note: Definitions of manufactures for 1965 and 1985, on the one hand, and for 1998, on the other, differ slightly: the former include SITC 9 (commodities not classified elsewhere).

[a]Data for these countries include significant exports from processing zones.

be undertaken in order to gain market access by leapfrogging over trade barriers or in order to secure access to raw materials. Some direct investment has also taken advantage of the low wage costs in developing countries and has been linked to new opportunities for global specialization within firms in the production of specific manufactures. But the most notable thing about the recent expansion in foreign direct investment is that it has been dominated by investments within and among the industrially more established countries. The investments have been mainly undertaken not to overcome barriers that impede exports or to tap cheaper sources of supply for the home market but, more simply, to increase the sales of corporations and strengthen their competitive position in an increasingly unified market.[2]

Competing Commercial Interests

The commercial interests pushing for easier access to foreign markets have almost always had their counterpart at home in demands to restrict foreign access to the domestic market. The trade of individual countries is always a two-way process, and (unless there are large outflows of capital) an expanding export trade is inevitably matched by rising imports. In medieval and renaissance Europe, traders perhaps encountered little opposition at home to the merchandise that they brought from other countries, such as silks or spices from Asia, since these did not threaten to supplant domestic production. Likewise, all countries today import some products that are noncompeting since their production depends on natural advantages that the importing countries do not have; imports of petroleum or of tropical fruits by temperate climate countries are examples.

More generally, however, imports are in actual competition with domestic production or could potentially be replaced with domestic substitutes. So, in modern times, an endless internal conflict between those commercial interests threatened by imports and those oriented around exports has been the hallmark of trade policy.[3] This has posed an insoluble dilemma for governments; in assisting their export industries to gain easier access to the markets of other countries, they have been confronted with demands from the other countries for comparable improvements in access to their own market, running counter to the interests of those at home who are threatened by imports.[4]

The Endless Tug-of-War

In any country, the composition of the conflicting commercial groups and the relative intensity of the pressures that they seek to exert on their government change ceaselessly over the years. Objective economic circumstances, both within the country and in the international economy, endlessly modify the composition and preferences of the two groups. Over the term of several decades, the most important source of internal economic change is economic growth itself; this creates structural changes that lead to the emergence of new export activities. Comparable unending changes also take place in the international economy. Long-term economic growth in other countries brings about global shifts in comparative advantage among individual industries and activities, and these shifts have inevitably had adverse effects on the older producers. One example is the shift to developing countries in comparative advantage in textiles and apparel that has taken place over the last twenty to thirty years. Another is the emergence in the 1870s of the regions of recent European settlement in the Americas and Oceania as huge, low-cost producers of temperate climate agricultural products.

Changing macroeconomic conditions over shorter periods, both at home and abroad, also affect export- and import-competing interests, altering the balance of opposing pressures that they bring to bear on their government. One destabilizing source can be fluctuating exchange rates. The kind of instability that beset the international monetary system in the 1920s or the large currency misalignments that have recurred since the early 1970s, for instance, repeatedly affected the balance of interests between exporting and import competing industries. A more general experience is the effect of recessions at home in intensifying protectionist sentiment; in prosperous times, politicians are more likely to shrug off the economic dislocations caused by foreign competition than in periods of recession or stagnation. The business failures and the social distress suffered by workers are likely to evoke a more sympathetic response when there are many in society who feel that their economic security is under threat.

However, it would be a great mistake to conceive of trade policy as no more than a summation of the influences exerted by competing commercial claims. The struggle of conflicting commercial interests to gain recognition for their claims takes place within a larger national environment where collective ideas about political aims and economic policy also have their impact. In open societies, the debate about policy is carried on endlessly in the political arena, in the media, and in academia, while in more closed societies, it may be largely confined to official circles. In both cases, there are two separately identifiable strands to these ideas and beliefs. One is the foreign policy that trade policy may serve. The other is comprised of the ideas and beliefs about economic and trade policy that best suit the nation.[5]

TRADE, PEACE, AND SECURITY

Over the centuries, nations allying themselves with others have sought to strengthen their ties by promoting trade cooperation.[6] Innumerable bilateral treaties of commerce–often pointedly called treaties of commerce and friendship–have been signed and honored. In modern times, trade policy has served political aims in more dramatic and far-reaching ways through the formation of customs unions and free trade areas. A prime instance in recent history was the signing of the Treaty of Rome in 1957, which founded the European Common Market. While the Common Market was advanced mainly on grounds of its economic benefits, an underlying motive of its architects was to bring an end to the long and bloody history of political and military conflict among European nations. It was with a parallel motive of promoting unification that Prussia came to use the creation of a common market among the German states in the early nineteenth century. On the North American continent, the inclusion of Mexico in the North American Free Trade Agreement furthered U.S. foreign policy in cementing its southern neighbor into the free market system.

The instance most directly relevant to the present history of advances in multilateral trade cooperation is the American initiative that was taken after the Second World War to establish a new trade regime. In no small part, the drive to establish the regime, as well as to set up the Bretton Woods institutions, derived from the conviction, held firmly by Secretary of State Cordell Hull, that the economic nationalism of the interwar years had greatly exacerbated political tensions and antagonisms among states and had contributed to the outbreak of war. A framework of rules and institutions was conceived to ensure that the postwar conduct of economic relations among nations would not revert to its former, anarchical and mutually destructive state. It was a remarkable piece of economic statesmanship and the basis for subsequent progress in trade cooperation. The new economic order might not have materialized had it not been seen to serve this larger, political purpose. (American commercial interests could have been met by more modest means, such as the negotiation of a series of bilateral trade treaties.) In the years that immediately followed, the increasing preoccupation of American foreign policy with the Cold War only added strength to a trade policy that made the multilateral trade regime its cornerstone. As the United States and the Soviet Union vied with each other to draw other states into their camps, the participation of these states in the multilateral trade regime was a way of linking them to the West.[7]

The large view of trade policy as an instrument for encouraging more pacific relations among states was not a new strand of thought in foreign policy. Though Cordell Hull had arrived at his assessment of the political benefits of an open trading system through his reflection on a different, particularly turbulent historical experience, he shared his belief with some of the great British economic thinkers and publicists of the nineteenth century. David Ricardo wrote in his panegyric to free trade that it not only raises the efficiency of production but also "diffuses general benefits, and binds together by one common tie of interest and intercourse, the universal society of nations throughout the civilized world" (Ricardo 1951, 133–34). Richard Cobden was even more insistent on the political benefit of trade; like Ricardo, he stressed the common interest in their material well-being that manufacturers and workers of different nations created through the exchange of their products. John Stuart Mill, too, lent his authority to the same benign interpretation of the political benefit of trade.

Most of us today take a less sanguine view but could nonetheless agree that expanding trade relations are, if anything, likely to moderate other sources of tension among nations. In the long debate that took place in the United States during the 1990s about trade relations with China, for instance, some sensibly emphasized the political dangers of excluding China from the world trading community, pushing it into adopting more self-sufficient policies that almost surely breed a more nationalistic view of the world.

Is a Hegemon Necessary?

The major role that U.S. foreign policy played in creating the postwar multilateral trade regime was, for a time, taken by some American political and economic thinkers to indicate that trade cooperation depended on the existence of a hegemonic power.[8] The view was that in the absence of a supranational authority that imposed its will on countries, only the existence of a hegemonic power—willing to persuade, cajole, and bully other states—could bring about cooperation; otherwise, states would remain caught up in their egoistical and shortsighted calculations. Proponents of this view supported it by pointing to the positive state of trade cooperation in the decades before the First World War and after the Second World War and to its parlous state in the interwar years. The periods of cooperation mostly coincided with the Pax Britannica and the Pax Americana. In the interwar years, by contrast, Britain's power had drained away, while the United States had refused to assume the hegemonic mantle.

But the argument claimed too much. As I shall discuss in chapter 3, Britain did not play an active role in promoting the network of trade agreements that formed the elements of a new trade regime in the latter part of the nineteenth century. Likewise, the need for a hegemon, such as the United States, has not proved a precondition of trade cooperation throughout all the years since 1945. Though the U.S. role in promoting trade cooperation over the decades immediately following the Second World War was much less equivocal than had been that of Britain in the nineteenth century, its hegemonic status gradually eroded as the nations of Western Europe and Japan established themselves as other centers of economic power. It has not simply been the overwhelming power of one country that has pushed others into acceding to trade cooperation; it has been their recognition that cooperation advances their own economic and commercial interest.

Of course, the dominant country has not refrained from exercising its power. Between the hegemonic model (in which the dominant power is able to impose its wishes on others) and the cooperative model (in which equally powerful countries freely enter into agreements with each other), there is a spectrum of possible relations. Relations between the very powerful and the very weak are closer to the former model, while those between the somewhat more powerful and the somewhat less powerful lie closer to the latter.

If not acting as a hegemon, the role of the United States has nonetheless been critical for trade cooperation in the postwar years. Without a leader to generate proposals for cooperation, to initiate discussions, and to confront others with negotiable deals, the global willingness to cooperate might have languished. It is only the largest and most powerful country that can exercise such leadership; the game could not be played if the principal player opted to sit on the sidelines.

ECONOMIC IDEAS AND BELIEFS: FREE TRADE AND NOT-SO-FREE TRADE

Ideas about the economic and trade policies that governments should pursue come from many sources and vary greatly in their level of intellectual sophistication. They run the gamut from, on the one hand, emotional appeals to nationalist sentiment that lightly cloak the self-interest of particular producers or workers to, on the other, intellectually disciplined analyses of national interest that respect both logic and fact. The most carefully reasoned arguments have come from economists. Over the generations, however, economists–no less than others–have put forward different and conflicting ideas. They have been influenced by the economic circumstances of their times, by the political and social institutions of the countries within which they have lived and worked, and by their own political beliefs (not least the role they assign to the state in economic and social affairs).

Beyond economists, the circle of people who influence opinion and make decisions about trade policy is wide and diversified. Each individual brings his or her own, more general understanding of political and economic affairs to the assessment of policy. For many the prescriptions of economists–drawn as they are from theories that focus only on economic activity and that abstract from the interconnected social and political conditions of real life–may seem too narrow to serve as a solid guide to policy. This is especially true for political leaders, who, by the nature of their business, are always searching for ideas that seem best to "fit" the preferences of their supporting political coalitions.

Whatever level of intellectual sophistication underlies them, the ideas and beliefs that have played some part in influencing or substantiating trade policies can essentially be differentiated by one key yardstick: the extent to which they have either favored or distanced themselves from free trade. Those favoring undiluted free trade have set the extreme limit to the debate. Their critics, while accepting that benefits flow from trade, have argued for varying degrees of protection in particular circumstances. In practice, the trade policies of most countries have reflected a mix of ideas, a mix that has changed over time as both national and international circumstances have altered.

The Free Trade Doctrine

The argument in favor of free competition in international trade is based on the simple and commonsensical notion that it is always best to buy in the cheapest market and to sell in the dearest. The idea that a country's national interest is best served if it specializes in whatever it produces more efficiently and if it imports what it produces less efficiently has long appealed to many of the smaller countries of the world whose size precludes highly diversified production. It should be no surprise that the smaller countries of Western Europe, for example, have been among the most enthusiastic advocates of an open, multilateral trading system.[9] The openness of the trade policies of Hong Kong and Singapore are also indicative of the influence of size in favoring the idea of specialization. But the outstanding historical example of a country embracing specialization as the foundation of its trade policy is Britain from the mid–nineteenth century to the outbreak of the First World War. As I will discuss in chapter 3, Britain was then exceptional in its unequivocal adoption of a free trade policy.

Among economists, the line of thought supporting free trade has had a long and distinguished history.[10] Adam Smith took up the simple notion of buying in the cheapest market and selling in the dearest and applied it to trade among nations. He saw the advantage of free trade, not only in the exchange of currently produced goods, but also in the increasing specialization that would follow from the expansion of markets. David Ricardo took the logic further and demonstrated that even if a country could produce all its manufactures or agricultural commodities more efficiently than its neighbor, it would still find it advantageous to trade (because of differences between the two countries in the relative efficiency with which each produces specific products). Among mainstream economists in the Anglo-Saxon, neoclassical tradition, the logic of free trade has been forcefully advocated right up to the present day, even though recent strategic trade theory has raised some significant qualifications.[11]

The prescription on trade policy from classical and neoclassical economists is inextricably linked with their belief in freely competitive markets. The central message of neoclassical theory is that freely competitive markets (which presume a set of social institutions that respect private property and freedom of contract) result in the most efficient allocation of productive resources among different possible uses and therefore bring about the optimum output of goods and services. (The theory deals with the allocation of existing productive resources and has less conclusive things to say about the process of increasing the volume and productivity of these resources to generate economic growth.)

The neoclassical view of free trade is presently in the ascendancy in economic circles within the United States, as it was in Britain during the country's heyday in the nineteenth century as the leading world industrial power. Its influence on policy toward the end of the twentieth century was nowhere more evident than in what John Williamson dubbed the "Washington consensus," the set of views that U.S. administrations and international financial agencies held on the economic policies that developing countries should pursue. Together, these administrations and agencies urged trade liberalization as part of a package of measures–including conservative fiscal and monetary polices, the deregulation of financial markets, and the privatization of public enterprises–designed to establish free competitive markets. (They did so with little regard for the wide differences among countries in the inherited social institutions or in the stages of development, or for the limited relevance of the theoretical base for the problems of economic growth.)

Popular Criticism of Free Trade

Numerous economic commentators from various times in history have flatly rejected the cosmopolitan, free market view of the world economy and have advocated more restrictive trade policies instead. In their approach to international trade, they have begun from a more frankly nationalistic position. Some have put forward powerful economic reasons for their position. Others have made less rigorous cases but have nonetheless struck a popular chord with electorates.[12] Among the latter are many recent commentators, both in the United States and the European Union, who have leaned toward the realist view of the world as composed of nation-states endlessly vying with each other for political or economic advantage. Seeing trade in that context, they have portrayed it as a competitive struggle among nations. For them, it is not a mutually advantageous exchange of goods and services but a zero-sum game in which there are winners and losers. Trade deficits with other nations are read as evidence that the game is being lost. Closely related–in rhetoric if not in logic–is the fear that increasing imports of manufactures from low-wage developing countries are depressing wages in the developed countries and generating unemployment.

Neither of these views are new; both have recurred, with slight changes, again and again in modern history. The first view has its roots in the mercantilism of the seventeenth and eighteenth centuries, when the wealth of nations was seen as a fixed quantity to be struggled over and (until Adam Smith challenged this major premise) not as something that could be increased through economic change and innovation. The second view also has a long history. Judith Goldstein has observed that in the United States during the decades between the Civil War and the First World War, the persistent theme of congressmen in election campaigns was the need for protection of the manufacturing industry, to safeguard the high-wage economy from being undermined by imports produced by "pauper labor" in Europe (Goldstein 1993).

Such arguments have always been popular with those working in import-competing industries, but they have gained broader support because of their apparent common sense. The arguments do not counter the free trade logic demonstrating that trade is mutually advantageous; they simply ignore it.[13] Though flawed in logic, they reflect, at root, a legitimate reaction to the social costs of the economic adjustments that are inescapable in a world of dynamic technological and economic change.

The Keynesian Critique

Undoubtedly, there have been periods in economic history—and there may well be again—when the international economy has justifiably seemed to be an anarchical and dangerously unstable place. It has sometimes been difficult, even for the most inveterate optimists, to take a benign and cosmopolitan view of the world economy. Such were the conditions that followed the onset of the Great Depression, and the response was widespread advocacy of more nationalistic trade policies.[14] In defending import controls and, more especially, restrictions on international capital flows, John Maynard Keynes was among the most cogent advocates of this view. Its advocates argued that under the circumstances of massive unemployment of both labor and productive capacity, the impoverishment of a nation could only be relieved by taking measures to increase the domestic utilization of these productive resources; if these measures conflicted with open trade policies intended to exploit comparative advantage, they should nonetheless override the latter, since they would yield greater present benefit. The ghost of this argument often haunts countries when they are hit by recession.[15] Action on this basis, however, is usually held back by the knowledge that if other countries retaliate, exports could decline too, thus offsetting any gains in employment in newly protected industries.

Protection and Economic Growth

The argument in favor of protectionist policies that has historically carried most weight, at least among economists, has been related not to the business cycle but to economic growth and development. The most powerful reason economic commentators have found for rejecting the free trade doctrine has been the disparity that they have seen to exist between their own nation's level of development and that attained by other, industrially more advanced countries.

Alexander Hamilton, for instance, was an early exponent of this view. He saw no reason why the citizens of the newly founded United States should not be as adept at producing industrial goods as their erstwhile enemies and distant cousins in England; his country possessed the markets, the natural resources, and a skilled and enterprising people.[16] As the first secretary of the treasury, he was able to translate his own ideas into action (which, incidentally, he did on his own initiative, not merely in response to pressures from commercial interests). He stood ready to make extensive use of his power and influence to support new enterprises through import duties, bounties, and bank credit. He was in fact instrumental in forming a corporation that selected a "green field" industrial site in New Jersey (named Paterson after the then governor) and that built factories to house textile machinery.[17]

Some decades later, in the 1840s, Frederick List, impressed by the industrial predominance of Britain and eager that Germany should attain comparable strength, put forward a similar case for protectionist policies in more articulated and extensively reasoned form (List 1885). His argument came to be known as the "infant industry argument." Protection of new industries from foreign competition was justifiable on the grounds that these industries required time to learn the new industrial skills that were necessary to become competitive with the more established foreign enterprises.

Whether directly influenced by the infant industry argument or not, almost all countries with relatively developed economies have, at some time, resorted to significant protection to promote domestic industrialization. In the nineteenth century, the nascent industries of Western Europe and of North America grew up behind protectionist barriers, and Japan had begun to follow suit by the turn of the century. In the first half of the twentieth century, the same pattern was followed in the countries of Eastern and Central Europe, and after the Second World War, they were joined by the numerous industrializing countries of Asia, Africa, and Latin America.

It is not plausible to say that these shifts in trade policy can be explained solely by the responses of governments to the demands of new manufacturing industries. For some countries, such as Japan or Russia, the need to build defense industries was an important incentive. But more generally, countries have been motivated by a strong sense of economic nationalism. Not only entrepreneurs but national elites have wanted to see industrialization take root and prosper within their own territories. They have embraced measures that would encourage their own citizens to find ways of making their own national resources more productive both by utilizing and adapting imported technologies and by improving their own skills, organization, and methods of production. But in a world already populated by more technologically advanced nations, their nascent industries faced competition from foreign industries that were already well along the learning curve and that enjoyed external economies not available to newcomers. Most countries have believed that without protection, they would have deprived themselves of the opportunity to initiate the indigenous process of learning new skills and of creating more efficient ways of production, a process that lies at the heart of economic modernization. Indeed, it is a fair speculation that in the absence of such nationalistically driven industrialization, the geographical spread of industrial modernization would be much less than it is today.

Protection and Trade Cooperation

The pursuit of protectionist policies has by no means been inconsistent with advances in multilateral trade cooperation. In an analysis of the conditions favoring trade cooperation, the proper contrast to be drawn is not between countries pursuing open trade policies and those pursuing protectionist policies but between countries pursuing export-oriented policies and those following more inward-oriented policies.[18] Throughout modern economic history, the use of protectionist measures has proven to be quite consistent with the search for foreign markets and the vigorous growth of exports.

In recent decades, the most successful industrializing countries in Southeast Asia—South Korea and Taiwan—amply illustrate the combination of export promoting and protectionist policies. The ideas about trade policy that have been influential in these countries (and, in earlier decades, in Japan) have recognized both the value of specialization in the international economy and the need for protection of infant industries. These countries have understood that by linking the development of some industries to foreign as well as domestic markets, they could tap into the benefits of specialization (economies of scale, externalities, technological innovation) in the process of their own industrialization. What differentiated them from the world of neoclassical free trade theory is that their governments did not leave the identification and emergence of these new industries to the free market but participated actively in their selection and fostered their growth through the use of specific policy measures. A condition of such active participation has been a pattern of close government-business relations entirely different from that assumed in the Anglo-Saxon, neoclassical model of free competition. They have broken ranks with the free trade protagonists who stress that the free play of market forces, operating within the environment of an open trade policy, will bring about the most efficient use of productive resources.[19]

The earlier postwar trade policies of many developing countries—particularly in Latin America, but also in India and elsewhere—conformed more to the inward-looking model, and these countries were generally less active in searching for access to foreign markets. That was not simply—or even mainly—because levels of protection were high. It was because they pursued a combination of policies (e.g., on trade or the exchange rate) that undermined the incentive to export. Protectionist measures, however, can justifiably be blamed as a contributory factor, since high levels of protection channeled labor and capital into high-cost industries that could not become internationally competitive. Domestic producers earned comfortable returns and acquired a vested interest in the retention of protection. Worse from a long-term point of view was the fact that if they enjoyed a monopolistic or oligopolistic position in the domestic market, these industries were relieved of the need to make the innovations that continually improved their competitive efficiency. The learning and adaptation that had taken place at first behind protectionist barriers could largely give way, in the absence of any competitive spur, to a tolerance of high levels of inefficiency. But all this was not to be laid at the doorstep of protection per se; it was the fault of excessive and indiscriminate protection.

INSTITUTIONAL CONDITIONS

Both commercial interests and ideas about trade policy can only gain expression through a country's established political institutions. Current policy decisions are made within institutional conditions that are inherited from the past, and these conditions embody the interests and ideas dominant in former years. It need hardly be said that these conditions can greatly affect both the timing and the content of shifts in national trade policies.

In open societies, the different commercial and labor interests press for policy changes through the political parties, industry associations, trade unions, other nongovernmental organizations, and personal ties. The outcome is shaped by how the changes are perceived as affecting other political and social groups, by the distribution of political power among the groups, and by the prevailing ideas and beliefs about the national interest. It can sometimes be a long time, however, before the actual distribution of political power catches up with shifts in the balance of commercial interests.

A clear example is the decades-long struggle by manufacturing interests in Britain during the nineteenth century to abolish the Corn Laws. These laws protected domestic agriculture and raised the price of staple foods for the working masses, and the manufacturers believed that this raised wages and undermined their competitive advantage. But despite the manufacturers' status as a powerful commercial interest and despite the intellectual support coming from the widely acclaimed free trade doctrine, Parliament resisted repeal for decades. Repeal directly threatened the economic interests of the landed aristocracy and gentry, who comprised the class that dominated Parliament. A realistic assessment of this situation caused the leader of the Anti–Corn Law League, Richard Cobden, to insist that political reform of the electoral system was the precondition for the abolition of the Corn Laws. Of course, such reform was also a long uphill struggle. (In one of the twists of history, Cobden was, in the end, proved wrong. Repeal of the Corn Laws came before electoral reform, in part because of the unrest caused by the bad harvests of the "hungry forties.")[20]

A still more idiosyncratic instance of how institutional conditions affect the timing and content of shifts in trade policy comes from the United States, and it has had large consequences for the progress of trade cooperation in the world as a whole since the end of the Second World War. At the time when the U.S. Constitution was drawn up, tariffs were a major source of public revenue. The Constitution assigned revenue-raising powers to Congress as the legislative body. This meant that trade policy came within the purview of Congress rather than that of the president, the head of the executive branch of government. The business of tariff setting was thus drawn into local politics. It became a back-scratching exercise in which congressional representatives helped each other to pass legislation that raised tariffs to please particular commercial or labor interests within their constituencies. With such an institutional arrangement, negotiations with other countries for mutual reductions in tariff barriers were impractical.

Only after the Great Depression, when the reaction against the notorious Smoot-Hawley Tariff Act put tariff raising beyond the political pale, did Congress agree to delegate some of its powers to the president. The delegation of power was highly conditional, however; and since the 1930s, there has been a long, slow, uncertain expansion in the negotiating powers that Congress has granted the president. Because of the leading role that the United States has played in postwar trade cooperation, this gradual institutional change has (as I shall demonstrate in this book) significantly affected the pace of advances in multilateral trade cooperation.[21]

In the present day, the multilateral trade regime itself, as represented by the World Trade Organization (WTO), is woven into the institutional conditions that confront the individual member countries. The rules of the WTO are embodied in the national laws and practices of the individual member countries, and their existence limits member countries' maneuvering room in making choices about their trade policies. Members have considered themselves bound by the rules and, if dissatisfied, could only seek redress by persuading others to make changes. Thus, each successive step in elaborating the norms and rules of the trade regime has added a new layer to the constraints within which subsequent decisions are made. Through this progressive modification of the existing institutional conditions, advances in trade cooperation have taken place.

2 Making Trade Relations Work

Most countries have individually exercised scant influence on the course of international trade relations. They have had to take the world as they find it and to decide their own policies accordingly. But a handful of countries have profoundly affected the global scene through their external relations, and the interaction of these countries has very largely determined the course and content of multilateral trade cooperation.

Over the last 150 years, this key group has been composed almost entirely of the same Western European and North American countries, the countries that were the first to industrialize extensively and whose economic power thereafter far outreached the rest of the world. Their relative positions within this group have shifted as the dominance of European countries before the First World War gave way in later years to that of the United States. But collectively, they have continued to constitute the core of the world economy. Other countries have been ringed around the core, their relationship to the center depending largely on their place in the hierarchy of power. In the nineteenth and early twentieth centuries, a great many of these countries around the core were politically or economically dependent, lacking the economic power to assert themselves as independent entities. But in the twentieth century, as industrialization has spread, countries outside Western Europe and North America–for example, Japan and, more recently, some of the newly industrializing countries–have moved closer to the center. The balance of economic power has, however, remained heavily tilted toward the industrially more established countries, and up to the present, their relations have very largely continued to shape multilateral trade cooperation.[1]

As will be seen many times in the historical chapters that follow, both the broad state of international political relations and the ebb and flow of economic prosperity have been pervasive influences affecting the course of trade cooperation among the industrially more established countries. However, two more specific facets to trade cooperation deserve some preliminary discussion before I begin the historical story. One is the exchange rate system within which trade is conducted; in all historical periods, it has impinged very directly on trade policy. The other is the set of operating ideas and principles that the core countries have devised over time to establish, maintain, and enlarge orderly trading relations.

EXCHANGE RATES AND COMMERCIAL POLICY

Of all the general circumstances that have affected the course of trade cooperation, one of the most important has been the state of international monetary relations. Since the beginning of our period of modern trade relations, the international monetary regime has undergone several transformations: periods of stable exchange rates, when the rate was either fixed or pegged, have been succeeded by periods of fluctuating rates, when the rate has been wholly or mainly determined by market forces. These different regimes have had major consequences for national commercial policies and for trade cooperation.[2]

In a real sense, it can be said that in the world before 1914, when all the major currencies had fixed gold values, national commercial policies were entirely insulated from exchange rate policies. Whatever considerations went into the shaping of commercial policy, the exchange rate was not one of them. The rate then appeared almost as though it were set in stone. If a country's balance of trade was worsening, there was no suggestion that commercial policy might be used as a defensive weapon. The central bank would take the appropriate deflationary action to stem any gold loss, and financial capital would also move in a supportive way to restore equilibrium in the external accounts.

After the First World War, this mechanism broke down, primarily because the discipline that it demanded in lowering domestic prices and wages was no longer socially acceptable. Urbanization and the rise in the influence of the industrial working masses had altered the balance of political power within countries. The attempt was nonetheless made to restore the gold standard, and it met with apparent success for a few years. But when the Great Depression of the early thirties happened, the standard collapsed.

Thus, for most of the interwar years, exchange rate instability and uncertainty prevailed. The injury to trade policy was severe. In a world of depreciating currencies, nations resorted to tariffs and quotas and, in the 1930s, to exchange controls, in efforts to protect domestic employment, prices, trade balances, or the gold value of their own currencies. National commercial policy became interlocked with national exchange rate policy. Multilateral trade cooperation could not be advanced in a world where the instability of exchange rates could cause governments to resort readily to trade restrictions.

For this reason, as the world planned for peace after the Second World War, the proponents of free trade were very clear that without a return to a more stable exchange rate regime, the prospects for greater trade cooperation and an expanding world trade were dim. The establishment of the Bretton Woods system, in which exchange rates were pegged but (in principle) adjustable, appeared to be the answer. Freer trade, however, was neither the sole nor the main objective of countries after the war. With the memory of the depression and the inflation of the interwar years still fresh in everyone's mind, the maintenance of high levels of economic activity and of stable domestic prices took precedence as primary goals. These goals demanded, however, that each nation be free to adjust its monetary and fiscal policies to its own circumstances. It appeared to the European countries that the only way such freedom could be exercised while maintaining the stability of exchange rates was through continuation of the import restrictions that most countries had introduced during or before the war. Multilateral trade cooperation was thus paradoxically launched in a world where the stable exchange rates deemed necessary for trade cooperation seemed to depend on continued trade restrictions.

This situation did not persist. Because of their success in maintaining high levels of domestic economic activity and their rapid recovery from the war, the European countries were emboldened gradually to relax their import and exchange restrictions for transactions on current account. It then became the widely held view in Europe that as long as countries retained controls on capital movements–which had been so destabilizing during the interwar years–both the stability of the exchange rate and the desired flexibility in domestic macroeconomic policy could be preserved. However, the progressive dismantling of the controls over current transactions–which was the condition for freer, more market-oriented trade–multiplied the opportunities for evasion of capital controls, slowly undermining the effectiveness of the latter. In the words of Barry Eichengreen, "the conjunction of free trade and fettered finance was not dynamically stable" (Eichengreen 1996, 194). The dilemma posed was that the three separate goals of autonomy in domestic macroeconomic policies, stable exchange rates, and freer trade were not mutually reconcilable. As James Meade had pointed out in 1955 (presciently as it turned out), free traders logically should have preferred variable exchange rates (see Irwin 1996, 203).

This dilemma merged with the fact that the Bretton Woods system of pegged exchange rates had proved more inflexible than planned. Partly because of speculative capital movements, countries found themselves unable to make the smooth adjustments in exchange rates that were necessary to correct structural disequilibria. When the misalignment of the dollar against other leading currencies, notably the deutsche mark and the yen, became chronic in the late 1960s and early 1970s, countries finally abandoned the pegged exchange rate system. The world returned, as in the interwar years, to a system of flexible exchange rates.

Unlike in the interwar years, however, the interaction between exchange rates and commercial policy, interaction that had formerly been so destructive of trade cooperation, was no longer present, at least not in its most virulent form. What brought about the distancing of exchange rate policy and commercial policy from each other?

Changes in private markets played some part. These have done something to lessen the adverse effects of exchange rate instability on the operations of those corporate enterprises engaged directly in foreign trade. Since the mid-1970s, the markets for financial derivatives have grown tremendously. For exporters and importers, it has become an easy matter to hedge against foreign exchange risks–at a small cost to themselves.

However, probably two main reasons persuaded governments to build a wall between their exchange rate and commercial policies. One was institutional; the other, intellectual. For commercial policy, the huge institutional difference with the interwar years was the creation of a formal trade regime under the General Agreement on Tariffs and Trade. This agreement placed legal constraints on the uses that individual countries could make of trade restrictions. But more important, in tying countries together, it also made them more aware that extreme abuse of trade measures for nontrade purposes could endanger their mutually advantageous, multilateral trade relations. Thanks to the Bretton Woods system, countries enjoyed a quarter of a century of very stable exchange rates, during which they habituated themselves to a trade regime insulated from exchange rate instability and began the relaxation of the trade barriers.

Greatly reinforcing the institutional change were the strides made in economic thinking. These have altered the way in which policymakers see the relationship between exchange rates and commercial policy. The simple and intuitively plausible argument was once that higher tariffs would generate greater demand for domestic goods and would therefore both improve the trade balance and raise domestic incomes, output, and employment. However, theoretical discussions since the 1960s have led to the conclusion that under a system of flexible exchange rates, this reasoning is not valid. The exchange rate would appreciate, and its repercussions on other macroeconomic variables could offset the expansionary gain. Indeed, the expansionary effect of a tariff increase in switching domestic expenditure from foreign to domestic goods could be more than offset by the contractionary effect of more domestic income being absorbed in tariff revenue.

Moreover, the responses of a country's trading partners must be taken into account. If a country used tariffs to reduce its imports, this could mean that other countries' incomes would also contract, thus reducing their demand for its exports. Further, other countries might magnify that effect by engaging in retaliatory tariff increases. Thus, the outcome of a general tariff increase is far from as simple as formerly believed. The effect of higher trade barriers on such macroeconomic aggregates as incomes and employment depend a good deal on the specific economic characteristics of each country (e.g., the share of trade in its national income and the responsiveness of its trade to changes in incomes and prices) and on the related policy decisions that each country and its trading partners make.[3]

The changed intellectual appreciation of the links between tariffs and other economic variables has largely, though not entirely, taken commercial policy off the table as a possible adjunct to exchange rate policy. The conventional view now is that if exchange rate misalignments are causing trade imbalances among countries, the proper approach to the problem is for countries to modify their mix of monetary and fiscal policies in a way that will bring about a realignment. Partly in pursuit of this aim, the leading industrial countries (originally the Group of Five, now the Group of Eight) have regularly held meetings (first proposed by President Giscard d'Éstaing of France) in an effort to coordinate their macroeconomic policies. (As critics have often said, the coordination coming out of these consultations has frequently been slim. But critics neglect the importance of the awareness of interdependence that these consultations foster. This surely has some effect in restraining countries from pursuing unilateral and shortsighted actions.)

For both these intellectual and institutional reasons, the exchange rate instability of the years since 1973, unlike the instability of the interwar years, has not stood in the way of advances in multilateral trade cooperation. The instability in the exchange rates of the major currencies has turned out to be far greater than expected and (leaving aside inflation-induced fluctuations) much greater than in the interwar years. Yet multilateral trade cooperation not only has survived but has made considerable progress. For policymakers of the interwar years, it would have been inconceivable that nations in an environment of such great exchange rate instability could make the advances in trade cooperation that happened in the Tokyo and Uruguay Rounds.

Yet the instability of recent decades has posed some serious threats to trade cooperation. In countries with persistently overvalued currencies, import-competing industries have been driven to demand protection, while exporting industries have complained of inability to compete in foreign markets and have called for unilateral reductions in trade barriers elsewhere. Sudden, large depreciations in exchange rates, such as have been forced by financial crises, have likewise provoked protectionist responses to surges of cheaper imports.

The link between exchange rate policy and commercial policy has, moreover, again drawn closer in recent years. Under the auspices of the WTO, countries have been opening up their financial services markets to each other. The corollary of this liberalization has been the relaxation of exchange controls on capital movements in numerous developing countries. Together, these have increased the possibility of large and sudden capital movements that destabilize exchange rates. For example, in the Asian financial crisis of 1997–98, large capital movements precipitated an abrupt and severe adjustment in exchange rates and domestic economic activity. By lowering export prices and intensifying competition, this adjustment, in turn, redounded adversely on trade policy in other countries where import competition had intensified.

TRADE DIPLOMACY: THE RULES OF THE GAME

In this anarchical world, nationalism is a sentiment that is universally powerful, molding the external relations of every country, whether large or small.[4] Adam Smith wrote of the "national animosities" and "mercantile jealousies" that pervaded trade relations among nations in his time, and since he lived, there has been no lack of evidence of the mutual mistrust that they continue to generate. The political realists rightly assert that the most elemental political concern of every nation is to protect its own independence and to assure its own survival; each nation wishes to preserve its own freedom to act independently as much as possible, and almost all nations fear domination by others. Commercial relations are conducted against this political background.[5] "Mercantile jealousies," though existing on a less elemental plane, are no less rife, and as Adam Smith said, these jealousies both inflame and are inflamed by the political mistrust (Smith 1937, 463). In efforts to overcome these forces that are predisposed to oppose open and stable trading relations among nations, trade cooperation has proved essential.

Many governments have, at different times, been successful in setting aside such nationalist fears and suspicions and have decided that the unilateral reduction of trade barriers was in the national interest. But for the greater part of modern history, the conception of national interest influential in most countries has derived from a combination of concerns about national independence and the commercial interest of the producing classes in society—the manufacturers, farmers, and workers. When considered together in determining commercial policy, these concerns have bred an emphasis on the need to placate nationalist sensitivities and domestic political constituencies. They have favored the pursuit of national commercial policies whose dominant aim has been to gain access to the markets of other countries and to limit access to one's own. But for countries to win greater access to the markets of others, they have had to allow—however reluctantly—greater access to their own. A mutual accommodation of national policies has been necessary.

This is the backdrop against which trade diplomacy has taken place. To gain from mutually advantageous reductions in trade barriers and from more stable trading conditions, trade diplomats have had to find ways of overcoming the mistrust that they and their trading partners share. In trade negotiations, the mistrust finds expression in two ways. First, trade diplomats and the governments that they represent want to be assured that the concessions they make to other countries are, in some sense, matched by the concessions that they receive; there is always the suspicion of unfairness, that one's own government is being asked to concede more than the other. Second, each government needs to be reasonably convinced that the other governments involved will abide by their promises; there is always the fear that other governments will find ways to wriggle out of their promises or even simply to disregard them.

Throughout modern history, certain operating ideas and principles have proved to be of great value in overcoming such mistrust and in arriving at acceptable trade agreements. These include such broad ideas as reciprocity, nondiscrimination, and national treatment, which go back for centuries. Since the Second World War, reciprocity has been reinforced by or partially merged into collective action, and other ideas, such as transparency, fair competition, and compliance (which can largely be regarded as more specific applications of the long-standing principles of nondiscrimination and national treatment), have been added to the canon.

How these ideas have been interpreted and applied over time is a central thread in the history of trade cooperation, and tracing these changes is a main part of the historical analysis presented in the chapters that follow. But before we enter into the tangled forest of historical events, some general comments on these ideas may be helpful as a guide.

Reciprocity: What Give-and-Take Means

"When I use a word," said Humpty Dumpty in Lewis Carroll's *Through the Looking Glass,* "it means just what I choose it to mean–neither more nor less." In policy contexts, the word *reciprocity* is used thus; its presence is, like beauty, in the eye of the beholder.[6] Reciprocity may mean no more than that the action of one party is contingent on an action by another; moreover, the nature of the action by the two parties may be quite different. More particularly, what reciprocity means when applied to relations between the powerful and the weak may not be the same as what it means when applied to relations between equals. The U.S. Congress in the nineteenth century, for instance, interpreted reciprocity in its relations with its Central American trading partners as the lowering of tariffs by the latter on pain of higher tariffs being imposed on their exports by the United States (see Goldstein 1993, 93, 114).

In the history of trade cooperation among the industrially more established countries, the idea of reciprocity has proved to be a powerful force. It has, however, been more narrowly defined to embrace not only contingency but also the notion of equivalence; the action of both parties has had to be, in some sense, equivalent. This has proved to be an important means of overcoming the mutual, nationalist suspicions that have often stood in the way of lowering trade barriers.

As long as tariffs on individual items were the principal issue of bilateral or multilateral trade negotiations, it was relatively easy to satisfy the condition of equivalence; it was always possible for countries to look to the value of trade affected as a means of measurement. Of course, even in the more distant past, many tariff negotiations dealt with more complicated issues than item-by-item reductions. For example, countries sometimes wanted to take into account differences in the initial level of tariff rates. But such has been the political importance of satisfying the demand for equivalence that much ingenuity has been exercised over the years in devising quantitative criteria for the more complicated cases as well.[7] The nontariff barriers addressed in the negotiations of more recent decades have presented even more difficulty in expressing concessions quantitatively, but surrogate measures have nonetheless been sometimes found and employed (see Hoekman and Kostecki 1997, 68–77).

These measures of equivalence have focused on the gains that export industries could expect to obtain from mutual reductions in trade barriers. From the point of view of each trading partner considered as a nation (each with multiple economic interests), the economic rationale for such measures has been distinctly weak. If a country were aiming to assess the national economic benefit accruing to it from reductions in trade barriers that it had successfully negotiated, it would make more sense to measure the effects of these concessions on such broad indicators as the level and distribution of income and output throughout the national economy. Attempts at such assessments have been increasingly made over the last quarter century, but not as part of trade negotiations. The more comprehensive assessments have assisted in shifting the attention of policymakers away from the narrowly based interpretation of reciprocity to a broader, economic assessment of the benefits of improved trade relations.[8]

In the years since the Second World War, part of the advance in trade cooperation has been the story of the gradual liberation of countries from the tyranny of precise equivalence in the interpretation of reciprocity. Trading partners have not somehow transcended their mutual, nationalist suspicions. Rather, new economic circumstances have emerged that have made a broader and more qualitative view of reciprocity inescapable. In part, as I will discuss more fully in chapter 6, the new circumstances were composed of both the broadening of the interest of American industry in foreign trade and the politically motivated movement of Western Europe toward economic integration. (In the face of the sweeping dismantling of tariffs in Western Europe, a cautious item-by-item approach to tariff negotiations could no longer satisfy the aims of American trade policy.) Also, as time passed and the average tariff levels of the industrially more established countries declined, nontariff barriers moved to the forefront of multilateral negotiations. Further, the content of trade relations later changed to include such issues as the service sector and intellectual property rights, with countries seeking changes in each other's national laws and regulations. Any notion that the old, quantitative measures of equivalence could be applied to such broader concessions became chimerical.

In the most recent multilateral trade negotiations, the packages of trade concessions given and received by individual countries have been complex. It might be expected that the idea of equivalence would have disappeared altogether; certainly, this would be true if equivalence were understood to mean some kind of quantitative parity, however measured. But the perception that the reciprocity in mutual concessions should be equivalent in some sense has remained present. In trade negotiations, the primary condition of success for the negotiators of individual countries is that they have won for their major constituencies back home greater or more assured access to the markets of other countries (at the cost of granting access to the markets of the own country that are politically less burdensome),[9] but this is not the sole condition. Even though governments believe that they have made a net gain in domestic political and economic terms, they are not indifferent to the gains made by other countries. National sensitivities are such that governments are concerned with relative, as well as absolute, gain. Governments are sensitive to any suggestion that their relative position in the hierarchy of nations has been diminished. Reciprocity in this broad sense–leaving governments' relative status unaltered–must still be satisfied.[10]

The Next Step: Collective Action

Yet another facet to the evolution of the idea of reciprocity stems from the fact that trade negotiators have been not only concerned with mutual concessions in the reduction of trade barriers but also, increasingly in the last few decades, preoccupied with the clarification and extension of the common rules governing trade conduct.[11] The source of the rule making lies in countries' fears that their trading partners may find ways to evade or ignore their agreements to improve market access. But once established, the rules have yielded the great advantage of ensuring greater stability and predictability in the national treatment of foreign commerce.

Such rule formation has brought to the fore an aspect of trade cooperation in which reciprocity shades into collective decisions based on mutual advantage. The first manifestation of this new level of cooperation was the General Agreement on Tariffs and Trade (GATT), negotiated after the Second World War. The agreement affirmed certain norms and principles for the conduct of trade relations, and it spelled these out in a set of rules that legitimized some actions and delegitimized others. This new facet of trade negotiations as a form of collective action was not much in evidence in the early GATT rounds of the 1950s and 1960s. The main focus was still on tariff reductions, which continued to be negotiated on the basis of reciprocity. However, the content of negotiations began to shift substantially in later rounds. In the Tokyo Round, it moved from the exclusive emphasis on tariffs to include codes on such matters as customs procedures or valuation. The new lines of action were taken substantially further in the Uruguay Round, when rules on such matters as subsidies, intellectual property rights, and dispute settlement procedures were introduced or strengthened.

It can be said that reciprocity was still present in these collective, rule-making decisions. Each nation agreed to modify its conduct in particular ways (some of which it may not have regarded as advantageous to itself) in the expectation that its trading partners would modify their conduct in other ways (some of which would be to its advantage). But for the participants, the benefits are no longer specific, mutually agreed concessions. What persuades each nation to enter into such agreements is not a calculation that there will be a rough equivalence in the benefit that it and others will experience but a more generalized belief that the new set of trading conditions will, on balance, be to its long-run advantage. Countries are participating in what political scientists define as a regime—a set of " implicit or explicit principles, norms, rules and decision-making procedures around which actors' expectations converge."[12]

Thus, over the last few generations, the perception of trade negotiations and trade relations has been changing. There has been a transition from bilateral trade negotiations to reduce individual tariffs based on specific reciprocity to multilateral negotiations focused increasingly on improving access to broad markets and on the elaboration of rules and procedures forming a common regime. Global economic growth and increasing specialization have been the underlying, driving force, and market capitalism has supplied the institutional framework. But the trend may also owe something to the moderation of nationalist fears of economic domination by others.

Nondiscrimination: Treating Others the Same

Like reciprocity, nondiscrimination—paradoxically known as the most-favored-nation clause—has a long history as a basic idea in trade relations.[13] Nations have included most-favored-nation clauses in commercial treaties since the days when they sought to gain access to each other's ports for their ships, paying port dues that were roughly comparable. Such agreements left each country with a fear that the other might proceed to grant even more favorable terms to a third country. If this were to happen, one of the two countries would have made a concession for which it was no longer receiving a comparable benefit, having been placed at a disadvantage vis-à-vis a third country. The solution, long ago devised by gifted, but unknown, negotiators, was to include in the treaty a clause stipulating that both parties would treat each other's ships in the same way as each treated the ships of the nation it most favored. When tariffs and other trade barriers became the subject of trade negotiations, nations resorted to the same idea for the same reason. States collectively elevated the idea to a high principle of international trade relations when it was accorded pride of place as Article 1 of the General Agreement on Tariffs and Trade, signed in 1947.

The principle of nondiscrimination has had and continues to have large benefits—well beyond its original intent—for international trade relations. By effectively linking together the tariff schedules of all countries that have accorded each other most-favored-nation treatment, it assures the exporters of these countries that they can compete on an equal basis in the markets of third countries. A major source of political rivalry is thus removed from the international scene; states are restrained from vying with each other in seeking preferential access for their exporters in the markets of third countries. This has been of particular value for the smaller and weaker countries, who have thus enjoyed some protection from demands for preferential access by their more powerful trading partners.[14] Moreover, it has also restrained governments from resorting too readily to discriminatory trade measures as a form of punitive, political action. The most-favored-nation clause has thus contributed to the creation of more stable commercial conditions, helping to insulate commercial decisions from arbitrary political interventions.

The principle has brought other large advantages. Any reduction in tariffs or other trade barriers negotiated between any pair of countries has been automatically extended to all other trading partners enjoying most-favored-nation treatment. Were this not so, at least some of these other trading partners could be expected to want to renegotiate their agreements in order to reestablish a more equitable competitive status. In the days of bilateral treaties, this would have implied an almost continuous process of renegotiating of trade agreements, a state of affairs detracting from the stable trading environment that exporters desire. Further, economists stress the less immediately perceptible, but real, economic benefit. Faced with the same tariff on the same imported merchandise no matter where it comes from, importers buy from the cheapest source. The most efficient foreign producers get the business, so from an international point of view, a more efficient use is made of productive resources.

However, an inherent contradiction between nondiscrimination and the idea of negotiating trade agreements on the basis of reciprocity as it is normally understood has been an endless source of tension in trade relations. The contradiction arises from the fact that in granting most-favored-nation status to others, a country extends any reduction in trade barriers negotiated with another trading partner to all the others on an unreciprocated basis. Nations have nonetheless mostly adhered to the most-favored-nation principle, because they have expected that the nonreciprocated concessions that they have made to other countries would in time be roughly balanced by the comparable, nonreciprocated concessions of others. But this benign assumption has not always been accepted. For many nationalistically driven negotiators, it has seemed a naive or overly tenuous expectation, and on innumerable occasions, they have sought to narrow the scope of nonreciprocal concessions.

Put more generally, the fear that countries have had in granting most-favored-nation status to others is that some of their trading partners would turn out to be "free riders"—that is, that the latter would benefit from concessions made by others without themselves intending to make comparable concessions at any time in the future. Countries have generally been willing to grant most-favored-nation treatment only when they have believed that their trading partners would behave fairly. In other words, they have still expected reciprocity in behavior, although the reciprocity could be unspecified both in timing and in content.

National Treatment: Still More Equality

Just as the principle of nondiscrimination has asserted that a country should accord equal treatment to imports from its different trading partners, so the principle of national treatment has called on countries not to discriminate internally between imported merchandise and comparable domestic products. Countries have sought to ensure that their merchandise, having been cleared by the customs authorities of the importing country, would thereafter be treated no less favorably than similar domestic products. Like nondiscrimination, the principle has a long history in international trade relations and was incorporated in the General Agreement on Tariffs and Trade as a central article (Article 3).[15]

In times past, what mainly concerned governments in requiring that a clause on national treatment be included in trade treaties was the fear that the products of their exporters might be subject to a discriminatory internal tax in addition to the payment of an import duty. But concerns have changed as tariffs and other barriers erected at national borders have been progressively lowered and as trade in services has grown. Exporters have increasingly drawn attention to other laws, regulations, and less formal practices that appear to discriminate in favor of domestic producers in foreign markets. Indeed, since the completion of the Uruguay Round, exporting countries have as often as not cited national treatment as a key issue in their trade disputes.

The long-standing reality is that the laws and regulations of different countries, the structure of their business organization, and even their more informal national habits and beliefs have often given domestic producers some measure of protection against foreign competition—although such protection was not necessarily the intent. Differences in these national characteristics generate many possibilities for conflicting interpretations of what legitimately constitutes national treatment. The expansion of the trade regime to include the service industries raises particular difficulties on this score, since the major service industries—banking, insurance, telecommunications, shipping—are generally subject to close government oversight. For many countries, for instance, the regulation deemed prudent for the domestic banking industry has had the consequence, at least until very recently, of severely limiting competition from foreign-owned banks, therefore raising difficult issues of national treatment.

Fair Competition

The idea of fair competition largely overlaps with the principle of national treatment, but it has acquired sufficient importance as a separate norm in trade relations to merit consideration by itself. It expresses the desire of countries to be assured that their businesses would be able to compete fairly with foreign enterprises, whether in foreign markets or in their own home market.

The longest standing source of complaint from traders, which goes back at least to the preindustrial era of mercantilism, is that governments in competing countries have been assisting their producers with bounties or subsidies. Differences in beliefs about the interventionist role of the state in the private economy have partly lain behind international conflicts over the issue, and shifts in opinion favoring a more restricted role for the state in industrial policy have eased the conflicts.

A different kind of objection, which is raised by producers supplying the home market, is that foreign enterprises have been pricing their products below cost in order to dump excess supplies or to gain a dominant market share. National concerns about the dumping of foreign goods also have a fairly long history, going back to the turn of the twentieth century, when German cartels engaged in the dual pricing of products for the domestic and foreign markets. But in the last thirty years, cases of alleged dumping practices have increasingly been viewed with skepticism outside of official circles, and many now believe that antidumping legislation is being widely abused as a convenient loophole through which governments can grant protection to politically vocal industries.[16]

In recent decades, as trade barriers at national frontiers have come down, a third source of complaint about unfair competition has come to the fore: that access to foreign markets is impeded by a range of restrictive business practices. Some countries have been concerned that their enterprises have been unable to gain access to marketing channels in potential export markets because national business practices have restricted entry; they have found the cause in national policies that have allowed anticompetitive practices to flourish. Because the multilateral regime at present contains no rules that deal specifically with competition policies, it is very much an open issue.

Transparency and Common Standards

Comparatively simple, but important, issues in trade relations are those of transparency in national customs rules and procedures and of some conformity to common standards. National rules and procedures may be so loosely defined that they allow wide scope for arbitrary administrative decisions that can be protectionist in effect and can nullify tariff concessions; even if clear, the rules and procedures of individual countries may differ sufficiently to be more protectionist in some countries than in others. They touch on such sensitive issues as health or safety standards and have therefore been sources of conflict. During the years of the postwar GATT/WTO regime, substantial efforts have been made to address these issues.

Compliance: Will Others Obey the Rules?

Both cooperation's continuation in trade policy and its subsequent advances to higher levels have depended critically on the respect that countries show for the rules of behavior by which they have agreed to abide. In the absence of any central authority to enforce agreements, countries rely entirely on a mutual understanding that each country will be willing to fulfill its obligations if others do so too.[17] If a country has been persistently remiss, its trading partners have always been able to retaliate by reneging on their reciprocal obligations. But a dilemma of trade relations is that retaliation, the one punitive weapon countries can use when they believe that their trading partners are not meeting their obligations, is a weapon that may not work. It may encourage the original offender to resume compliance, but it may as likely provoke counterretaliation if the country is large and powerful. The alternative of not punishing the original offender may have no better outcome, since it may lessen the willingness of others to abide by the rules. If this behavior becomes cumulative, cooperation declines.[18]

Countries have striven to contain a threat to compliance that comes from disputes that arise out of the interpretation of the agreed rules. Individual countries interpret their obligations in ways that are convenient to themselves but that their trading partners may regard as violations. Disputes arising out of such interpretations were common in the days when countries entered into bilateral trade treaties, and provision was sometimes made for some form of arbitration. These disputes have remained no less common in the more recent world of a multilateral trade regime. In an effort to find ways of settling disputes that the parties could not resolve themselves, the General Agreement on Tariffs and Trade established a process of arbitration in the settlement of disputes as well as rules for the punishment of offenders. Countries often ignored the process, however, which impaired confidence in the rules. In an attempt to shore up confidence, countries adopted more rigorous procedures during the Uruguay Round. It has to be recognized, however, that compliance has nonetheless continued to rest not on any enhanced power of enforcement but on the mutual willingness of countries to respect the rules as interpreted by adjudicating bodies.

National Sovereignty: Overruling the Rules

Though nations have been increasingly ready to accept multilateral treaty obligations in order to gain easier and more stable access to each others' markets, they have at the same time sought to preserve their freedom of action as much as possible. They have looked for ways to exempt themselves from their obligations whenever these have proved irksome. This has been easiest for the most powerful countries to do. Application of the GATT rules to agricultural trade was waived at the behest of the United States in 1955, for instance, because the rules clashed with domestic agricultural programs. Later, the industrially more established countries together obtained an exemption from GATT disciplines in regard to textile and apparel exports from Japan and a number of developing countries. They were thus able to discriminate against certain trading partners without violating the letter of the law. Such a unilateralist use of power violated the idea of multilateral trade cooperation based on mutuality of interest and agreement on common rules. The weaker nations, however, had no practical option but to accept the situation if they wanted to continue to participate in the multilateral trade regime.

It is nothing new in history that nations have, if able, found ways to evade their treaty obligations whenever domestic political circumstances have appeared to demand it. In recognition of this political reality, most treaties until the late 1920s contained a clause providing that the terms of the treaty would no longer apply if a signatory deemed that its "vital national interests" or "national honor" was at stake (see Levi 1976, 56). In the field of trade relations, it was not uncommon for nations simply and peremptorily to denounce their commercial treaties.

Nations have, however, been reluctant to act illegally if that can be avoided, and in trade relations, that reluctance has almost surely increased since the nineteenth century. Statesmen have long been aware that a nation's influence is enhanced by a reputation for reliability, which has become of greater value as the economic interdependence of countries has grown. However, most governments have also been able to conceive of particular circumstances in which they would not be willing to abide by their treaty obligations. When the General Agreement on Tariffs and Trade was drawn up, the attempt was made to define these circumstances, thus allowing countries to waive their obligations without abandoning the agreement. Among the more obvious and familiar reasons for discontinuing obligations were threats to national security, to public morals, or to the health and safety of the population. More novel at the time were several economic reasons, including the right to impose quantitative restrictions on trade in the event of severe balance-of-payments difficulties, the right to form customs unions or free trade areas, the right of countries to take action against sharp increases in imports that cause damage to domestic producers, and the right of countries in the process of development to assist infant industries with protective tariffs or other measures.

As much as anything, however, these economic reasons reflected not agreed definitions of exceptional circumstances but disagreements about underlying economic issues or uncertainty about how to deal with them in a multilateral trade agreement. Inclusion of the economic reasons was necessary to persuade countries to accept the main rules, but debate about how these reasons should be understood to modify the main rules has since been a perennial feature of trade relations. The use of quantitative restrictions for balance-of-payments reasons, for instance, was a bone of contention among the industrially more established countries for a number of years. A recurrent concern has been how to distinguish between preferential trading arrangements that were merely discriminatory and arrangements that were legitimate because their intent was to establish a customs union or free trade area. Under what circumstances countries can fairly protect themselves from import surges has likewise remained an unresolved and contentious issue. But perhaps the most important disagreement of all has turned around the question of how the trade regime should be modified to accommodate trade relations among countries at different stages of development. All these issues make their appearances in the historical account of trade relations that follows.

3 Trade Cooperation before 1914

The present-day multilateral regime has its origins in the network of bilateral trade agreements that were negotiated among European countries during the mid–nineteenth century. But the ideas and principles underlying the regime were not an invention of the nineteenth century. For several hundred years, nations had entered into treaties of commerce with each other to protect and advance their own commercial interests. One of the most elemental and long-standing concerns of monarchs and their governments, evident since medieval times, was to gain certain basic rights for their merchants when they traded in neighboring countries. Their first aim was to protect their merchants and their property from arbitrary arrest and seizure, so they sought assurance that their subjects would receive the same treatment under the laws of other states that the latter accorded their own merchants–an early manifestation of the notion of national treatment that has played such a central role in trade relations.

As trade by sea increased after the great explorations and navigational achievements of the fifteenth and sixteenth centuries by Spanish and Portuguese seamen, the terms on which foreign ships could enter ports to trade in cargo also became a major subject of treaties. While most European countries placed restrictions or prohibitions on the use of foreign ships to carry domestic produce or produce from their colonies, some landing of cargo brought from foreign ports by foreign ships was allowed on payments of taxes and port dues. In these historical circumstances, trading nations sought not to overcome the protective effect of these regulations but to ensure that their ships and cargo were treated no worse than those of other foreign countries. Thus, a clause assuring the trading nation that it would receive the same treatment as the most-favored-nation began to appear in commercial treaties centuries before it was elevated into a high principle of the modern multilateral regime.

THE UNILATERALIST FREE TRADE POLICY OF NINETEENTH-CENTURY BRITAIN

When the great nineteenth-century expansion in foreign trade took off following the industrial revolution and the end of the Napoleonic wars, Britain stood out as the economic leader. In some respects, its position was not unlike that of the United States after the Second World War. Though it did not exercise the military dominance of the United States, it was a great maritime power, and it enjoyed a technological superiority that gave it a strong competitive advantage over others. Britain's rising commercial interest was to gain ready access to foreign markets and sources of supply. Its search was made easier by—and partly accounted for—the existence of its huge empire, which provided what was virtually an overseas extension of the domestic market. (Cambridge economist Alfred Marshall saw the existence of the empire as a basic reason for the rise of the British entrepreneurial class [Marshall 1946, app. A].) A substantial proportion of British manufactures, however, also went to the countries of Europe and the Americas.

Like most European countries, Britain entered the nineteenth century with a protectionist policy in place. It had long pursued protectionist measures to support its technologically advancing industries and to favor the expansion of its merchant marine. The new export interests in the manufacturing industry were slow to influence policy, and the change eventually made to accommodate these interests—the unilateral lowering of national tariff barriers—is surprising, at least when viewed through the lens of present-day beliefs and practices. The reasons for the long delay and for the particular twist in policy lay in the specific economic circumstances and institutional conditions that prevailed in Britain at the time.

In the slow adaptation of its policy to the new interests, Britain's first notable step was to pass the Reciprocity of Duties Act of 1823, which signaled the abandonment of the policy—pursued during the eighteenth century—of making reciprocal concessions on a strictly bilateral basis in treaties with close trading partners. Third countries had responded to these preferential treaties with retaliatory measures or by raising their duties or port dues in the hope of negotiating better terms. The policy had not assured British traders the stable conditions that they desired. With the adoption of the Reciprocity of Duties Act, Britain negotiated several new commercial treaties that were significantly different because they extended most-favored-nation treatment to trading partners. While hedged with numerous exceptions, the treaties, in principle, gave both signatories some equality of treatment regarding port dues and accorded each other's exports their most favored rates of duty. These treaties were sometimes paralleled or succeeded by tariff reductions, although success on that score was limited. (What Britain saw as reciprocity in reductions failed to convince its trading partners. Britain was the undisputed leader in exports of manufactures, but because of its protectionist agricultural policy, it offered only restricted access for the agricultural exports of its partners.)[1]

Mutual tariff reductions were not a central issue in trade relations among countries at that time. In almost every independent country, duties on foreign trade were regarded as being in the domain of domestic fiscal policy. Central governments derived a substantial part of their revenue from these duties (as most governments in Third World countries continued to do in the early decades after the Second World War). Accordingly, there was a widespread assumption that any changes in tariffs were a matter for each country to decide by itself in the light of its own fiscal policy. The negotiation of tariff reductions on any extensive scale was not seen as a key instrument of trade policy.

In the circumstances that prevailed at the time, British exporters saw the maintenance or improvement of their access to foreign markets as lying not so much in the lowering of tariff barriers abroad as in reducing production costs at home. They sold their manufactures readily, despite high tariff walls, and they believed that they could continue to do so as long as their costs could be kept down. But domestic agricultural production, particularly food production, was highly protected. They reasoned that if agricultural protection could be ended at home, it would lower the cost of wage goods (most notably food), which would enhance the competitiveness abroad of domestic manufactures. There was, moreover, a common–if mistaken–notion that other countries were raising their tariffs on manufactures in retaliation for British agricultural protection. It was hoped that the lowering of British trade barriers would encourage other countries to follow suit. These commercial beliefs fired the decades-long campaign for repeal of the Corn Laws (the laws protecting domestic agriculture) and for a shift of policy to free trade, a campaign led vigorously by Richard Cobden and John Bright, both in and out of Parliament.[2]

In the early 1840s, some progress in lowering trade barriers was made by Sir Robert Peel, the prime minister at the time. Bad harvests, high corn prices, and cyclical unemployment generated popular unrest, and Sir Robert had, moreover, become intellectually convinced by the argument for free trade. In 1842, export duties were abolished, and some import duties, including duties on imported corn, were reduced; further reductions were made in 1845. Full acceptance of the free trade policy was delayed because, as I described in chapter 1, the landed gentry still exercised substantial political power and strongly resisted reform. They were finally defeated, however, by the traumatic events of the "hungry forties." When bad harvests persisted and were accompanied by the potato blight in Ireland, causing great distress and famine, the free traders finally won the day.[3]

The dissatisfaction with the prevailing protectionist policy derived strong intellectual support from the doctrine of free trade that had been put forward by Adam Smith and David Ricardo, the leading economists of the age, known today as the classical exponents of the free market, capitalist system. Britain was surely no less nationalistic than other countries at the time, and such a policy of unreciprocated, unilateral reductions in tariffs could have been seen–and almost certainly would be seen today–as a failure to safeguard the national interest. However, in line with the teachings of the classical economists, the free traders were convinced that the reduction of tariff barriers was in a country's own best interest and that it thus made no sense to make the reductions conditional on similar action by other countries.[4] The free trade doctrine meshed well, then, with the commercial interest of the manufacturers.

The free trade doctrine became deeply entrenched in British trade policy, serving not only as a justification for its introduction but also as a model for the guidance of policy thereafter. It took some twenty years for the policy to be fully implemented, since alternative sources of revenue had to be found; it was only with the introduction of an income tax that the final steps could be taken. But the policy persisted well beyond the era of Britain's industrial supremacy. This persistence was owed not only to the institutionalization of the policy but also to its consistency with the laissez-faire liberalism that prevailed in Victorian Britain. As it was then seen, the business of government was largely to defend life and property at home and abroad. It was certainly not to engage in the manipulation of import duties for the purpose of intervening in some way in the functioning of the domestic market.

THE NEW NETWORK OF COOPERATIVE TRADE TREATIES

Almost by definition, the unilateralist free trade policy of Britain contributed nothing directly toward the advance of trade cooperation; it is almost a historical accident that Britain played a role in ushering in a new phase of trade cooperation. The opening occasion was the signing of the Cobden-Chevalier Treaty between Britain and France in 1860. The treaty proved important because it gave rise to the negotiation of a series of bilateral trade treaties–mostly among continental European countries–that placed trade cooperation on a new footing. First, the reduction of tariffs on a reciprocal basis moved to center stage in trade negotiations; second, in making the reductions, countries accorded each other most-favored-nation treatment. These two operating principles of reciprocity and nondiscrimination became central ideas enabling subsequent progress in trade cooperation up to the present day.[5]

The necessary condition for the advance in trade cooperation after 1860 was undoubtedly the nascent industrialization of the countries of Europe. These countries were very aware of Britain's industrial superiority and took national pride in the efforts of their own producers to exploit the new technologies generated by the industrial revolution. The larger countries gave emphasis to the importance of their home market as the rightful province of their own new industries. New industrial growth, however, also led to an intensification of the search for markets and for sources of supply beyond national frontiers.

The Cobden-Chevalier Treaty

The more immediate circumstance advancing trade cooperation was the signing of the Cobden-Chevalier Treaty. The occasion for the treaty was as much political as commercial or economic. In both Britain and France, leaders at the time felt the political desirability of some immediate gesture of friendship between their nations. Louis-Napoléon was concerned that in having seized the territories of Italian principalities, he was seriously antagonizing the other powers of Europe; some political leaders in Britain believed that recrudescent fears at home of an expansionist France could further estrange the two countries and engender more warlike behavior. These political concerns coincided with a conviction on the part of Louis-Napoléon and his advisors that France was slipping behind economically and needed to enhance the competitiveness, efficiency, and pace of technological innovation in its own industry and agriculture.

Louis-Napoléon had been impressed by the reforms introduced in Britain by Sir Robert Peel when he lowered tariffs and repealed the Corn Laws. Europe's trade had, in fact, risen strongly since the reforms (its exports had increased by 6 percent per annum, faster than at any other time in the century), strengthening the belief that there was a link between free trade and economic growth.[6] The free trade idea was sweeping Europe, and Richard Cobden was invited to several capitals to speak. At the instigation of Michel Chevalier, his key trade advisor, Louis-Napoléon had lengthy discussions with Cobden. Louis-Napoléon was accordingly well disposed to the proposal that France should likewise seek to lower its trade barriers, both internal and external. Many French producers, however, who had long been sheltered behind protectionist barriers, feared greater foreign competition, and they had friends in parliamentary circles. But by seeking reciprocal tariff reductions from Britain, Louis-Napoléon was able to counterbalance this opposition with the support of those who would benefit from greater exports.[7]

Cobden, who negotiated on behalf of Britain, was unenthusiastic about such reciprocity; as a convinced free trader, he believed that tariff reductions were to be gladly made and were not something to be reluctantly conceded in the process of hard bargaining. Still, Britain undertook to lower duties on imports of French wines and spirits; it recognized that the treaty had a larger political purpose. Cobden wrote to a friend: "I would not step across the street, just now, to increase our trade, for the mere sake of material gain. . . . But to improve the moral and political relations of France and England by bringing them into greater intercourse and increased commercial dependence, I would walk barefoot from Calais to Paris" (quoted in Hinde 1987, 288).

The New Network

It may be that what brought the Cobden-Chevalier Treaty into being was the fear that national antagonisms might get out of control. The treaty nonetheless had consequences of longer-term significance for international trade cooperation. It initiated the emergence of a network of bilateral trade agreements among the main trading nations of Europe, the prototype of the multilateral trading system that we know today. The agreements were the outcome of negotiations principally aimed at achieving tariff reductions on a reciprocal basis, and because they included most-favored-nation clauses, the agreements were interlocked. With the signing of the Cobden-Chevalier Treaty, producers in other European countries became concerned that they would be competing in France with British exporters who would enjoy a tariff advantage. France, as it had hoped, was soon approached by these countries to enter into commercial treaties with them. The prospect of access to the French market was, in effect, used as a lever to gain tariff reductions from others. The core of these subsequent negotiations was the schedule of "conventional" tariffs that France had drawn up under its treaty with Britain. In return for tariff reductions from the other countries, France agreed to use the schedule applicable to the most favored nation—namely, Britain.

The linchpin in this network of trade agreements was the most-favored-nation clause. The treaty between Britain and France provided that "each of the high contracting parties undertakes to allow the other Power to profit by any such favor, privilege, or abatements in the tariffs of duties on imported articles mentioned in the present treaty as either of them might grant to a third Power" (Article 19). Clauses of this nature became standard in the agreements subsequently drawn up by other European powers. This broke the past pattern of bilateral agreements that confined any concessions to the negotiating countries and that—being discriminatory in consequence, if not in intent—were the cause of bitter trade rivalries.

The United States: A Free Rider

One major trading nation that did not become part of the new network was the United States. The U.S. Congress did not, for the most part, see tariffs as an issue that was negotiable between nations; the determination of their level was a matter of domestic policy. In fact, the predominant view among U.S. politicians was that high tariffs were necessary to protect the American market and the American worker from the competition of cheap European labor (see Goldstein 1993, 93, 114). Tariff reductions negotiated by the United States to gain concessions from trading partners related mainly to noncompeting imports, such as tropical products. In the same spirit, tariff reductions were granted on a strictly bilateral basis; they were extended to other countries only on the condition that the latter likewise granted the United States equivalent concessions.

This conditional view of the most-favored-nation clause became a source of much irritation to U.S. trading partners and a fertile ground for trade disputes. The European nations tolerated the American policy as long as the United States remained mainly an exporter of food and raw materials, commodities subject to low or even zero tariffs in their own countries. But as the United States became a significant world exporter of manufactures, the disparity in the American treatment of European exports became a cause of increasing complaint among European manufacturers. The United States was enjoying the status of a "free rider," benefiting from the unconditional most-favored-nation treatment that other countries accorded it, but not granting the same treatment to them.

INDUSTRIALIZATION, PROTECTION, AND TRADE COOPERATION

The network of commercial treaties that came into being after the signing of the Cobden-Chevalier Treaty brought about a period of lowered trade barriers in Europe. The outright import prohibitions practiced by some countries were mostly dropped in favor of tariffs, and existing tariffs were reduced. One observer at the time believed that tariff levels were cut by about half, and incomplete evidence for individual countries is consistent with this view (see Barclay 1914, 65; Shafaeddin 1998, 16). Moreover, most commercial treaties were for a duration of ten years, so a greater measure of stability was introduced into trade relations. It is not surprising that in the 1860s and into the 1870s, many believed that a new era of more liberal trade policies appeared to be dawning, at least among the countries of Europe. However, the movement toward greater trade liberalization came to a halt in the 1870s. While there was no substantial reversal in the downward revision of tariffs until the 1890s, the political rhetoric had shifted in favor of protection.[8]

The rise in protectionist sentiment is partly explained by shifting group interests within each country. Long-term economic growth altered the relative importance of these interests within society, and changes in current economic circumstances modified each group's perception of its own interest. The worldwide depression that began in 1873 and lasted until 1877—perhaps as severe as the depression of 1929—was one such change in circumstances.[9] A more lasting factor was the large structural change caused by falling transport costs and the mechanization of extensive agriculture in North America. Europe's agriculture faced an increase in lower-cost overseas supplies of grains and other agricultural products, and it entered a long agricultural recession that persisted from the 1870s to the 1890s. Agrarian interests joined forces with the many industrialists who were pressing for protection.

The climate of political opinion at the time assured such group interests a favorable hearing for their demands for more protection. It was a period of strong nationalist rivalries among European countries. Germany and Italy were newly founded as nation-states. (Prussia had recently proved its military prowess in the Franco-Prussian War of 1870.) In the last decades of the nineteenth century and into the twentieth century, the leading nations, including the United States, vied fiercely with each other to establish or extend their overseas empires or spheres of influence. Overseas territories were perceived as important not only as markets but also because the idea of national self-sufficiency in raw materials carried considerable weight as an element in national security.

Germany

In Germany, the shift toward a more protectionist stance took place in the late 1870s, under Chancellor Otto von Bismarck. Prussia had long prevailed on the Zollverein—from its early formation as a customs union of German states—to pursue a low-tariff policy, and over the years, Bismarck himself had largely rejected calls for more protection. Industrial interests, however, were gradually acquiring a rising political influence. The formation of the Zollverein itself, with its large internal free market, was probably a major reason for Germany's industrial growth and the advancing industrial influence. Also shifting the balance in their favor was the cession of Alsace and part of Lorraine to Germany after the Franco-Prussian War of 1870; these territories were centers of heavy industry and accustomed to higher French protection. The depression in agricultural prices, brought on by the influx of grains from North America and the Ukraine, appears to have finally persuaded Bismarck to abandon his free trade stance.[10] Since higher tariffs on agricultural products provoked protests from industrial businesses and workers, industrial tariffs were also raised, consummating the "marriage of iron and rye." In this changed climate, a succession of tariff increases followed. The increases gained momentum in the 1890s in reaction to similar policy shifts in other countries.

In the decades following the shift in policy, Germany's industrialization advanced strongly, and the country emerged as a world leader in such industries as steel, chemicals, and the electrical industry. Germany simultaneously became a major exporter of manufactures. By 1900, in fact, manufactures accounted for approximately 70 percent of total German exports, a higher proportion than attained even by Britain (Batchelor, Major, and Morgan 1980, table 6.10). As a consequence, Germany exercised some restraint in its tariff policy, because it did not want to provoke its trading partners into retaliatory increases in their tariffs (see Clapham 1955, 319). A long-considered revision of the German tariff structure was introduced in 1902. It was based on the "scientific" principle of cost equalization (widely accepted at the time as reasonable), according to which duties should reflect the difference between domestic and foreign costs. (Duties tended to rise with the degree of processing; raw materials were free of duty, while finished manufactures attracted the highest rates.)

France

After pursuing a more liberal trade policy under the regime of Louis-Napoléon, France, too, became more protectionist in sentiment, after its defeat by Prussia at Sedan in the Franco-Prussian War of 1870.[11] Parliament resented its loss of command over tariffs that followed from the signing of long-term commercial treaties. Since the executive branch of government had the power to negotiate treaties, it could commit the country to tariff schedules that did not have the approval of the legislature. Parliament's solution was to introduce the Méline Tariff, which set minimum and maximum rates of duty within whose limits the executive branch could set the actual rates to be applied in trade agreements. In practice, the government applied the minimum rate in trade with countries enjoying most-favored-nation treatment. However, these minimum and maximum rates could be altered at any time by Parliament; so, in principle, the stability of the older regime of treaties was lost. In 1895, the Loi du Cadenas virtually gave government the authority to raise tariffs at will, and between then and 1908, the power was exercised thirty-seven times.

Russia and the United States

The support for protectionism coming from the fusion of nationalism with domestic industrialization was strongest in the two large countries of Russia and the United States, although both were no more than peripheral members of the new network of commercial treaties. In the 1890s, Russia, urged on by its industrialists and having a finance minister who was persuaded by Frederick List's infant industry argument, made further substantial increases to its already high tariffs. Since it was firm in regarding tariff setting as an autonomous matter, it did not feel bound by the restraint that commercial treaties normally imposed on the alteration of tariffs.

The United States likewise saw tariffs as almost exclusively a matter of domestic policy. The country had emerged from the Civil War with a higher tariff structure than before, since tariffs were raised to help pay for the war. The South, which favored free trade, had lost its political influence, so Congress came to assume a more deliberately protectionist stance. With its huge and expanding internal market, American industry knew no border restraints on its growth and diversification. Though the United States stood alongside Germany in industrial leadership, only 30 percent of total U.S. exports in 1899 consisted of manufactures (Batchelor, Major, and Morgan 1980, table 6.10). Congress raised tariffs in the McKinley Tariff Act of 1890 and, after a brief flirtation with tariff reductions, moved to an even greater level of protection with the adoption of the Dingley Tariff in 1897. Though American exporters of manufactures organized themselves to advocate changes in U.S. trade policy and, in particular, to gain acceptance for the idea of negotiating mutual tariff reductions on the basis of reciprocity, it was to no avail at the time (see Becker 1982, chap. 4).

Other Countries

Even in Britain, some disenchantment with laissez-faire liberalism crept into the political debate by the turn of the century. Britain was losing its industrial preeminence and was experiencing much greater competition both at home and in export markets. A Conservative Party leader, Joseph Chamberlain, began to advocate some protection for domestic industry and the formation of a preferential trading area within the British Empire.

Almost all of the other countries outside of Europe and the

United States that were able to pursue independent tariff policies also leaned toward greater protection. Japan, which had been obliged to follow a low-tariff policy by the commercial treaties foisted on it by foreign powers when it first opened up to trade, began to assume a more protectionist stance by the turn of the century. Much earlier, Australia, New Zealand, and Canada, all of which had been accorded tariff autonomy by Britain, had moved to introduce some protection of domestic industries. The larger Latin American countries (Argentina, Brazil, Mexico, and Venezuela) were likewise protectionist. Only the Ottoman Empire continued to pursue the low-tariff policy that it had long followed.

Most of the other countries of the world were not able to pursue independent trade policies at the turn of the century. Either they were colonies or dependencies of the Western powers, or they were too weak to resist the latter's dictates. This was true for most of the Asian countries from India to China, most of the African countries, and the many smaller countries of Central America and the Caribbean. One indication of their common state of dependency is the fact that a British citizen was inspector general of the Chinese customs authorities from 1863 to 1908 (see Foreman-Peck 1995, 47). In these vast, economically undeveloped parts of the world, virtual free trade policies continued to be rigorously pursued.

Not a Global Free Market

The move toward greater protection among most of the leading trading nations has to be seen in its proper perspective. The rise in tariff levels among the European countries was generally not excessive. By 1914, the average level of import duties on manufactures was 13 percent in Germany, 20 percent in France and Sweden, 18 percent in Austro-Hungary and Italy, 9 percent in Belgium and Switzerland, and only 4 percent in the Netherlands (League of Nations 1927). Tariffs on many agricultural products and raw materials were low or zero. Moreover, other trade barriers, such as import quotas or exchange control, were virtually unknown. Still, it is quite clear that the pre-1914 period was not an era of undiluted free trade. Britain chose to practice free trade, and the many colonial or semidependent countries of the Third World were obliged to do likewise; but tariff levels in continental Europe were not insignificant, and there were many internal barriers to foreign competition. Further, among independent countries outside Europe, tariff levels were high. By 1913, the average level of duties on goods imported into the United States–whose economic growth, incidentally, was greater than that of any European country between 1870 and 1914–amounted to 44 percent. In Russia, it was 84 percent; in Japan, 30 percent; in Australia, Canada, and New Zealand, between 15 and 26 percent; and in Argentina, Brazil, and Mexico, between 28 and 70 percent (Bairoch 1993, table 3.2).

THE NEW BONDS TESTED: RETALIATORY ACTION AND TRADE WARS

The drift into a world of unilateral tariff increases was only one element in the indirect assaults on trade cooperation that occurred from the 1870s on. Some commercial treaties were not allowed to run their course but were denounced in midstream, and long periods elapsed before they were replaced by new treaties. Bilateral trade relations were thus deprived of a stable business environment and were vulnerable to arbitrary administrative action. After France had denounced its treaty with Britain, the representative of the British Chamber of Commerce in Paris observed in the late 1870s that the want of a treaty was exacerbating relations between the two countries; past restraints in judging each others' actions were gone, and misunderstandings escalated into recriminations (see Barclay 1914).[12] Even when trade agreements were signed and conventional tariffs were established, the duration of the agreements was generally shortened. Moreover, besides less stability in trade barriers, other sources of tension were arising from accusations of unfair competition, particularly the alleged dumping that ensued from the dual pricing system of the German cartels.[13] But most serious of all were the trade wars that broke out on several occasions.

Trade wars ensued when countries overreached themselves in seeking to shift the balance of advantage between easier access to foreign markets and more difficult access to their own. In this regard, the 1880s and the 1890s were a period when countries learned through hard experience that cooperation placed limits on unconstrained, independent action. When the reciprocal nature of cooperative trade relations was myopically forgotten, trade wars erupted.

There were a number of these major confrontations known as trade wars: the Franco-Italian war, 1886–95; the Franco-Swiss war, 1892–1895; the Russo-German war, 1893–94; the Spanish-German war, 1894–99; and the Rumania–Austro-Hungary war, 1886–93.[14] Though each differed in specifics, the pattern of mutual loss was similar.

The Franco-Italian Trade War

The bitter war between France and Italy serves as an instructional example. Italy, which had not long achieved its unification as a nation, set about increasing its tariffs both to raise revenue and to promote industrial development. It denounced its commercial treaty with France in 1886; introduced a new tariff schedule the following year, raising the level of industrial protection to about 60 percent; and then proposed the negotiation of a new treaty with France. France refused. In late 1887, Italy went even further and asked France to reduce its tariffs on major Italian exports–silk, wine, oil, and cattle. The French response was to threaten punitive duties if Italy did not revert to the terms of the old commercial treaty. There ensued a succession of tariff-raising actions and retaliations, proposals and counterproposals, which failed to resolve the issue. By 1895, Italy was obliged to accept defeat. It had to apply the terms of the treaty that it had denounced, and it had to accept that its exports would be subject to the higher tariffs incorporated in the more recent Meline schedule adopted by France. France might have persisted longer in the war. It decided, however, that its political aim of prying Italy loose from the Triple Alliance would be better served by the restoration of more open trading relations than by punitive tariffs. (The Triple Alliance was composed of Austro-Hungary, Germany, and Italy and was clearly directed against France.)

Trade between the two countries fell substantially during the trade war, and both countries experienced dislocation in their export markets and sources of supply. However, an equivalent decline in exports bore more heavily on the Italian economy as the smaller and less developed of the two. It only aggravated matters for Italy that its exports to France fell by more than did French exports to Italy. In taking the aggressive stand that initiated the trade war, Italy had apparently misread the economic situation quite badly. It believed that its exports to France would be less easily replaceable than was actually the case, and it failed to take realistic account of its relative weakness as the smaller country.

But the more general lesson was that a trade war had costs for both trading partners. However easily either partner could find alternative markets and sources of supply, there were costs both in the temporary dislocations caused by the readjustments and in the lower profitability or higher cost of their substitute market or source of supply.

COOPERATION WITHOUT A HEGEMON

The foundations of modern trade cooperation were laid in the second half of the nineteenth century. The negotiation of reciprocal trade agreements incorporating most-favored-nation treatment became the established way for countries to gain assured access to each other's markets. These practices of reciprocity and nondiscrimination emerged out of the practical experience of countries in finding arrangements that fulfilled their commercial aims while simultaneously allaying the political objections and fears that were raised at home.

The underlying driving force behind this advance was the intensified search for markets generated by the industrialization of Europe. Manufacturers everywhere, joined by farmers in some countries, pressed for easier access to foreign markets. This large economic change, leading to greater commerce among nations, need not have fostered cooperation in trade policies; it could have led to increased rivalries among nations and to attempts to establish exclusive markets. But in nineteenth-century Europe, the use of force was not generally a feasible alternative to diplomacy as a way of gaining access to the markets of neighboring countries; nations were not prepared to risk war over the issue. Even the smaller countries could not be threatened by the larger without the latter risking confrontation with other larger powers. The network of bilateral agreements that emerged, however, was always at risk, since all nation-states harbored the desire to exercise complete autonomy over their commercial policies. What restrained them from yielding excessively to their own inclinations was less a recognition of the mutual benefits that flowed from trade cooperation than a fear of retaliatory action if they went too far in restricting access to their own markets.

Though still the leading economic and maritime power, Britain played no direct part in the design or implementation of the new world of trade cooperation. Having adopted free trade, Britain had given away the bargaining counter necessary for the negotiation of reciprocal reductions in trade barriers.[15] Britain's contribution as a leader was, at best, indirect. In underwriting an international system of stable exchange rates, in providing both short-term and long-term capital, and in deploying a naval power that it was willing to use in support of unhindered trade and respect for contracts, Britain helped substantially to create a climate conducive to the growth of world trade. But its doctrine of laissez-faire liberalism and its policy of free trade did not take root in other countries or account for their movement toward greater trade cooperation. For a time in the 1860s, with Britain as the great example, the export-oriented model of development attracted supporters in the governments of Europe and gave an added impetus to the new wave of commercial treaties that then emerged. But for most of the century, other countries raised skeptical eyebrows at the coincidence of interest between British industrial leadership and its espousal of free trade policies, and they were not dissuaded from resorting to protection of their own new industries. In trade at least, the fairly liberal international economic order that prevailed from 1860 to 1914 was not a consequence of British preeminence. It grew out of an often reluctant cooperation among nations, and as James Foreman-Peck has observed, it emerged unaided by leadership or hegemony (Foreman-Peck 1995, 115).

4 The Failed Attempts of the Interwar Years

Though several attempts were made to advance trade cooperation in the interwar years, they met with almost unmitigated failure. In the years immediately after the end of the First World War, the prewar system of trade cooperation came under attack and did little more than survive. In the subsequent few years between 1926 and 1931, when most nations had returned to the gold standard, it appeared that the drift toward more nationalistic commercial policies might be arrested; but national differences proved too great to bridge. In the aftermath of the Great Depression in the early 1930s, the liberal trading order came close to disappearing altogether. In many countries, the state management of economic resources was superimposed on the operation of free markets. The principle of nondiscrimination, which limited political intervention in commercial relations, ceased to have a place in their trade policies. Still, trade policies in the interwar years saw incipient changes that were to assume importance in restoring trade cooperation after the Second World War: the first moves were made toward multilateral trade negotiations to supplement and even supersede the more traditional bilateral negotiations, and in the United States, a shift began toward support for a more open, nondiscriminatory trade regime.

Many specific reasons can be adduced for the signal failure to advance trade cooperation in the 1920s and for its near demise in the 1930s. The reasons fall into three sets. First, the war itself and the subsequent peace settlement had wrought drastic changes in both the political and the economic relations of the countries dominating the trading community. Politically, one legacy of the war was a spirit of vehement and often vengeful nationalism that permeated the states of continental Europe and bedeviled cooperation. Economically, it drastically altered the external relations of countries both as traders and as lenders and borrowers.

Second, within all the societies of Western countries, the shifting balance of political power brought about by the emergence of huge, urban working populations began to manifest itself, not only through the widespread organization of labor, but also in the more popularly responsive nature of governments. Prewar economic policies that had worked well enough in a world of self-regulating markets for goods, finance, and labor now encountered social resistance. One victim of these new circumstances was of particular importance for trade cooperation: the stability of exchange rates.

The third set of factors were the blows to trade cooperation that came from the onset of the worldwide depression of the early 1930s. The depression spread from the United States, where a recession was severely aggravated by the weakness of the banking system; by extensive household, farm, and corporate debt; and by mistaken policy responses. It engulfed the world economy, creating conditions that tore apart the fragile international economic order stitched together in the late 1920s.

THE 1920s: TRADE COOPERATION UNDER SIEGE

The political backdrop to trade cooperation in the 1920s was not hopeful. It is probably fair to comment that nationalist prejudices and short-term political calculations were particularly rife during this period (see Condliffe 1950).

When the First World War came to an end in 1918, the Allied leaders made sweeping changes in the political map of Europe. Borders were redrawn, and new nations arose in Central and Eastern Europe from the ashes of the Austro-Hungarian and Ottoman Empires. The leaders, however, failed to establish a stable, political equilibrium. Germany felt humiliated by the terms of the Treaty of Versailles. French policymakers, ever fearful of German revanchism, focused single-mindedly on national security and reparations. Britain, by contrast, urged disarmament and was reluctant to make security commitments. After the U.S. Senate rejected President Wilson's internationalist policy, the United

States eagerly sought to minimize its entanglement in European affairs. In Russia, the Bolsheviks supplanted the czarist regime, and the country withdrew into autarky.

From the war and the terms of peace came a greatly altered, worsened set of economic circumstances for trade relations.[1] Europe's recovery was slowed by shortages of foreign exchange to finance imports for reconstruction, and its limited supply capabilities impeded the restoration of exports. Markets lost during the war could not be recovered. Further, the war had much worsened Europe's external payments position. Such economists as John Maynard Keynes railed against the destructive consequences of the punitive reparations levied on Germany and against the shortsightedness of American insistence on full repayment of inter-Allied debts by a weakened Europe;[2] but the warnings fell on deaf ears. The debtor countries had no option but to strive to increase their exports to other countries in order to make their reparations or debt payments. However, industries in other countries resented the intensified competition from these exports, and their resentment stimulated protectionist demands. Moreover, among the newly created countries of Europe, protectionist policies were preferred; being politically insecure and imbued with nationalist hopes, they gave emphasis both to economic self-sufficiency and to catching up industrially with their neighbors.

Unstable Exchange Rates and Tariffs

The war likewise swept away the stable exchange rate system that had operated so securely before 1914. Having resorted to inflationary financing of the war effort, most of the belligerents had been compelled to suspend gold convertibility and to impose exchange controls as the war progressed. Still, after the war, the guiding aim of economic policymakers was to restore the prewar order of self-regulating markets. There was general agreement among countries on the desirability of returning to the gold standard as soon as possible. In the interim, pending the stabilization of currencies, countries allowed their exchange rates to float. The subsequent period of freely floating exchange rates, in which governments did not intervene at all in foreign exchange markets, was notable for volatility of rates. Some blamed speculative capital movements for perversely exaggerating the fluctuations. Others traced the instability to recurrent laxity in domestic monetary and fiscal policies.[3] Whatever the relative importance of these particular causes, the uncertainty about exchange rates sullied the prospects for trade cooperation. Tariffs became a second line of defense against "exchange dumping" (the fall in price of imported goods that was occasioned by the sudden depreciation of a trading partner's currency), and some countries were quick to impose surtaxes on imports from trading partners who let their currencies depreciate.

Nondiscrimination under Attack

Though the early 1920s saw no evidence of trade cooperation in the form of reciprocal reductions in trade barriers, the increases in tariffs were at least generally moderate (see Condliffe 1950, 480). Constituting a more serious threat to trade cooperation during the period were attacks made on the idea of nondiscrimination, attacks motivated by vehement nationalist sentiment. By the terms of the peace treaty, Germany was obliged to accord most-favored-nation treatment to all the Allied countries, but no reciprocity was required of the latter. The Allied countries could withhold most-favored-nation treatment from Germany or even impose prohibitions on imports of its goods. France, in particular, was very reluctant to practice nondiscrimination. Apart from the narrow motive of wanting to see each and every tariff concession strictly reciprocated, France also wanted to be able to use commercial policy as a diplomatic instrument in bolstering its national security.[4] Despite foreign protests, the French Parliament of the early 1920s prohibited the government from entering into agreements that accorded other countries unconditional most-favored-nation treatment. To avoid retaliatory action by other countries, which would have harmed French exports, the French government assured them that it would, in practice, evade the prohibition laid down by its own Parliament (see Haight 1941, 128–31).

In a potentially somewhat more positive development from the point of view of multilateral trade cooperation in the long term, the United States was concurrently shifting to the adoption of unconditional most-favored-nation treatment. This change, introduced by the Harding administration on the basis of its interpretation of the Fordney-McCumber Tariff Act of 1922, was clearly of importance in the evolution of U.S. trade policy and, as a consequence, of multilateral trade cooperation. The main, immediate reason for the adoption of the clause was the recognition that European trading partners were reluctant to continue to grant the United States most-favored-nation treatment if it persisted in failing to reciprocate.[5] The change in policy was, however, of quite limited significance at the time, since the United States was still committed to high tariffs and was not ready to pursue an open trading policy. In fact, the Fordney-McCumber Tariff Act raised tariffs in advance of any new trade agreements that might be entered into, and it authorized the president to impose punitive tariffs on any nation that refused to extend most-favored-nation treatment to the United States. The act served as a way of gaining easier access to the markets of other, weaker trading partners without making any reciprocal concessions in domestic tariffs (see Eckes 1995, 90–93).

In the Franco-American negotiations of 1927, for instance, France sought tariff concessions from the United States as a condition of applying its lower, most-favored-nation tariffs to imports from the United States. But the American position was that most-favored-nation treatment should be accorded by both sides regardless of tariff levels. The incongruity of this position was recognized by some spokesmen for large corporations with an interest in access to foreign markets. Eugene P. Thomas of United States Steel Corporation said flatly that "foreign trade is necessarily reciprocal." He spoke of "a deplorable confusion of ideas with regard to the true conception of commerce among nations, which is mutual exchange to mutual benefit" (quoted in Becker 1982, 174). But this view of trade relations based on reciprocity had little or no influence in congressional circles at that time.

Attempts at Multilateral Trade Cooperation

By the mid-1920s, more normal economic conditions were seemingly returning. The United States was enjoying a booming prosperity, and the economies of most European countries—with the major exception of Britain—were expanding at a fair pace. Between 1925 and 1927, most countries returned to the gold standard, with its advantageous regime of stable exchange rates. German reparations had been scaled down by the Dawes Plan of 1924, and international capital markets were again functioning freely. Since the trade conditions imposed by the Treaty of Versailles had expired, France was faced with an urgent need to make new trade arrangements with Germany. The convention signed in 1927 marked a new direction in French trade policy. France and Germany accorded each other most-favored-nation treatment, and France veered away from its dalliance with a discriminatory commercial policy. As the French Parliament, moreover, yielded to the government the authority regarding the control of tariffs, the tariff regime was marked by a new stability. By 1928, three-quarters of the duties inscribed in the French tariff schedule were fixed by international agreements and could not be increased unless these agreements were violated (see Haight 1941, 124–40).

Under these circumstances, the League of Nations convoked an ambitious world economic conference in 1927 to address trade issues. Several international conferences had been held in the early 1920s to reach agreement on outstanding political and economic issues. While the conferences had recommended standstills or reductions in tariffs, these efforts had found no support in national capitals.[6] Like their predecessors, the parties at the 1927 conference, which included an impressive array of experts from the official, business, and academic worlds, wholeheartedly recommended that governments lower trade barriers. They urged governments to reduce their tariffs through all possible channels—unilateral, bilateral, and multilateral (see Salter 1936, 43).

As a result of these recommendations, some sporadic steps were taken by governments to reduce their tariffs unilaterally or through bilateral negotiations. The main hope, however, lay in the possibility of multilateral negotiations. But unfortunately, countries could not agree on a common formula for tariff cuts. Countries tended to divide between newer, high-tariff countries and older trading nations that retained relatively low tariffs. The low-tariff countries felt that equal percentage cuts in tariffs would be unfair to them, while the high-tariff countries maintained that greater cuts by them would place a disproportionate burden of adjustment on their economies. The low-tariff countries were, moreover, inhibited from making tariff cuts among themselves, since such cuts would benefit the high-tariff countries through the most-favored-nation clause. Put in more general terms, the low-tariff countries felt caught in the inherent contradiction between the unconditional most-favored-nation clause and the demand for reciprocity, and they viewed the newer participants as free riders (see Salter 1936, 47). The parties at the 1927 conference at least reached an agreement on a tariff truce pending a positive outcome of the search for a tariff-cutting formula, and they also encouraged countries to simplify their customs procedures and to move toward more uniform customs nomenclatures. However, the tariff truce eroded rapidly as the world economy slid into depression.

The best that can be said for trade cooperation in the 1920s is that if it did not advance, it at least survived. The principle of nondiscrimination suffered some assaults but remained largely intact, and though tariffs rose, the increases were generally moderate. Britain, still virtually a free trade country, struggled to play the role of economic leader; though both its economic power and its political power had waned, it remained a major market for many countries. As some have suggested, if Britain had been willing to threaten other countries with raising its own tariffs, it might have been successful in persuading them to participate in effective multilateral negotiations. But it was not willing to do so, and other countries remained secure in the knowledge that their access to the British market would continue even though they themselves made no concessions in their own high tariffs (see Salter 1936, 48).[7]

THE 1930s: THE NEAR DEMISE OF TRADE COOPERATION

For many years, accounts of the interwar years singled out the passage of the Smoot-Hawley Tariff Act in 1930 as a major event that affected international trade relations and contributed to the onset of the Great Depression. It raised tariffs substantially, and when President Hoover failed to veto the bill, it certainly did harm to trade cooperation. Some countries raised their tariffs as the bill was being debated. When it passed into law, numerous other nations introduced retaliatory increases. From the point of view of long-term trade cooperation, the most discouraging feature of the event was the ease with which countries could persuade themselves to participate in a downward spiral of shortsighted, unilateral actions and reactions.

The Gold Standard Implosion and Its Effects on Trade Policies

Far more important for international trade cooperation than the passage of the Smoot-Hawley Tariff Act was the effect that the Great Depression had in shattering the stability of the exchange rate system.[8] The shaky currency stability that had been achieved through restoration of the gold standard collapsed. Even in the five years or so in which the gold standard had again worked, its fragility had been evident. Britain was no longer strong enough to underpin the regime with sterling, and the dollar had become the principal gold-backed currency (with the franc being a third reserve currency). However, the United States (and France as well) was, with reason, not willing to follow the old gold standard rules of inflating domestic money supply when foreign exchange flowed in and of deflating when the opposite happened. As a country in which foreign trade then played only a minor role, it preferred to gear its monetary policy to the state of its domestic economy, not to its balance of payments. The automatic mechanism that brought about adjustment in the trade balance was thus suspended. Adding to the stresses in the gold standard system, parities set for sterling and the franc proved to have overvalued the former and undervalued the latter. When the depression swept through the world, the strain on Britain proved too much. It began losing gold and foreign exchange heavily, and rather than raise interest rates and retrench still more at home, it went off the gold standard. Several other countries linked to sterling, including most Commonwealth and Scandinavian countries, followed suit. Japan also devalued at the end of 1931. In allowing their currencies to depreciate, these countries gained a competitive advantage over countries remaining on the gold standard.

Other countries initially reacted differently. Most of the continental European countries had experienced bouts of severe inflation in the first half of the 1920s as a consequence of the underlying distributional conflicts permeating societies. In reaction, those in power in the late 1920s and early 1930s gave great weight to preservation of the stable gold value of their currencies. Germany, which had known hyperinflation, was among these countries. It resisted going off the gold standard. However, after an initial attempt to deflate its economy, it broke with free market mechanisms and introduced an array of exchange and import controls that protected the external value of its currency while permitting an expansion of domestic economic activity. It was followed by other countries, particularly in Central Europe and Latin America. In these new circumstances of extensive exchange controls and import controls, both Germany and the other countries developed a network of bilateral clearing arrangements to manage their trade and payments. Such state-managed arrangements were the antithesis of the open, nondiscriminatory system of trade; they set aside the whole idea of an international system of trade based on the operation of free markets.

The "gold bloc" countries (primarily Belgium, France, Holland, Italy, and Poland) likewise sought to retain the gold value of their currencies, but without introducing an extensive array of exchange and other controls. Due to falling prices worldwide and depreciating currencies in the sterling area, however, producers in the "gold bloc" countries faced a surge of lower-priced imports, and as a protective measure, these countries introduced import quotas. These quotas were initially seen as a temporary measure, to be abandoned when the financial crisis passed; but they were to become a fixture of commercial policy. In France, for example, it was not long before quotas introduced to protect farmers from the fall in prices of food imports were extended to manufactures.

While the state-managed system introduced by Germany and others clearly eliminated nondiscrimination as a principle guiding their external trading relations, the "gold bloc" countries sought at least formally to continue to respect it in order not to lose most-favored-nation status in their export markets. They did so by taking import volumes in a recent year as a guide in the allocation of quotas. However, in France, it also became the aim of commercial policy in the early 1930s, as it had been in the early 1920s and 1890s, to withdraw unconditional most-favored-nation treatment and to seek an exact reciprocity from each and every trading partner. Moreover, France reasserted its tariff autonomy and stopped entering into trade conventions that tied its hands in changing tariffs at will.

Even Britain finally broke decisively with its free trade tradition. Though two of Britain's three political parties and most economic opinion in the country had remained firmly attached to free trade policies in the 1920s, the depression eroded British intellectual and popular support for free trade. Faced with an apparently unshakable determination on the part of the government to remain on the gold standard, John Maynard Keynes publicly proposed a tariff in March 1931.[9] His argument was that since a public works program to raise employment encountered the objection that it would increase imports and thus worsen the trade balance (thereby undermining business confidence), an across-the-board tariff should be introduced; such a tariff would offset a deterioration in the trade balance and allow foreign lending to continue unabated, and by switching expenditure to home goods, it would also contribute to higher employment. To counter the objections of the free traders, Keynes also argued that the measure should be seen as a temporary one that would buy time for the organizing of an international program to reinflate economies. The government did not act on his proposal. However, within the year, a new government came to power, and although Britain had gone off the gold standard by that time (thereby undermining Keynes's intellectual case), it passed into law the Import Duties Act of 1932 (see Skidelsky 1994, 386). Britain imposed a general tariff of 10 percent and subsequently introduced a new tariff scale in which duties ranged from zero to over 20 percent (see Foreman-Peck 1995, 200).

Britain also joined the ranks of those delivering blows to the principle of nondiscrimination. Along with the Commonwealth countries, it established a preferential trading area at the Ottawa Imperial Conference in 1932. France and the Netherlands, other major colonial powers, likewise tightened their trade links with their colonies; when France introduced import quotas, for example, trade between the metropolitan power and the colonies remained free, while imports from other countries into the colonies (as into France) were subject to quotas (see Haight 1941, 246–47).

Last Efforts at Restoring Multilateral Cooperation

Many sensible people recoiled from the desperate, every-man-for-himself policies that governments fell back on in the worst months of 1931–32. As an outcome of the contraction in domestic demand everywhere and the resort to nationalistic policies, trade declined dramatically; between 1929 and 1932, the trade volume of the North American and European countries fell by a quarter. Some were convinced that the cause of the Great Depression lay in the breakdown of the international economic system. Many more at least agreed that the depth and duration of the depression were worsened by the breakdown. They believed that the path toward economic recovery lay in restoring stable exchange rates, international financial flows, and open trade.

Toward this end, work began on preparation for another world economic conference, to be held in 1933 (see Salter 1936, 64). However, underlying differences in views about the causes of the depression and consequent disagreements in prescription doomed the conference to failure. The new Roosevelt administration, in particular, saw the way forward quite differently than did the defenders of the old, liberal, free market international order. For the administration, the first task was to bring about the recovery of economic activity at home, unimpeded by a policy focused on maintaining a stable exchange rate. Thus, even as world leaders were conferring with each other in preparation for the conference, the United States announced a depreciation of the dollar against gold. The administration was acting on its belief that the depression had to be fought through measures that would reverse falling domestic prices (and therefore falling incomes). Such a reversal would lessen the real burden of the debt carried by farms, corporations, and households, which was dragging down economic activity. Important among the U.S. measures were agricultural price supports, minimum wage legislation, and gold revaluation. In denouncing a fixed value for the dollar, President Roosevelt spoke of "fetishes of central bankers" that should not be allowed to stand in the way of domestic policies intended to overcome the depression.[10]

For European countries and especially for Britain, the action of the United States rang the death knell of the conference. In a world where the gold value of even the strongest currency could not be regarded as stable, any slim hope of reaching agreement on an exchange rate regime was gone. If countries would not bind themselves to maintaining an orderly exchange rate regime, there was little point in negotiating restraints or reductions in tariffs, since these could be easily undermined by competitive depreciations.

At the time, the protagonists of the old liberal order were right in stressing the importance of currency stability for trade cooperation. But they had no solution to the even more fundamental precondition of adequate levels of domestic demand. There was neither intellectual agreement on nor political acceptance of the action that was needed to meet this precondition: a coordinated reinflation of the major economies and the provision of international credits to finance short-term balance-of-payments disequilibria.[11]

After the conference, there was little notable improvement in international economic relations. The United States reestablished the gold value of the dollar at a fixed rate in 1934, and Britain, France, and the United States drew up a tripartite monetary agreement in 1936. The agreement, however, was not much more than an expression of intent to refrain from competitive depreciations and to eschew import quotas; no real progress was made toward restoring a more orderly exchange rate system.

A Quiet but Large Shift in U.S. Trade Policy

Trade policy in the 1930s did see one development that assumed considerable importance in the establishment of the new multilateral trading system after the Second World War: the passage of the Reciprocal Trade Agreements Act by the U.S. Congress in 1934. This act marked a break in the long-standing approach of the United States toward its trade policy. The country had long acted on the belief that it could increase its exports without liberalizing access to its own markets—using, if necessary, the threat of negative reciprocity. In essence, the act recognized reciprocal reductions in trade barriers as the way to gain easier access to foreign markets. It thus denoted a shift to a more open trade policy. To this end, Congress yielded up its exclusive authority to set tariffs and granted the president the power to negotiate tariff reductions with other countries. Along with the unconditional most-favored-nation clause that had been incorporated into policy after passage of the Fordney-McCumber Tariff Act of 1922, this change finally set the United States on the same path toward multilateral trade cooperation that the European nations had begun to tread uncertainly in the 1860s.

It may seem strange that a shift toward a more open trade policy took place in the United States at this time; both nationally and internationally, the recovery in business conditions was still weak, and there was mass unemployment. An underlying reason for the shift was undoubtedly a long-term, upward trend in American exports of manufactures (mostly of large corporations), which had been taking place over the decades. This factor does not, however, explain the curious timing of the shift. One political and parochial reason for the timing was the recognition by the Democratic Party that its traditional support from the export interests of southern agriculture could be successfully augmented by that of the large corporations if a more open trade policy were part of the Democratic platform (see Eckes 1995, 95). Also, there was concern among farmers and manufacturers that they might lose markets or that American firms might migrate to Canada, as a consequence of the preferences introduced by the Ottawa Imperial Conference. Further, passage of the Reciprocal Trade Agreements Act was eased by the popular disenchantment with policies pursued under the preceding Hoover administration, including the highly protectionist policy embodied in the Smoot-Hawley Act (see Goldstein 1993, 144).

Something of the U.S. shift in policy is also owed to the appointment of Cordell Hull as secretary of state under President Roosevelt. Though not widely acclaimed as a great secretary of state, he was notable for his single-minded determination in seeking to reform American trade policy. He brought into the Roosevelt administration liberal ideas about trade policy that he had carried with him since the years before the First World War. In his *Memoirs,* Hull expressed his debt to E. J. Hill, a fellow congressman from Connecticut with whom he had innumerable discussions after his election to Congress in 1906 (Hull 1948, 83).[12] Hill was reputed to be the best informed man in Congress on tariffs and trade; he had traveled extensively to study the commercial policies of other countries. Hull was thus well aware of the more liberal trade practices that had evolved in Europe during the latter part of the nineteenth century. He records that he had initially opposed high tariffs because they raised the cost of living, sheltered monopolies and trusts, and reduced purchases of American products by foreigners. He said that by 1916, however, he had broadened his understanding of the relation between trade policy and foreign policy, believing that unfair trade practices had contributed to the outbreak of war. He was convinced that "unhampered trade dovetailed with peace" (Hull 1948, 81).[13]

The immediate practical significance of the Reciprocal Trade Agreements Act in the 1930s was modest. Although Congress had authorized the president to reduce tariffs on a reciprocal basis by up to 50 percent, Cordell Hull moved cautiously for fear of activating the protectionist lobbies. He had to bear in mind, too, that renewal of the presidential authority would have to be sought in three years' time. Many of the early agreements were with Latin American countries whose main exports to the United States consisted of duty-free tropical products or raw materials. Other agreements were with countries whose specialized manufactures did not compete directly with American products. Still more important reciprocal agreements were also negotiated with Canada and, later, with Britain (see Kindleberger 1973, 237–38). The agreements usually contained a clause stating that in the event of an exchange depreciation by one of the signatories, the agreement would be suspended.

Despite the limited practical results of the Reciprocal Trade Agreements Act, it was nonetheless the signal of a new direction in American trade policy; it became the starting point of America's postwar approach to the founding of the multilateral trade regime. Though Cordell Hull resigned in 1944 for reasons of ill health and thus was not a participant in the formation of the postwar regime, he carried the liberal pre-1914 ideas about trade relations into the post-1945 world.

The shift in American trade policy would not have been enough to usher in the new postwar regime if the larger lessons of the interwar years had not been learned. It had proved virtually impossible to advance or even maintain trade cooperation without a fairly orderly exchange rate regime and (as a still more proximate condition) without tolerable levels of domestic demand and employment. These conditions were necessary to prevent resort to trade policy as an instrument of national exchange rate policy or of macroeconomic employment policy.

MULTILATERAL COOPERATION IN THE INTERWAR YEARS: WHY WAS IT SO INEFFECTIVE?

In the interwar years, countries generally were not unaware of their economic interdependence. Most policymakers understood well that they relied on access to each others' markets for the sale of their exports and for supplies; they knew that they had extensive relations with each other as creditors and debtors; and they appreciated that the value of their currencies depended on foreigners' willingness to hold them. Were this not so, it would be difficult to explain the numerous international conferences that were convened in the 1920s and early 1930s to address monetary, financial, and trade problems. But the attempts at cooperation failed repeatedly. Some writers have blamed the failure on the lack of a hegemonic power. The United States declined to assume the mantle of leadership that Britain no longer had the strength to bear. It is certainly true that a leader with authority, willing to propose new measures, is a condition of effective cooperation. But a more fundamental condition is broad agreement among countries on a course of action that is mutually supportive and that each country is willing to pursue because it is convinced that the action will further its national interest. Such agreement was lacking in the interwar years. There was agreement about the broad aims that the conferences were supposed to achieve, but there was neither intellectual agreement on solutions that were economically effective nor political acceptance of workable solutions at home. Countries took decisions on exchange rate policy and trade policy independently of each other because they felt they had no other option. Charles Kindleberger observed that in the 1930s, the British economics profession "almost drew the lesson that each country should take care of itself without regard to external effects," though only a few years earlier, almost all of Britain's economists and most of its politicians, including those in the ruling Labor Party, had vigorously upheld both free trade and the international regime of the gold standard (Kindleberger 1973, 304–5).

5 The Founding of the Postwar System

The foundations of the multilateral trade regime that we know today were laid in the years immediately after the Second World War. The time was auspicious for a large advance to be made in trade cooperation. The United States had emerged as an unquestioned superpower, and it had both foreign policy and commercial reasons for wanting to promote its trade relations with other countries.

The immediate steps taken toward greater trade cooperation were strongly influenced by the response of American policymakers, both political and economic, to the near anarchy of the world's interwar years. Their vision was for a grand assembly of international institutions, with the United Nations at the apex. These institutions were to be bulwarks against the aggressive political behavior and economic nationalism that had together bred the turbulent history of the 1920s and 1930s. The driving force behind this new order was a remarkable combination of American power and idealism, an idealism described by Dean Acheson, then assistant secretary of state and later to become secretary of state, as a mixture of "Wilsonian liberalism and utopian dream." As part of this vision, "economic arrangements–even the new ideas of Maynard Keynes–were to be brought into conformity with the classical economic goals of removing obstructions from the free movement of goods, people, and funds as means of expanding trade and development" (Acheson 1969, 726).

The political blueprint, which Dean Acheson disparaged with reason, quickly proved to be unrealistic, even naive. But the economic framework, embracing a smaller world of market-oriented countries, emerged as a remarkable creation of enlightened statesmanship. It provided an orderly and largely benign environment for international monetary and financial relations over the next quarter century and for trade relations up to the present day.

Among those planning for the economic world of the postwar years, the interwar experience had left no doubt about the close interdependence of international monetary, financial, and trade policies or about the broader interdependence between national macroeconomic policies and external economic relations. Disparate national economic policies could destabilize international monetary and financial relations and be highly disruptive of trade, yet independently pursued national economic policies appeared the key to protecting high levels of domestic economic activity. The dilemma was far from academic. There was a widespread concern at the time–mainly, but not exclusively, among the British policymakers–that once the high level of aggregate demand generated by wartime requirements had abated, the United States might not be able to avoid another crippling depression. The message for international policymakers was that the design of a new international monetary and financial system in which orderly exchange rates would be consistent with the maintenance of high levels of economic activity was the first order of business. It was seen as the precondition of expanding trade relations. Before the war ended, American and British officials had in fact already agreed on the establishment of the Bretton Woods institutions. The International Monetary Fund was to oversee an orderly exchange rate system and to facilitate balance-of-payments adjustments through the provision of credit, and the International Bank for Development and Reconstruction was to promote long-term capital flows. However, the birth of a new regime for trade relations did not immediately follow. It came later and was more troubled.

THE HAVANA CHARTER: AN ILL-CONCEIVED PROPOSAL

American ideas for a new trade regime were discussed intermittently with the British during the war years. Proposals were not put forward, however, until the end of 1945, partly because of the

U.S. administration's fear of arousing the protectionist lobbies in Congress. This was well after the other political and economic elements of the new order had been introduced and even established. When the jointly sponsored proposals did come, they were nonetheless imbued with the same hopeful intention of the American postwar planners to establish a new system of global economic relations.[1]

The American and British Proposals

The American drafters saw the charter as a vehicle for urging universal acceptance of their own conception of a freely competitive, private enterprise system. The proposals went well beyond the boundaries of trade policy as it had been understood in the past. Their draft was unexceptional in reaffirming the long-standing principles of nondiscrimination and national treatment and unremarkable in calling for the elimination of quantitative restrictions. But it also encompassed other, less familiar areas, introducing guidelines for restrictive business practices, for international commodity agreements, and—at the behest of the American business community—for the treatment of foreign direct investment by host countries.

By contrast, the British, who had participated in the drafting, differed strongly in their economic beliefs and priorities. True to their overriding concern with protecting the level of economic activity at home, they insisted that the draft assert the obligation of all countries to maintain high levels of employment. While fulfillment of this obligation was recognized to be largely an internal matter, its inclusion in the draft charter provided a justification for the use of quantitative import restrictions in some circumstances.

The Response of the European and Developing Countries

The draft drawn up by American and British officials was discussed at several international meetings, culminating in the conference convened at Havana in October 1947 (and not concluded until March 1948). Negotiations on reductions in trade barriers were initiated as part of these meetings. Because the negotiating authority of the U.S. administration—as granted by Congress—

expired at the end of 1947, these negotiations were completed in the middle of that year. The outcome was the General Agreement on Tariffs and Trade, which is discussed more fully later in this chapter. At the time, it was expected that this agreement would be incorporated into the Havana Charter as the segment dealing with trade relations proper.

Both in the preliminary meetings and at the Havana conference, many countries criticized the draft charter for failing to take adequate account of their political beliefs and aspirations or of their specific economic circumstances. The American advocacy of a liberal, free market international economy found few enthusiastic supporters. Because of their interwar experience, their current economic circumstances, and their social philosophies, both the other industrially more established countries and the developing countries were more convinced than the United States of the need for substantial state participation in the management of the economy.

The wartorn countries of Europe disagreed with the draft on a number of points. The most important source of disagreement arose from the gap in understanding of their actual economic circumstances at the time. For the Europeans, the overwhelming need was to undertake the extensive physical reconstruction of their economies and to adapt themselves to substantially altered economic circumstances. They were not prepared to risk the rapid dismantling of their wartime systems of economic controls and to rely on freely functioning markets to effect the adjustment to the new circumstances. (Underscoring the point was the debacle of sterling convertibility, which had been undertaken reluctantly by the British in the middle of 1947 on the urging of the United States.) Fearing the internal dislocation that might ensue from this course of action, the Europeans preferred to pursue a more gradualist strategy in the relaxation of controls. They accordingly differed markedly with the United States on the issue of quantitative restrictions. Not only did they want to retain use of these restrictions for balance-of-payments reasons, but in view of the "dollar shortage," they also wanted to apply them in a discriminatory way as a means of increasing their total volume of trade.

There were also other, more specific points of disagreement.

For instance, the Europeans wanted tighter rules on export subsidies than the United States was willing to accept, since the latter was aware of the agricultural surpluses that its price support program was capable of generating. The Europeans also wanted more rigorous rules on safeguards for weak industries than the U.S. administration believed Congress would accept. Further, the Europeans and the Americans interpreted restrictive business practices differently.

The developing countries–led by Brazil, India, and Chile–were likewise critical. The issue of economic development had been largely neglected by the British and Americans in their initial drafts. At the insistence of the developing countries themselves, an amendment to the draft charter declared economic development as a primary objective of the proposed International Trade Organization. Both the British and the Americans subsequently opposed the developing countries when they suggested more specific amendments that would allow them to implement their own development policies and programs. For instance, the developing countries pressed their case to be free to use quantitative restrictions as they saw fit in support of their own development aims. The United States representative strongly resisted this position, arguing that if other countries freely used quantitative restrictions, the demand would arise in the United States for it to follow suit; if the most powerful country employed this weapon, other countries would be the losers. Equally wide differences of opinion appeared over the issue of the treatment of foreign direct investment. Imbued with a desire to assert their economic, as well as their political, independence and often suspicious of foreign economic domination, developing countries held drastically different views about the rights and obligations of host countries. At their insistence, an interpretative note attached to the Geneva draft of the charter even asserted their right to confiscate foreign investments without compensation under certain circumstances (see Gardner 1969, 364–68).

The Hapless Outcome

The charter that emerged from Havana in March 1948 was weighed down with exceptions to the rules that it enunciated, and neither of the original sponsors retained much interest in it. By that time, the wartime enthusiasm for planning a new international economic order had dissipated. The Cold War had become an ugly reality, the North Atlantic Treaty Organization was taking shape, and a more pragmatic spirit was dominating American foreign policy. As Richard Gardner has observed, there was now much less faith in the idea that "elaboration and enforcement of formal principles would always promote the orderly settlement of national differences" (Gardner 1969, 373). The American business community, moreover, was fiercely critical of the final document. In its view, the document failed to condemn trade preferences and quantitative restrictions with sufficient vigor, it appeared to condone state planning, and its revised provisions about the treatment of foreign direct investment were quite unacceptable to the original sponsors. Some members of the U.S. Senate also expressed concern that the charter infringed too much on national sovereignty. In the end, the U.S. administration never sought congressional approval of the charter, which quietly disappeared into limbo.

As an exercise in multilateral cooperation, the charter was a dismal failure. In the circumstances that confronted them at the time, many countries could not see what net benefit might accrue to them from participation on the terms put forward by the original drafters. To accommodate their own interests, they accordingly insisted on the inclusion of numerous exceptions to the rules. Some exceptions to rules are inevitable if the rules are to encompass a variety of circumstances, but when exceptions become too numerous or far-reaching, they only underline the absence of a basis for mutually advantageous cooperation. Perhaps the charter's greatest weakness was that its American drafters had planned for a world of free market economies that did not exist. They failed to appreciate the magnitude of the transitional problems that the European countries faced (in response to which the Marshall Plan was a delayed, but generous, recognition), and both they and their European allies showed scant understanding of the economic problems, aspirations, and nationalist sentiment of the developing countries.

GATT: THE SALVAGED CORE

A more pragmatic core to the Havana Charter survived: the General Agreement on Tariffs and Trade, successfully negotiated in Geneva during 1947. With the Havana Charter not ratified, this agreement set the framework for the postwar trade regime. The agreement came into effect on January 1, 1948.

While the agreement drew much of its language from the Reciprocal Trade Agreements Act passed by the U.S. Congress in 1934, its key principles of reciprocity, nondiscrimination, and national treatment were of much longer standing. They had been forged over a great many decades and had begun to acquire general currency among nations as far back as the mid–nineteenth century. In a broad sense, the General Agreement on Tariffs and Trade built on the network of nondiscriminatory agreements that had existed among European countries in pre-1914 years. The large change was that it transformed such bilateral agreements into a single multilateral convention, in a new recognition of the interdependence of countries and of their mutual interest in international cooperation.

A New Endeavor in Multilateral Rule Making

Much less ambitious than the Havana Charter, the General Agreement on Tariffs and Trade was nonetheless a landmark in the history of trade cooperation. For the first time, nations agreed on a multilateral set of norms, principles, rules, and procedures to guide the conduct of their trade relations. The broad intent of the agreement was that countries should enter "into reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade."[2] The agreement reaffirmed nondiscrimination and national treatment as broad principles that should guide trade relations. It also endeavored to spell out a number of specific rules and procedures that would both facilitate customs clearance and reassure governments that their trading partners would not be able to evade agreed reductions in tariff barriers.

For those engaged in the export trade, the ways in which customs authorities administered national trade laws often mattered as much as tariff rates themselves, since the interpretations and practices of the authorities affected the amount of tariff that traders had to pay and the length of time necessary to clear goods through customs. There were several customs regulations that could affect the amount of duty that was paid. How goods were classified in a tariff schedule determined the rate of duty that they would attract. So, too, did the method of valuing the imported goods for the purpose of calculating the duty. Then, there were the criteria used to determine whether the imported goods could be regarded as originating in a country to which the GATT most-favored-nation tariffs applied. In addition, other costs could arise for exporters because customs formalities caused delays in moving goods out of the bonded warehouses or because the goods had to be scrutinized to determine whether they met national health or safety standards. Further, there were the practices of subsidizing products or of dumping them at below-cost prices in foreign markets; both could render ineffective the tariff schedules that governments had agreed to apply to each other's trade.

National practices and policies in regard to these matters differed quite substantially and were usually well embedded in national administrations. The elaboration of multilaterally agreed rules was a new venture, and there were many technical and policy differences to resolve. For example, even at the level of such a largely technical issue as customs classification, though some attempt had been made in the interwar years to move toward a more uniform customs nomenclature, considerable differences remained when the General Agreement on Tariffs and Trade was drawn up. In these circumstances, the rules concerning customs practices and procedures drafted at the inception of GATT were less specific injunctions than broad statements about what national practices were expected to conform to. Years passed before more uniform systems of classification and more standardized customs formalities were introduced and before more comprehensive and explicit sets of rules on such matters as customs valuation and technical standards were adopted. (In fact, not until the Tokyo Round of the 1970s did such rule making move to a new level. Revisions and refinements have continued up to the present day.)[3]

On the still more sensitive issues of subsidies and dumping, the drafters of the General Agreement on Tariffs and Trade barely succeeded in doing more than acknowledge the problems. On subsidies–then extensively employed by all GATT signatories–the most the negotiators could accomplish was an agreement that countries should not seek to nullify agreed tariff reductions by introducing subsidies for competing domestic products. (Though some countries also wanted an agreement that exports should not be subsidized, the United States–concerned about agricultural exports–objected.) On dumping, the GATT rule was hardly more than a recognition of the right of countries to impose countervailing duties, though it did include the condition that action should not be taken unless the dumping was causing or threatened to cause "material injury."[4]

Yet another important innovation of the new GATT regime was a procedure for the settlement of disputes between trading partners. The negotiators expected that, for the most part, disputes would continue to be settled in what was the traditional way for sovereign states–through diplomatic consultation and conciliation. However, the General Agreement on Tariffs and Trade provided that if a country was dissatisfied with the outcome of bilateral consultations and still felt that its trading partner was failing to abide by its obligations as a contracting party to GATT, it could take the dispute to the governing body of GATT. Moreover, if the governing body agreed with the complaint, it could authorize the complainant to suspend its obligation to the offending party. This provision tentatively introduced into the settlement of disputes an element of adjudication by a third party, a step reinforced during the 1950s, when the practice of appointing panels of disinterested parties to make rulings on disputes began. For the individual countries, however, whether to invoke the procedure and whether to comply with any rulings were still matters of diplomatic judgment. It could not be said that in subscribing to the agreement, countries had agreed to submit themselves to a semijudicial procedure for the settlement of disputes.[5]

The Initial Tariff Cuts

The immediate practical outcome of the Geneva meetings was the successful negotiation of reductions in tariff barriers. The method was to negotiate reductions on an item-by-item basis. In preliminary wartime discussions between the Americans and the British, the latter had proposed that there should be a large, across-the-board percentage cut in tariffs. This was their counterproposal to the American demand that Britain dismantle its system of Commonwealth preferences. In the American view, Commonwealth preferences were a particularly objectionable barrier to U.S. exports and exemplified the need for general adherence to the principle of nondiscrimination (although the United States had its own preferential trading arrangements with Cuba and the Philippines). In the British view, it was essential for the country to restore its export trade as quickly as possible after the war. Britain was not willing to give up its preferred access to Commonwealth markets unless it was compensated by much easier access to the American market. The British also observed that the United States was not able to bind its tariff reductions for more than three years and that, moreover, the United States reserved the right to withdraw tariff concessions in the event of serious injury to its industries (see Gardner 1969, 352).

In the end, the U.S. administration's concern not to provoke protectionist sentiment in Congress decided the method of tariff cutting. In opting for the item-by-item approach, the United States was more able to adapt its negotiations to accommodate particularist interests. This approach also sidestepped a major problem that had arisen in interwar proposals for across-the-board cuts, namely, whether both high-tariff and low-tariff countries should make the same percentage cuts. Using this approach meant, however, that negotiations had to be conducted on a bilateral basis between principal suppliers. That these bilateral negotiations took place simultaneously within a multilateral setting had a certain advantage; pairs of countries could draw other suppliers into the negotiations to ensure that the latter made other reciprocal concessions. But this advantage only underlined the fact that the item-by-item approach made for tight bargaining based on a narrow interpretation of reciprocity.[6]

The negotiations resulted in quite significant cuts in tariffs. While it began from a position of relatively high tariffs, the United States appears to have made the largest cuts. By 1950, in fact, the average level of duties imposed by the United States on manufactures was lower than that of most of the larger European countries.[7] Besides tariff reductions, countries also agreed to bind tariffs on a number of items carrying low or zero duties. In seeking to eliminate Commonwealth preferences, the United States made little immediate headway. While some preferential rates were reduced or eliminated, more than two-thirds of the preferences accorded to Britain by the Commonwealth countries remained unchanged (see Gardner 1969, 360). However, the point had been made, and in later years, no new preferences were added, while the margin of preference was gradually eroded as tariffs were progressively reduced.

A Notable Advance in Cooperation

As with most negotiated outcomes, the General Agreement on Tariffs and Trade was shot through with weaknesses. The rules and procedures that formed its core presumed that trade was taking place among largely industrialized, private enterprise economies in which the price mechanism operated freely. Actual conditions everywhere differed in varying degree from this model. One consequence was that the membership of GATT was far from universal. The then communist countries, with their centrally planned economies, were the extreme case; they remained outside the new regime. For the different reasons discussed shortly, many developing countries also remained nonparticipants. Only twenty-three countries participated in the initial negotiations—though, taken together, these countries accounted at the time for approximately 60 percent of world trade.[8] Even among the founding members of GATT, differences were substantial, as is reflected in the large qualifications and exceptions made to the rules.

Most countries had extensive systems of import controls in place at the time, and the only pragmatic solution that reconciled such controls with the underlying philosophy of GATT was to recognize their use as temporary and exceptional measures. In another awkward inconsistency, the industrially more established countries excluded trade in agricultural products from the rules because these countries—including the United States—pursued domestic price support programs that entailed import restrictions. There were, moreover, disagreements between the Americans and the Europeans on other issues, such as subsidies and safeguards. Indeed, for reasons just discussed, the rules and procedures often had to be drafted in vague and ambiguous language to win agreement at the time. But even with all its weaknesses, the General Agreement on Tariffs and Trade was a notable advance in multilateral cooperation; not the least of its contributions was that it created a vehicle for subsequent rounds of multilateral trade negotiations.

THE DEVELOPING COUNTRIES AS OUTSIDERS

No more than twelve of the original signatories of the General Agreement on Tariffs and Trade came from the developing world.[9] At the time, a significant number of developing countries, mainly those in Africa, were still colonial territories, but most of the developing countries in Asia and Latin America were independent nations and free to participate. The majority of the developing countries, however, saw little or no benefit in submitting themselves to the obligations of GATT membership. This position did not change in many countries until the 1970s or later.

A fundamental reason for the disinterest that most developing countries showed toward the General Agreement on Tariffs and Trade lay in the structure of their production and trade. They were still predominantly producers and exporters of primary products. Their trading interest was to protect their access or gain greater access to the markets of the industrially more established countries for their agricultural or mineral exports. For noncompeting agricultural products and for minerals, they generally faced few barriers in the industrially more established countries; the latter customarily placed few tariffs or other trade barriers on tropical foods and beverages or on the industrial raw materials coming from the developing world. In competing agricultural products, such as grains or sugar, the case was quite different. Developing countries faced an array of import restrictions in industrial countries, stemming from the latter's efforts, greatly intensified in the depressed 1930s, to support their farmers' incomes through programs to control domestic prices and production. But these programs, though having large effects on trade, were treated by the industrially more established countries as outside the purview of the General Agreement on Tariffs and Trade (and they remained so until the Uruguay Round).

Given the structure of their exports, it is not surprising that most developing countries did not find the General Agreement on Tariffs and Trade to have much relevance for them. Dominating their thinking was the history of severe instability that had characterized world trade in individual primary commodities, accentuated by the recent memory of the great distress experienced in primary commodity markets during the 1930s. In face of the tendencies toward overproduction and extreme price instability that appeared inherent in primary commodity markets (whether national or global), the focus of interest was on measures for stabilizing prices at remunerative levels. Just as the industrially more established countries sought to regulate agricultural production and prices at home, so the developing countries pressed for international commodity agreements to cover a range of both agricultural and mineral products.

In some competing agricultural products where the industrially more established countries already exercised extensive state control over domestic output and markets, international commodity agreements were, in effect, an extension of the regulatory activity through which the state allocated a share of the domestic market to developing country exporters. The idea of the state regulation of markets for individual products at the global level continued to attract many followers in subsequent decades—not only in developing countries. The state management of markets for internationally traded goods later came to be applied to certain industrial products, such as textiles and steel (as is discussed in chaps. 6 and 7). Such an approach to international trade had little in common with the freely competitive market principles that imbued GATT.

However, not only their export interests caused most developing countries to find GATT irrelevant to their needs. As states ambitious to develop economically, they generally valued the freedom to protect new domestic economic activities as they saw fit. Most countries, moreover, felt that they needed to exercise tight control over the use of scarce foreign exchange earnings;

they believed it was necessary to allocate these resources to the purchase of essential supplies of food, fuel, raw materials, and capital goods, rather than to allow the free market to buy imported consumer goods. Article 18 of GATT, which deals with infant industry protection and allows the use of import restrictions for balance-of-payments purposes, gave, in principle, no small latitude to developing countries. But for most developing countries, the question was whether it was worth submitting to any of the GATT disciplines in view of the virtual absence of clear benefits.

6 The First Twenty-Five Years of the New Trade Regime

From a global point of view, the first quarter century of the new trade regime was a politically tense and dangerous period. Antagonism between the Soviet Union and the United States, as leaders of two opposing groups of nations, was persistent and acute, flaring up in such confrontations as the Berlin blockade and the Cuban missile crisis. Wars were fought in Korea and Vietnam to contain the feared expansion of communist rule. Soviet troops marched into Czechoslovakia and Hungary to suppress rebellions. As the Kuomintang government collapsed on mainland China and retreated to Taiwan, a new regime hostile to the West emerged in China.

For the major trading nations of the noncommunist world, however, the global political tensions in no way impeded the consolidation and growth of their newly formalized trade relations. On the contrary, the national security concerns of the United States reinforced its economic and commercial interests in urging trade cooperation on other friendly or neutral countries. In the 1950s and the 1960s, a conviction of most in the American policy community was that the country's foreign policy interests were best served by an open, multilateral trading regime linked with a stable, international monetary and financial system. The resoundingly successful Marshall Plan saved Western Europe from grave social malaise and helped to place its economies on a path of rapid economic recovery and growth. For similar geopolitical reasons, President Eisenhower was concerned in the 1950s that Japan should not be driven to seek markets for its exports in China or other communist countries, and he strove to give Japan access to the American market. The belief in strengthening economic and commercial ties extended to the developing world, where both the United States and its Western European allies employed financial and trade measures to edge countries into aligning themselves with them.

Taking the first quarter century as a whole, economic conditions in the industrially more established countries created an environment favorable to the expansion of trade and the development of trade cooperation. For these countries, the period has been dubbed a golden age of economic performance. Thanks partly to a high rate of growth in productivity, their economic growth averaged 4.9 percent per annum between 1950 and 1973, a sustained rate of increase in output well in excess of anything that had been known in earlier decades. Rates of unemployment consequently remained persistently low, and the upward trend of prices was relatively modest. Assisted by the stable exchange rate regime established at the Bretton Woods Conference, trade flourished. The growth of world trade easily surpassed that of world production, and everywhere, the relative size of the export sector within national economies regained a status that it had not known since before the First World War. For the developing world generally, however, the period was less evidently buoyant. Though benefiting positively from the prosperous time in the industrially more established countries, a great many developing countries were still largely peasant or semisubsistence economies taking only their first steps toward industrialization, as was reflected in the modest pace of their economic growth.

THE EARLY ROUNDS

The first twenty-five years of the General Agreement on Tariffs and Trade saw a succession of negotiating rounds conducted among GATT members. The most significant was the Kennedy Round, held in 1964–67; it proved to be the occasion for notable changes in how trade relations were conducted. The Kennedy Round, however, was preceded by negotiating rounds in Annecy in 1949, Torquay in 1951, and Geneva in 1956 and again in 1960–61 (the last being known as the Dillon Round). While these rounds produced some reductions in trade barriers and improvements in the rules, their effects were of modest proportions.

A Reluctance to Move Forward

The reasons for the absence of any large forward steps in multilateral trade liberalization and cooperation in the years immediately after the new regime was founded were rooted mainly in the economic circumstances of the time. Tariffs and the other trade barriers, to which the General Agreement on Tariffs and Trade largely addressed itself, were not, in fact, the primary obstacles limiting access to markets in these years. Dominating trade and financial relations was the acute scarcity of convertible currencies that most countries other than the United States experienced as a consequence of the war. Governments felt compelled to apply tight exchange and import controls, and these controls limited market access.

The lack of foreign exchange to settle accounts was a principal constraint on trade between countries. In the late 1940s, governments in Western Europe sought to relieve this constraint through an arrangement for the multilateral clearing of bilateral balances among themselves. This arrangement was discriminatory, but it nonetheless permitted a mutual expansion of trade. Countries in the British Commonwealth, through their membership in the sterling area, were similarly able to relax this constraint on their trade with each other. It was not until after the end of the Korean War, in 1952, that the "dollar shortage" began to diminish and that some Western European countries initiated the gradual dismantling of their exchange and import controls. As these controls slowly receded into the background, tariffs and other trade barriers moved toward the front of the stage as operationally significant restrictions on market access.

Without strong pressure from commercial export interests, the U.S. Congress was reluctant to approve new trade initiatives that might upset domestic industries fearful of increased import competition. It kept a tight leash on trade policy by renewing the presidential authority to enter into trade negotiations for only two years at a time and sometimes for the even shorter period of one year. Until the Dillon Round, it also limited to 5 percent the magnitude of the tariff cuts that could be negotiated. Further, Congress intermittently revised legislation relating to the incorporation of an "escape clause" that weakened or limited tariff concessions in trade agreements.[1] Thus, in 1951, the Tariff Commission was called on to estimate the point below which a tariff could not be reduced without causing injury to the competing domestic industry, and negotiators were enjoined not to make tariff concessions below this "peril point." If a mistake was made about the "peril point," industries could still seek relief under the escape clause that provided for redress for injuries sustained as a consequence of tariff concessions (see Destler 1986, 20).

With tariff negotiations based on item-by-item bargaining and hobbled by the U.S. "peril point" restrictions, most countries expressed considerable dissatisfaction with the paucity of the results of these early trade negotiations. Forces were at work, however, that would break down the reluctance of the U.S. Congress to move forward in trade liberalization. The underlying factor was undoubtedly the continuing and strong growth in American industrial exports; merchandise exports almost doubled in value between 1950 and 1960. The more immediate precipitating cause was the formation of the European Economic Community (EEC), which came into being in 1958—by far the most important event in international trade relations in the 1950s.

New Impetus: Formation of the EEC

As I observed earlier, the movement toward economic integration in Western Europe was fathered more by political beliefs than by economic ones. Certainly, for the smaller countries, the economic consideration of the need for market expansion through foreign trade was dominant. When Belgium, Luxembourg, and the Netherlands formed the Benelux customs union in 1948, their economic size and the long-standing importance of foreign trade for their economies were powerful motives. But the lineage of the European Economic Community is different; it goes back to the founding of the European Coal and Steel Community (ECSC) in 1951. Brilliantly conceived by Jean Monnet (then head of the French Commissariat Générale du Plan) and politically managed by Robert Schuman (then French foreign minister), the ECSC was proposed partly to overcome the immediate political problem of what to do about the Saar. Because of the Saar's great coal resources and its iron and steel industry, it was a territory of economic importance to both France and Germany. (It had also been a cause of rancorous conflict after the First World War.) The formation of the ECSC created, in effect, a unified market for coal and steel among the member countries. For these countries—France, Germany, the Benelux countries, and Italy—the ECSC was a political stepping-stone to the even larger goal of economic integration. Through a restatement of the political relations of Western European countries in terms of their common economic interests, centuries of deep political hostility and conflict lost their relevance.[2] In 1957, when the six countries signed the Treaty of Rome that brought the European Economic Community into being, they initiated the formation of a huge customs union, the European Common Market, which evolved into what we know today as the European Union. The formation of this union almost immediately began to have large consequences for international trading relations.

The first reaction came from Britain. Fearing that the new customs union would harm its commercial interests, Britain proposed the formation of a larger European free trade area, a frankly preferential area emptied of the political intent of the European Economic Community. However, this proposal was rejected. As a defensive response, Britain, the Scandinavian countries, and other Western European countries set about establishing a second large trading bloc, the European Free Trade Association (EFTA).

For geopolitical reasons, the United States fully supported the formation of the new European Economic Community and its principal arm, the European Common Market. The United States recognized that the newly proposed customs union would clearly discriminate against American exports, contradicting a principal reason why the nation had championed the General Agreement on Tariffs and Trade; in American eyes, a prime purpose of the agreement had been to outlaw the trade discrimination practiced by preferential trading arrangements, particularly the British system of Commonwealth preferences. But because of the political importance of the new European Economic Community, the United States willingly accepted this departure from nondiscrimination, even though it placed American exporters at a disadvantage in competing with EEC members within the Common Market.[3] Another source of potential damage to some American export interests arose from the way in which the customs union proposed to establish a common external tariff; the new tariff was to be an arithmetical average of existing national tariffs, which implied that the tariffs of Germany and the Benelux countries would rise while those of France and Italy would fall. In these circumstances, the one way to safeguard American commercial interests as much as practicable was to negotiate reductions in the external tariff of the Common Market both to minimize the extent of the discrimination and to limit the tariff increases required of Germany and the Benelux countries.[4]

Both the Dillon and the Kennedy Rounds were responses to this new situation. The Kennedy Round (discussed shortly) was a milestone in the postwar history of trade cooperation. The earlier Dillon Round was important because it signaled the renewal of a more activist role by the United States in promoting trade liberalization. However, the U.S. administration still faced a Congress reluctant to do anything that might upset domestic industries or their workers. The European Economic Community sought to be helpful to the administration in its dealings with Congress, offering to make across-the-board cuts in its tariffs of up to 20 percent if Congress would authorize the administration to reciprocate (see Foreman-Peck 1995, 268). But Congress was not willing to relinquish its power to protect specific industries and would not deviate from the established method of negotiating tariff reductions on an item-by-item basis. It did agree that individual cuts of up to 20 percent could be negotiated. In the end, the Dillon Round did not achieve item-by-item cuts of more than 10 percent. A broader, less precise approach to reciprocity had to await the Kennedy Round.

THE KENNEDY ROUND: A MILESTONE

In terms of postwar, trade liberalization among the industrially more established countries, the Kennedy Round was a large step forward, since it accomplished substantial reductions in tariffs on manufactures. It was also notable, more generally, in terms of the changing nature of trade cooperation, for two quite opposite reasons: it marked a shift in the United States–the leading trading nation–toward a broader interpretation of reciprocity (one that was essential to the advances in trade liberalization made in later rounds), but it also moved in a less liberal direction. While restrictions by individual countries on imports to protect specific industries were not new, the Kennedy Round was the first occasion in which the industrially more established nations collectively agreed to act in a discriminatory way against much weaker countries. The industry at issue was textiles and apparel. The discriminatory action was in violation of the norms–if not of the rules–embodied in the General Agreement on Tariffs and Trade so recently ratified by these countries.

While the Kennedy Round was, in large part, a response to the formation of the European Economic Community, the vigor with which the Kennedy administration pursued the aim of trade liberalization also owed something to its particular stance on foreign policy. The administration chose to meet the perceived threat of Soviet expansionism with a reaffirmation of American leadership in both the political and the economic spheres. It reasserted trade liberalization as part of its strategy to broaden and strengthen links among friendly countries. In regard to the developing world, the emphasis in policy shifted from preservation of the status quo to support for governments engaged in social and economic reforms. Foreign aid was stepped up, and such new programs as the Alliance for Progress and the Peace Corps were launched.

In seeking negotiating authority from the U.S. Congress, earlier administrations had been cautious in their approach, fearful of arousing too much opposition from protectionist lobbies. The Kennedy administration, after having first placated the textile lobby (as will be described shortly), took a bolder line. (George Ball, then undersecretary of state and a convinced internationalist who had worked closely with Jean Monnet, played a large part in initiating the new policy.) For one thing, the administration took steps to set aside the "peril point" legislation that had so emasculated the position of American negotiators in earlier rounds. More positively, it won authority from Congress to negotiate tariff cuts on an across-the-board basis, not only item by item as in the past.

Proposals to cut tariffs by a uniform percentage were not new. They had been mooted at international conferences during the interwar years but had not been implemented. They had been proposed again by Britain at the outset of the postwar years and most recently by the EEC. Now, new circumstances that demanded a bolder response had arisen, in the form of two, huge, European preferential trading areas; only for this reason did the American administration feel strong enough vis-à-vis Congress to dismiss the demand for a more precise accounting of equivalence.[5]

The Kennedy Round negotiations began in 1964 and were completed in 1967. (Despite the name of the round, the Johnson administration represented the United States; President Kennedy had been assassinated in 1963.) The immediate result was a substantial reduction in the tariffs on manufactures of the industrially more established countries. Tariffs on dutiable manufactures were cut, on the average, by 36 percent in the EEC and the United States and by 39 percent in Britain and Japan (see Preeg 1970, 208–11). Agricultural products were relatively unaffected by the round. The United States had requested a waiver from GATT rules for agricultural trade in 1955, and the EEC was adamant, as it had been in the Dillon Round, that its Common Agricultural Policy was not a negotiable subject.[6]

While the Kennedy Round was successful in reducing tariffs, it did not bring about any significant changes in the GATT rules that governed the conduct of trade. During the negotiations, governments reached agreement on the redrafting of the antidumping rule and on changes in methods of customs valuation of dutiable goods.[7] However, the U.S. Congress remained sensitive to any apparent infringement of its authority to determine trade policy, and it refused to ratify the agreed changes, on the grounds that in going beyond tariff reductions, the administration had exceeded its mandate.

Despite the friction between Congress and the administration, the Kennedy Round marked an important shift in the American attitude toward trade cooperation. That attitude moved away from an interpretation that focused on the narrow balancing of mutual benefits that might be generated by specific product-by-product concessions. The United States came to consider benefits in more general, economy-wide terms. This shift to what Robert Keohane has called "diffuse reciprocity" cleared the way for the broadening of future negotiations to embrace trade-offs whose costs and benefits were much less easily calculable (Keohane 1986, 19).

The Textile Expedient: Not Breaking the Letter of the Law

The Kennedy Round's progress in tariff reduction and the accompanying U.S. embrace of a broader concept of reciprocity came with a heavy price: the introduction, at the multilateral level, of a measure that was both protectionist and discriminatory. At the behest of the United States, the most powerful trading nations joined together to draw up a multilateral agreement that, by indirectly but effectively imposing quantitative restrictions, discriminated against the cotton textile exports of Japan and, soon after, those of Hong Kong, Taiwan, and South Korea. These powerful nations insisted on negotiating the agreement under the auspices of GATT, though that was an incongruous move.[8] For the advocates of free markets, the agreement was an uncomfortably retrograde step. For those who hoped to promote the conduct of trade relations on the basis of agreed rules, its worst feature was that it so blatantly broke the rule of nondiscrimination.

The measure was first introduced as a politically expedient act that the Kennedy administration deemed necessary. The textile and apparel industry in the United States had warned of its discontent with imports from Japan during the preceding Eisenhower administration. Though Japanese imports accounted for only 2 percent of apparent consumption in 1956, they dominated certain very specific lines of production, such as gingham and women's blouses. President Eisenhower was loathe to use overt quantitative restrictions that would both be in violation of GATT obligations and hurt European textile exports to the United States, so his administration brought pressure on Japan to apply voluntary export restrictions. However, the American textile and apparel industry was not satisfied. It was, moreover, politically influential, being a large employer scattered throughout numerous congressional districts.[9] When John F. Kennedy became a candidate for president and sought support from the southeastern states where the cotton textile industry was well established, he promised more rigorous action. However, his administration was equally reluctant to violate GATT openly. At the same time, it was well aware that most European countries were still making use of quantitative restrictions, not only for balance-of-payments reasons, but also to keep out Japanese products.[10] Britain's government had also already resorted to voluntary export restraints in response to rising imports from India and Pakistan under Commonwealth preferences. For the United States, therefore, a multilateral agreement appeared attractive; it would draw the European countries into an orderly marketing arrangement that would make for a better sharing of the burden of Japan's exports.[11]

The initial Short-Term Arrangement regarding International Trade in Textiles did not make much of a dent in the exports of Japan or in those of Hong Kong (which it also initially covered). The arrangement was at first very limited in its product coverage and made relatively generous provision for annual growth in quotas. It was presented as a measure that importing countries would invoke only to deal with import surges that threatened "market disruption." But as George Ball, its main author, recognized, the arrangement was open to abuse. Having become an accepted instrument among the industrially more established countries and being a politically convenient way for placating protectionist demands, the Short-Term Arrangement regarding International Trade in Textiles soon became the Long-Term Cotton Textile Arrangement (which later graduated into the Multi-Fiber Arrangement). Over time, the arrangement embraced an ever more extended range of textile and apparel manufactures and an ever widening group of developing countries, and the annual increase in quotas was steadily pared down. Not long into the operation of these arrangements, Japan largely shifted out of textile and apparel exports to focus on higher-technology products. Accordingly, the Multi-Fiber Arrangement became a discriminatory measure used by the more powerful, industrial countries against the exports of a principal manufacture from weaker, developing countries.

At least in the earlier years of these arrangements, their "voluntary" character gave the exporting countries room for maneuver.[12] Since the export restraints had to be negotiated, the exporting countries could bargain for better terms. Their bargaining power was, however, small. They could have refused to cooperate, protested to GATT, and been authorized to threaten retaliation, but they would have then run the risk of a worse fate, namely, the unilateral imposition of quotas by the industrially more established countries. For the latter, retaliatory action might have harmed some of their own exporting industries and caused some political lobbying at home. But even more feared at the time, at least in the United States, was that GATT rules and procedures might be invoked, which would have openly called into question the good faith of the United States in abiding by internationally agreed obligations of which it had been the main author.[13] This might have been of no consequence to the textile and apparel industry and hardly more to its representatives in Congress concerned with votes in their districts, but it mattered to officials in Washington attuned to the fragile nature of foreign relations.[14]

Intended as a short-term expedient, the initial arrangement formally respected the rules of GATT by sidestepping them. Had it been a transient arrangement, it might have been regarded as no more than a temporary aberration. GATT had not failed to recognize that circumstances could arise in which countries might want to restrict specific imports to give their industries some time to adjust to intensified competition. Article 19, better known as the "safeguard clause," was intended for that purpose. But it was expected to be applied in a nondiscriminatory way. Further, it was intended to deal with the kind of surges in imports that might follow a negotiated reduction in tariffs. It was not intended to arrest the kind of lasting structural change in comparative advantage that was taking place in the world's textile industry. When the arrangements became institutionalized, it was not possible to characterize them as anything but an exercise in power entirely at odds with the spirit of GATT (understood as a set of agreed rules for the conduct of trade).

THE DEVELOPING COUNTRIES AS PETITIONERS

If a reminder was needed, the arrangements governing trade in textiles and apparel made clear once again the unequal nature of economic relations between the developing countries and the industrially more established countries. For a great many developing nations, the balance of advantage in the 1960s continued to remain, as in the 1950s, with nonmembership in GATT. By 1965, thirty-five more developing countries had joined GATT. However, a good number of these were ex-colonial African territories whose accession to GATT was not negotiated but was inherited from the former colonial powers.

Lacking bargaining power individually, developing countries endeavored in the 1960s to articulate a collective policy toward their commercial relations with the industrially more established countries. They gradually formed a worldview of these relations that, as it evolved in the 1970s, increasingly challenged the Western model of free market capitalism. In the 1960s, however, the first collective endeavors of the newly formed Group of Seventy-Seven (as it was known in UN forums) was to call for stronger commodity agreements, more foreign aid, the establishment of UNCTAD as a counterpoint to GATT, and preferential treatment in trade. In their economic assessment of world trade, the Group of Seventy-Seven was strongly influenced by the pessimism of opinion makers in the earlier postwar decades about the long-term export prospects of the primary producing countries—which included nearly all developing countries. Many people gave credence to the theory of Raul Prebisch and others that there was an inherent tendency for the terms of trade of these countries to deteriorate in the long run.[15] Even among those who did not subscribe to this particular argument, the common expectation was that the inability to achieve adequate growth in export earnings would constrain the pace of domestic economic development.

Part of the response to this perceived situation was to place the expansion of domestic import-substituting production at the center of development policy. Another part, articulated through the Group of Seventy-Seven, was to put forward a distinctively different view of the norms and practices that should govern trade relations between the developing countries and the industrially more established countries. At its heart was the idea of no reciprocity, a position that was in direct contradiction to the central operating principle on which trade cooperation among the industrially more established countries had been built. The Group of Seventy-Seven argued that to promote the industrialization and development of their countries, their exports should enjoy preferential treatment in access to the markets of the industrially more established countries, whereas the latter should accept the need of the developing countries to protect their nascent industries. The developing countries thus assumed the role of petitioners. They were hoping that, for foreign policy reasons or out of a sense of human solidarity, the industrially more established countries would set aside the central condition of the trade cooperation that had so far emerged.

Because of the climate of East-West rivalry that prevailed in this period, the industrially more established countries, in their official statements, did not oppose the main thrust of the developing countries' argument. Indeed, they responded positively. As a measure of their formal concurrence, they agreed in 1965 to include in the General Agreement on Tariffs and Trade a part recognizing special and differential treatment for developing countries (Part IV).

On a more practical plane, the industrially more established countries agreed at the second meeting of UNCTAD in 1968 to study the introduction of a generalized system of tariff preferences—called simply the Generalized System of Preferences (GSP)—to apply to developing countries. It was not, of course, a new thing for the industrially more established countries to grant developing countries preferential access to their markets. Preferential arrangements between colonial territories and the metropolitan powers had a long history, and even after the former gained their independence, these arrangements persisted; a notable instance was the Yaoundé Convention signed in the 1960s between the European Economic Community and former colonies. However, these arrangements usually provided for reciprocal preferences and were limited to particular countries. By contrast, the Generalized System of Preferences was nonreciprocal and applied to developing countries in general. The European Economic Community introduced the GSP in 1971, followed by the United States in 1976. The members of GATT granted such schemes a waiver from the nondiscrimination rule for a period of ten years (see Rahman 2001, 196–97).

On the face of it, the 1960s might appear to have been relatively benign in terms of trade policy for the developing countries. But the benefits were uncertain and ambiguous. While the systems of generalized tariff preferences accorded not insignificant benefits, the industrial countries granted tariff reductions on a quite selective basis, subjected these reductions to quotas, and retained the freedom to remove them virtually at will. Moreover, against the preferential system must be weighed the introduction of the discriminatory textile arrangements that were gradually made more restrictive and extended to other products and countries. The broader reality was that the developing countries, lacking bargaining power, were at the mercy of one-sided decisions made by the industrially more established countries in response to foreign policy considerations or internal political pressures. While these decisions had consequences that were by no means always baneful, their arbitrary character deprived trade relations of the stability that is a main benefit of a rules-based system.

7 The Turbulent Decades of the 1970s and 1980s

For multilateral trade cooperation, the 1970s and 1980s were particularly stressful decades. Protectionist sentiment and unilateral action to shelter specific industries from foreign competition have almost always been present on the political landscape of every country. But such sentiment especially gained strength in the industrially more established countries in the late 1970s and early 1980s, and these countries individually took numerous actions to restrict access to their markets for particular goods or services. Indeed, the protectionist upsurge appeared to acquire such force that a growing number of observers expressed deepening fears for the viability of the multilateral trade regime. The nadir of international confidence in the regime perhaps came in November 1982, when GATT convened a ministerial meeting on trade policy. In a meeting reminiscent of the trade conferences held in the 1920s and 1930s, representatives made urgent calls for countries to commit themselves to "standstills" on further protectionist measures.[1] Such a commitment was seen as the best that could be accomplished at the time, though it exercised no more restraint on national policies than it had in the interwar years.

Though the fears were understandable, the regime built up by multilateral trade cooperation survived the stress. There were strong countercurrents at work below the surface, and despite the adverse economic circumstances of the period, the influence of those currents was sufficient to preserve trade cooperation and even to revive the forward momentum of trade liberalization. Though the world economy grew more slowly in the 1970s and 1980s than it had in the preceding two decades, world trade continued to expand more rapidly than world production (the exceptions being solely the two recession years of 1981 and 1982). In the United States, the leading trading nation, exports of goods and services actually rose over the two decades, from about 5 percent of gross domestic product in 1969 to about 10 percent in 1989. The drive behind the search of corporate enterprises for markets and sources of supply was evidently not diminishing. It provided the impetus for the initiation of two more sets of multilateral trade negotiations during these decades, the Tokyo Round, which began in 1973 and was completed in 1979, and the Uruguay Round, which was started in 1986.

THE TOKYO ROUND

Though the worst stresses to trade cooperation were not to become apparent until the later 1970s, the environment at the commencement of the decade was hardly auspicious. The United States was experiencing a recession, and the overvaluation of the dollar not only aggravated the protectionist pressures generated by recession but also impaired the performance of exports. President Nixon responded to the situation with the establishment of the Commission on International Trade and Investment Policy, better known as the Williams Commission. When the commission issued its report in 1971, it spoke of a "crisis of confidence" in the international system of trade and payments.[2]

However, by the time the Tokyo Round was launched in 1973, the U.S. economy was booming, and the overvaluation of the dollar had disappeared as a result of the major currency realignment that followed abandonment of the Bretton Woods exchange rate system.[3] Though the boom was succeeded in 1974 by a lengthy period of worsened economic conditions in all the industrially more established countries (as is described more fully in the next section of this chapter), the Tokyo Round negotiators were nonetheless able to agree on a further, substantial reduction in tariffs. By the time negotiations were completed in 1979, the industrially more established countries had agreed on reductions that brought their average tariff levels on manufactured imports down to less than 5 percent. Most distinguishing the Tokyo Round from its predecessors, however, was the major effort made to tighten the trade rules of GATT. The round was also notable in extending the reach of the principle of national treatment into a new area of domestic policy—namely, government procurement. Both of these departures assumed still greater importance in later advances in trade cooperation in the 1980s and 1990s.

The past success of countries in lowering tariffs (which they then bound themselves not to alter) was the central reason for the new focus on trade rules in the Tokyo Round. As tariff barriers were lowered, traders became increasingly aware that national laws and regulations relating to trade presented numerous other impediments to foreign competition. The more governments negotiated away their power to utilize tariffs for protectionist purposes, the more they were urged to utilize these other measures as alternative means of protection. The Williams Commission, in particular, stressed that American exports were being impeded by foreign nontariff barriers. It accordingly proposed multilateral negotiations to draw up codes of conduct on several practices deemed restrictive of trade.

The belief that other countries were using nontariff barriers to frustrate the effects of tariff reductions was not confined to the United States. The Europeans, among others, took exception to some American practices. The "injury test" that GATT required countries to apply in cases where countervailing duties against subsidized imports were being sought was neglected in the United States. (The affected industry was supposed to be able to demonstrate that it had suffered significant injury as a result of subsidized imports.) The Europeans also wanted to return to issues raised during the Kennedy Round, when the U.S. administration had agreed to new rules relating to antidumping duties and to methods of customs valuation. (As I mentioned in chapter 6, Congress had rejected these changes on the grounds that the administration had exceeded its negotiating authority.)

Some Rules Are Tightened

The agenda for the Tokyo Round gave a large place to the negotiation of codes of conduct on several trade-related practices or procedures. It made most progress in tackling those barriers that had their source in the practices and requirements of national customs and trade administrations: the methods used by customs authorities in valuing imports for the purpose of levying duties, import licensing procedures, and the technical requirements that imports had to meet to satisfy national health or safety standards.[4]

When duty was calculated on an ad valorem basis, the method used in valuing imported merchandise was clearly important in determining the amount of import duty that an importer had to pay. The method varied considerably, so the new code established rules to introduce greater uniformity. The administration of import licensing was another source of dissatisfaction, since customs authorities could apply licenses in ways that others saw as discriminatory. The new code introduced procedures to eliminate this possibility. Another obstacle facing many imported goods was difficulty in meeting the technical requirements laid down by national authorities for major categories of products (e.g., electrical appliances or pharmaceuticals). The technical standards, the methods of testing, and the systems of certification could—intentionally or not—be effective barriers to imports. The new code sought to ensure that the principles of nondiscrimination and national treatment would be respected in the administration of technical regulations, and it encouraged a movement toward the international harmonization of standards and methods.[5]

Less progress was made in strengthening the unfair-trade rules relating to subsidies and dumping; only modest changes were adopted. In fact, whereas the Europeans wanted a more rigorous application of the injury test, the U.S. Congress relaxed the injury requirement through the 1974 Trade Act. There was, moreover, a significant difference of opinion between the United States and Europe on subsidies. The United States complained that European governments provided extensive subsidies to individual industries either directly or through state ownership; the Europeans countered that the huge U.S. public expenditure on the armaments and aerospace industries was, in effect, subsidizing the technological research and development that gave American industry its competitive edge. Different beliefs about the appropriate relationship between the state and private enterprise lay close to the heart of this issue. One side saw subsidies as a legitimate instrument of state-directed industrial policy, while the other side believed that the state should generally allow the market to determine industrial performance.

The failure to make progress on antidumping rules occurred for a more straightforward, political reason. Despite intellectual recognition that a more rigorous and transparent set of rules about antidumping duties was needed to prevent their abuse as a protectionist measure, governments were reluctant to redraft the rules in ways that would restrict their room for maneuver. Precisely the looseness of the rules was politically attractive. Should the demands of industries agitating for protection become politically too burdensome, the loose rules provided governments with a means of placating the industries in a manner consistent with GATT obligations.

Unresolved Issues

For political reasons, even less progress was made in dealing with two protectionist devices that were being resorted to by the industrially more established countries: voluntary export restraints and orderly marketing agreements. These measures lay outside the rules of GATT and were substitutes for action that could be taken under the safeguard clause in GATT. This clause required, however, that import restrictions be applied in a nondiscriminatory way. Primarily for this reason, the industrially more established countries had preferred not to invoke the clause but to resort instead to action outside GATT rules. In the hope of outlawing the use of voluntary export restraints and orderly marketing agreements, an attempt was made during the Tokyo Round to revise the safeguard clause to make it an operational alternative. But the attempt foundered on the fact that most of the industrially more established countries, particularly the EEC, continued to insist on the freedom to apply import restriction in a discriminatory way.

The Tokyo Round failed even more clearly to subject agriculture and textiles—two key sectors of merchandise trade—to GATT disciplines. Both sectors continued to prove highly resistant to open trade policies. President Nixon, like President Kennedy before him, had made promises to the textile industry in his 1972 reelection campaign. The outcome, which had the active support of European governments, was the conversion of the Long-Term Cotton Textile Arrangement into the Multi-Fiber Arrangement.

The United States placed agricultural trade on the agenda of the Tokyo Round. While the United States protected some agricultural products, such as cotton, sugar, and dairy products, it wanted to open up foreign markets for products in which it had a competitive advantage, such as wheat and beef. The EEC, however, was wedded to its Common Agricultural Policy, with its highly protectionist barriers of import quotas and variable levies. For the EEC, the stabilization of rural production and incomes was politically more important than the liberalization of trade. In its view, the best way to manage international markets for agricultural products was the negotiation of market shares through such means as commodity agreements.

Government Procurement: A Limited Extension of National Treatment

A more positive outcome of the Tokyo Round was the code relating to government procurement. The code required governments to abandon the practice of awarding public contracts only to national suppliers. This marked a significant new step in trade cooperation, because it took the trade regime beyond the realm of barriers at the border and into the world of internal policies. It was an extended application of the idea of national treatment, one that was carried much further in the Uruguay Round. But the code was also significant because the industrially more established countries decided that unconditional most-favored-nation treatment should not apply to it. Countries that agreed to sign the code would apply it only to the other countries that had signed it. It was a breach of the principle of nondiscrimination that had been at least formally, if not practically, respected since the founding of GATT.

Recognition of Preferential Treatment for Developing Countries

What the developing countries secured from the Tokyo Round was indicative of the dualism in rules and practices that the multilateral trade regime was acquiring. At UNCTAD conferences in the 1960s, these countries had won acceptance from a number of the industrially more established countries for the proposed Generalized System of Preferences. In the Tokyo Round, the developing countries gained a change in the General Agreement on Tariffs and Trade to provide a legal basis for preferential status under the GSP. It was understood, however, that over time, developing countries should graduate from their preferential status and become subject to the nondiscriminatory rules of GATT.

What Did the Tokyo Round Accomplish?

Did the Tokyo Round significantly advance trade cooperation? Viewed in a long-term context, the answer is surely positive. With the number of countries participating in the negotiations rising to ninety-nine, GATT acquired a more universal character; the industrially more established countries brought their average tariffs to low levels; several rules of conduct were refined or standardized, reducing the scope for arbitrary, unilateral action; and the principle of national treatment was extended to a new area. Perhaps most important was the shift in focus from past negotiations, which had concentrated largely on the negotiation of roughly equivalent reductions in tariff levels. In the Tokyo Round, the new emphasis was on reaching a consensus on common rules; in furthering trade cooperation, countries were no longer insisting on the careful balancing of reciprocal concessions as the sole basis for successful negotiations. On the other side of the balance sheet, however, was the evidence that the industrially more established countries remained unwilling to relinquish more than a modest portion of the considerable freedom they exercised to take unilateral action against specific imports. The completion of the Tokyo Round by itself thus did nothing to arrest the concurrent erosion of confidence in the multilateral regime.

THE UPSURGE IN PROTECTIONIST SENTIMENT AND ACTION

Commentators in the 1970s and 1980s put forward a number of different reasons for the loss of confidence in the trade regime and the upsurge in protectionist sentiment that occurred at the time.[6] Some pointed to the decline in American hegemony that followed from the resurgence in economic strength of Western Europe and Japan; they claimed that with its economic preeminence being challenged, American interest in advancing the open trade regime was diminishing. Others identified a general ideological shift away from the postwar free trade consensus as countries struggled with the loss of dynamism in economic growth and with structural weaknesses.[7] Critics of state intervention argued that the sources of rising protection lay precisely in the reluctance of governments to expose industries to the market forces that would bring about adaptation to changing conditions. They applied this argument particularly to Western Europe, where market rigidities traced to social legislation associated with the welfare state, especially such rigidities in the labor market, were seen as generating resistance to adaptation.

Whatever part such reasons may have played, it is clear that the main cause of the upsurge in protectionist sentiment and action lay in the much worsened general economic circumstances that the industrially more established countries were contending with during a large part of the period. Most significant was the deterioration in the levels of general economic activity. For the first time since the end of the Second World War, these countries simultaneously experienced a serious recession in 1974–75, and their subsequent recovery was marred by slow economic growth, higher levels of unemployment, and rising inflation. After OPEC's second oil price increase in 1979, monetary authorities sharply restricted the money supply as a counterinflationary measure, and in 1981–82, the world economy slid into the most severe of the postwar recessions. These conditions bred protectionist demands by businesses facing contracting markets at home and by workers fearing the spread of unemployment.

Events in the international economy aggravated these conjunctural conditions. When the Bretton Woods monetary system collapsed in 1973, it was replaced by the unfamiliar arrangement of fluctuating exchange rates. While it was believed (as I discussed in chapter 2) that this arrangement would ease external balance-of-payments adjustments, it was certainly not foreseen that exchange rates would become subject to wide swings over periods of several years. The consequence for countries was that, at times, both their exporting and their import-competing industries experienced severe price competition because of exchange rate changes. The U.S. dollar, for example, rose strongly against other currencies in the first half of the 1980s; its value against the yen increased by no less than 60 percent between 1981 and 1985. This gave added force to domestic producers' demands for relief through some measure of protection.[8]

These adverse economic circumstances overlaid the stresses arising from the need of industries to adapt to long-term shifts in global competitive advantage. Such shifts, which are inherent in a growing world economy, took particularly dramatic form in the 1970s and 1980s. At that time, Japan was joined by the newly industrializing countries of Southeast Asia in achieving extraordinarily high rates of economic growth and industrial transformation. Their newfound competitive strength–initially in textiles and clothing; then in heavier industries, such as steel, shipbuilding, and cars; and latterly in the technologically newest industries, such as consumer electronics and semiconductors–confronted industries in the industrially more established countries with fresh demands on their adaptability. That the structural change was quite rapid is suggested by the rise in the share of total merchandise imported into both North America and Western Europe from Japan and the newly industrializing countries of Southeast Asia between the 1960s and the 1980s (see table 4). It is not possible to say how well the countries of North America and Western Europe might have accommodated themselves to the fast-paced emergence of Japan and other East Asian countries as major industrial exporters if the depressed and unstable economic conditions of the period had not occurred. But it is clear that their governments' responses to the actual conditions focused substantially on the industries most affected by these structural changes.

A Spate of Additional Restrictions

Though, as members of GATT, the industrially more established countries had bound themselves not to raise their tariffs unilaterally, they all entered the 1970s with long practice in the use of nontariff, protectionist measures. The bilateral quotas established under the Long-Term Cotton Textile Arrangement, which became the Multi-Fiber Arrangement in 1974, stood as outstanding instances alongside quotas on many agricultural products. Most Western European countries had also continued to make use of quantitative restrictions on imports of a number of products (e.g., cars) since the end of the Second World War. The United States, too, had placed restrictions on particular imports, such as steel and petroleum, at different times and for varying periods.

In the late 1970s and early 1980s, governments opened the floodgates to a spate of additional restrictions on imports as they yielded to demands from individual domestic industries. In particular, numerous voluntary export restraints or orderly marketing agreements were negotiated with exporting countries. Before the early 1970s, only a handful of such arrangements had been known to exist–aside from those covering textiles and apparel. By the mid-1980s, however, the World Bank counted ninety such arrangements (see Grilli 1988, 313). In addition, governments began to make much greater use of their room for discretion in interpreting and enforcing national trade laws. In the EEC, administrative interpretations of customs rules and procedures, such as rules of origin or local content requirements, were used to restrict imports. A notorious instance was the ruling by the French authorities that videocassette recorders could be imported

TABLE 4. Share of Total Merchandise Imports from Japan and Six Asian Traders in North America and Western Europe

	Percent of Total Merchandise Imports				
	1963	1973	1983	1993	1998
Into North America					
Japan	7	11.4	14.2	16.2	11.7
Six Asian Traders[a]	2.4	6.1	10.6	12.7	11.4
Into Western Europe					
Japan	0.9	2.2	3.3	4.5	3.6
Six Asian Traders[a]	1.2	1.5	2.3	4.0	4.2

Source: World Trade Organization 1999, tables II.3 and II.4.

Note: If trade among the members of the European Union is treated as intratrade, the share of trade from the other countries rises dramatically. For example, for 1993, the share becomes 12 percent for Japan and 10 percent for the six Asian traders.

[a]The six Asian traders include Hong Kong, Taiwan, Thailand, South Korea, Singapore, and Malaysia.

into France only through the town of Poitiers, an inland town many miles from the nearest port and with very few customs officers (World Bank 1987, 141). Further, provisions in national trade laws relating to unfair trade—where the criteria determining unfair trade were again a matter of administrative discretion—were extensively employed to deter foreign competition. In the United States, for example, where the International Trade Commission had previously been asked to investigate no more than a trickle of cases alleging that imports were subsidized or being dumped, the number of cases investigated soared to well over six hundred in 1979–85.[9] (While a great many cases were finally dismissed or withdrawn, the official acceptance of formal complaints by domestic firms was sometimes sufficient in itself to discourage foreign competitors, since cash had to be deposited to cover possible penalties that would be imposed on past trade.)

The rise in protectionist sentiment and action was general among the industrially more established countries. Protectionism, at least in sentiment, was probably more strongly expressed in the EEC, which, at the 1982 GATT ministerial meeting, showed more reluctance than others to accept any curtailment of its freedom to exercise administrative discretion or make bilateral arrangements. But the more striking features in the responses of governments in all these countries are the similarities, not the differences. The similarities are all the more striking when we recall that in certain of these countries, the sea change in economic beliefs from faith in state intervention to greater reliance on the private market was first making its appearance. Most date the first signs of this change from somewhere in the late 1970s. David Henderson, for instance, favors 1978 as the watershed year, since the governments of the countries in the Organization for Economic Cooperation and Development (OECD) then agreed to allow the free market to determine oil prices (Henderson 1998, 32). Also around this time, the United States, under the Carter administration, was moving to deregulate the air and road transport industries. In 1979, the British Conservative Party ousted the Labor Party from power, and Margaret Thatcher's government began its program of privatization. In 1980, Ronald Reagan, another convinced free market politician, was elected president in the United States. In 1982, Helmut Kohl, a Christian Democrat, took over from Helmut Schmidt, a Social Democrat, as chancellor in Germany. In France, however, the Socialist Party candidate, François Mitterand, became president in 1981. Despite the underlying shifts in economic ideas and beliefs that were already surfacing in some countries and despite the swings both ways in political leadership, the trade policy responses were everywhere much the same. Governments, whatever their professed ideological positions, responded to the worsened economic conditions with much the same blend of expediency and defensive nationalism.

The Industries That Gained Protection

It is striking that different countries acted in support of much the same industries in the 1970s and 1980s. While there were some industries that gained particular attention in one or the other country (e.g., motorcycles and semiconductors in the United States), the major industries that were successful in winning political support for protection were common. These included textiles and apparel, steel, cars, footwear, and consumer electronics. This similarity reflects the fact that industries in both regions were affected by the same shifts in competitive advantage that were taking place as a consequence of the long-term structural changes occurring in the world economy.

Leaving aside agriculture, which was effectively not part of the GATT regime at the time, the textile and apparel industry and the steel industry were the most resistant to adaptation.[10] In textiles and apparel, the industrially more established countries cooperated in converting the Long-Term Cotton Textile Arrangement into the broader Multi-Fiber Arrangement in 1974. When the arrangement was renewed in 1977, Britain and France were among the most active members of EEC pressing for considerably more stringent terms. For the steel industry in both the United States and Western Europe, a similar pattern of quantitative import restrictions and market management emerged over the years.

Faced with the growth of an efficient steel industry in more recently industrializing countries and with a mature market for steel products at home, the steel industries in the United States and Western Europe experienced recurrent bouts of excess capacity. By the late 1960s, the United States had already negotiated voluntary export restraints with Japan and Western European countries, and the latter had done the same with Japan. In the face of strong steel demand, the United States allowed these restraints to lapse in 1974. But when the steel market again became depressed in 1977, the Carter administration introduced the "trigger price mechanism," and the EEC quickly followed suit with a similar device. (The mechanism established a "fair value" import-reference price. Imports below that price were subject to prompt antidumping investigation.) The Reagan administration scrapped this mechanism in 1982, but as the economy was barely recovering from recession and as the U.S. dollar continued to rise against other currencies, the U.S. steel industry again sought the restoration of quantitative restrictions. As a tactical move, the industry lodged a slew of cases against European producers, alleging unfair trade on grounds of subsidies or dumping. The EEC threatened retaliation. Despite its free market convictions, the U.S. administration was obliged to negotiate voluntary export restrictions with European producers, and the U.S. steel producers thereafter dropped their unfair-trade cases. When the EEC cut its steel imports in 1983 to make room for the output formerly exported to the United States, the U.S. industry complained that Japanese exports formerly directed to Europe were now being diverted to the United States. The upshot in 1984 was a tighter system of quotas, covering most exporting countries and administered by the governments of the industrially more established countries on both sides of the Atlantic.[11] The managed market for steel, like that for textiles and apparel, became a semipermanent feature of international trade policy. It differed, however, from the restriction on trade in textiles and apparel, because it managed trade among the North American and Western European countries as well as trade between these regions and both Japan and the industrializing, developing countries.

This retreat into semipermanent protection was by no means true of all the industries that won some measure of protectionist support at the time. In some industries, adaptation to the underlying change in competitive conditions was taking place through the "internationalization" of production, which gradually sapped protectionist demands. The response of the U.S. car industry, for example, was to intensify its strategy of dispersing its production of car components and car assembly among different countries to take maximum advantage of production cost differentials and market proximity; it also entered into alliances with Japanese manufacturers to benefit from their managerial and technological strengths. (Japanese manufacturers, for their part, set up production in North America and Western Europe to insure against possible future trade restrictions.) In both North America and Western Europe, the outsourcing of production by major manufacturers in the footwear and consumer electronics industries was taking place simultaneously with campaigns by the same industries to win protection for domestic manufacture of the same products. Vincent Cable describes how, in Britain, the divided interests of the consumer electronics industry between companies seeking to preserve the operations of existing plants at home and companies already contracting the production of their brand-name products to manufacturers in Southeast Asia weakened the industry's determination to lobby for protection. As a nice twist, Japanese companies that had set up production in Britain joined with British companies in seeking protection from external competitors. The Japanese access through Britain to other markets in the European Economic Community did not go down well with the latter's consumer electronics firms, some of whom were outsourcing production to competing manufacturers in other Southeast Asian countries (see Cable 1983, 209–13). Thus, economic and commercial forces at work in some industries were causing structural adjustment through the internationalization of production. While protectionist measures may have slowed down the pace of such adjustment, the adjustment eroded the demand for the measures themselves.

A GATT Wounded but Alive

The turbulent economic events of the 1970s and 1980s put an end to the sense of security and predictability that had marked the economic climate of the previous two decades. A heightened mood of commercial uncertainty and social insecurity in the industrially more established countries generated a demand for some form of action to relieve conditions being experienced by businesses and labor, and this demand merged with the ever present nationalist sentiment to channel much of the political response into protectionist trade measures. While governments since the end of the Second World War had made substantial advances in establishing rules for the orderly conduct of trade relations, the less benign economic circumstances that prevailed placed the rules under considerable stress. GATT could not accommodate nationalist political reactions to the domestic effects of serious recessions, slower economic growth, wide swings in exchange rates, or rapid structural changes.

Nevertheless, by comparison with the interwar years, when all these adverse circumstances were also present, multilateral trade cooperation was in much better shape. GATT did not stop the industrially more established countries from taking unilateral protectionist measures. But these countries did so in ways that, at least formally, did not break GATT rules; they resorted to the informal measures of voluntary export restraints or orderly marketing agreements and the use–or, better said, abuse–of national trade legislation consistent with GATT. Moreover, in relations among themselves, these countries–despite often shrill language of mutual accusations, threats, and counterthreats–were circumspect in introducing new, protectionist measures directed against the export of manufactures to each other. With the major exception of the steel industry, they did not attempt to negotiate quota-type restrictions with each other, and the number of unfair-trade cases that actually resulted in protectionist measures was quite modest. In relations among these core countries, GATT rules continued to be largely observed, both formally and in spirit.

In trade relations with Japan, the newly industrializing countries of Southeast Asia, and the other industrializing countries of Asia and Latin America, both the quota-type restrictions and the national unfair-trade legislation were more frequently employed. It is obvious that by comparison with the bargaining power that the EEC and the United States exercised in their relations with each other, the position of these other countries relative to either the EEC or the United States was weak. From the earliest days of textile restrictions in the late 1950s, Japan had become familiar with the negotiation of voluntary export restraints or orderly marketing agreements. These were applied to the steel industry in the 1960s. With its military dependence on the United States and its limited imports relative to its exports in its trade with the EEC and the United States, Japan was in a weak position to retaliate against discriminatory action. In the later 1970s and early 1980s, as I have already noted, the use of voluntary export restraints spread to other industries and to other rapidly industrializing countries in Southeast Asia. Particularly in the trade in steel, other developing countries elsewhere were also drawn into the net. Protectionist measures under unfair-trade legislation likewise fell disproportionately on the developing countries. In the United States, for example, more than one-third of the cases investigated under the legislation dealing with subsidies or dumping between 1979 and 1985 were directed against exports of manufactures from developing countries (see Destler 1986, 246–341). This number far exceeded their share of total manufactured imports into the United States.

Thus, the weaknesses of the multilateral trade regime revealed by the events of the 1970s and 1980s were twofold. First, the rules of the regime were not proof against nationalist, protectionist action in times of general economic difficulty. Second, the rules presumed a greater willingness than actually existed on the part of the industrially more established countries to make adjustments that would readily make room in international trade for the fast-growing, newly industrializing countries. That the rules were evaded or abused did not, however, undermine the regime, because the countries most sinned against were individually in a weak bargaining position. These countries had to accept the arbitrary behavior of their main trading partners. It was not a condition of their trading relations that their trading partners would behave in the predictable and orderly way promised in the rules.

THE AMERICAN ADOPTION OF AN "AGGRESSIVE" TRADE POLICY

Because the United States was the leading economic power in the 1970s and 1980s, the U.S. response to rising protectionist and nationalist sentiment was particularly important for multilateral trade cooperation at that time. Reflecting domestic political cross-currents, the U.S. response was complex. Besides yielding, often reluctantly, to demands for protection from import competition, U.S. administrations took other, distinctly different and even contradictory lines of action. Mainly to gain greater access to foreign markets, but partly also as a counteroffensive against the protectionist drift, the United States initiated two further rounds of multilateral trade negotiations, the Tokyo Round and the Uruguay Round. The former has just been discussed, and the latter is the subject of chapter 9. It is enough to say here that they helped to rally commercial interests engaged in foreign trade to the cause of resisting a retreat from an open trade policy. At the same time, however, the U.S. Congress developed another course of action, which it pressed on successive administrations to follow: a set of measures that sought to penalize other countries that were engaging in practices that “unreasonably” or “unjustifiably” harmed American trade. These countries were to cease the harmful practices or be penalized for failure to do so.[12]

The U.S. Congress first embodied this approach in Section 301 of the 1974 Trade Act. Congress gave the president power to penalize other countries that were deemed to be engaging in unfair trade practices; these practices included not only subsidies and dumping, which were already covered by other sections of the Trade Act, but also other practices, such as those arising out of government procurement, restrictive business practices, or the administration of exchange and import controls. In the Trade Agreement Act of 1979, the procedures under Section 301 were tightened. Never satisfied that successive administrations were applying the provisions of Section 301 forcefully enough, Congress went further in the Omnibus Trade and Competitiveness Act of 1988. It added provisions, known as “super” 301, that required the president to identify a priority list of unfair trade practices allegedly used in particular countries that would have to be eliminated within a specified time period on pain of retaliatory action. It also included a new provision specifying that the failure of a trading partner to recognize the intellectual property rights of a U.S. corporation or citizen was to be regarded as an unfair trade practice.

To some degree, the congressional action was an understandable expression of irritation with the trade conduct of some other countries. There is no question that, like the United States, other countries were often remiss in living up to the trade concessions and supporting rules that they had agreed to in past negotiations. There is no doubt, too, that the procedures established in GATT for dispute settlement and enforcement of obligations were weak and often ineffective; countries could with impunity easily delay or even ignore rulings made in GATT. Congress could be seen as legitimately expressing its frustration with the inadequate means of enforcement of GATT rules. Section 301 was, in fact, carefully drafted to be consistent with U.S. obligations under GATT. Other countries could not claim that the United States was legally overreaching itself. Section 301 required that the administration respect the procedures of GATT in any dispute with another country. It could technically be argued that the United States was just asking other countries to abide by their GATT obligations; the other countries had nothing to fear if they behaved correctly.

However, this is too legalistic a view. Other countries resented the evident attempt to bring pressure on them through procedures established in the U.S. Congress. Though nominally supplementing GATT procedures, the acts set up the United States as both prosecutor and judge of other countries concerning any infractions of GATT rules. These acts singled out individual countries for particular political and diplomatic attention by the United States, and they accordingly invested trade disputes with a broader political significance. It was, moreover, a one-sided process, since infractions by the United States were obviously not to be included. This appeared as an incipient reversion by the leading trading nation to the unilateral use of power for advancing its own interest. This expression of unilateralism made Section 301 a threat to multilateral trade cooperation.

This shift in trade policy was not chosen deliberately by U.S. administrations. Successive administrations have sought to deflect Congress from demanding action to protect import-competing industries, by channeling its trade legislation into market-opening measures; such legislation was ostensibly less damaging to trade cooperation. Moreover, in executing the trade laws, the successive administrations have generally been more circumspect than Congress would have wanted them to be. Though U.S. trade representatives have generally adopted an aggressive stance in their public utterances about the trade policies of other countries, they have been more restrained in their actions.

In practice, the United States has made numerous allegations of unfair trade practices by other countries under these laws, and it has sought to have the practices suspended or altered. In a number of the cases raised since the mid-1970s, the United States succeeded in obtaining some accommodating change from its trading partner, thus improving market access for the exports of specific industries or corporations. From a national point of view, however, the quantitative gains in trade appear to have been quite modest. They pale almost into insignificance when compared with the gains won through multilateral trade negotiations.[13]

U.S. administrations in the 1970s and 1980s thus walked a tightrope between congressional demands that they act unilaterally and aggressively and the knowledge that such action attacked the foundations of multilateral trade cooperation. The U.S. Congress, for its part, felt much less constrained by the treaty obligations entered into by past or current administrations. In other words, it was less sensitive to the reciprocal nature of trade relations with other countries. In its deliberations, the center of gravity moved much closer to the states and electoral districts from which its members came; this was especially true in the House of Representatives where, as Tip O'Neill, a former Speaker of the House, so succinctly said, " all politics is local" (O'Neill 1994).

The more assertive stance of Congress in the 1970s and 1980s was facilitated by the success of reforms within the legislative body that were quite unrelated to trade. I. M. Destler has described how a new generation of politicians in Congress in the 1970s successfully challenged the concentration of power and the secretive backroom politics of the old committee system; but in successfully decentralizing power and making procedures more open, they also made individual legislators more vulnerable to pressures from their constituents for protectionist measures (Destler 1986, 59–62). Senator John Danforth observed in 1983, "The small number of experienced Washington players in the executive branch and on the Hill who once dominated U.S. trade policy have been faced with growing pressure from forces less knowledgeable or less convinced by our traditional open trade philosophy" (Danforth 1983, 46). This pressure was another manifestation of the tension that always exists between nationalist sentiment and the necessary constraints placed on it by a functioning and mutually advantageous regime of trade cooperation.

RELATIONS BETWEEN THE UNITED STATES AND JAPAN

The trade tensions that arose in the 1970s and 1980s found their most acute expression in relations between the United States and Japan. American dissatisfaction with these relations gave rise to a voluminous flow of speeches, articles, and books in which national sentiment often won the battle over dispassionate analysis. Underlying sources of the explosion of dissatisfaction lay in general economic circumstances discussed earlier in this chapter—poor performance of domestic output and employment, exchange rate swings, and problems of structural adaptation. But the particular focus on Japan had additional, more specific reasons. Many American multinational corporations felt frustration from having failed to gain a share of the large and lucrative Japanese market. It was a high-income market that was second in size only to the United States, but despite some notable exceptions, major industries (e.g., the automotive industry) had succeeded neither in penetrating the market with their exports nor in establishing subsidiaries there. Further, in some technologically new industries, such as the semiconductor industry, which American companies had been the first to develop commercially, Japanese manufacturers appeared to be taking the lead internationally. The belief was that their success depended, in no small part, on Japanese industrial policy. It was alleged that they enjoyed a sheltered market at home that not only enabled them to establish themselves in the first place but also allowed them to pursue a dual pricing system at home and abroad. Finally, the United States began to run a huge trade deficit in the early 1980s, whereas Japan recorded a surplus of roughly comparable magnitude. This only confirmed many people in their belief that while the United States pursued an open trade policy, Japan did not.[14] In the political mood of the time, successive U.S. administrations felt compelled to enter into a series of negotiations with Japanese governments, intended to improve access to the latter's markets.

The historical background to Japanese-American trade relations is of some importance in explaining these developments. In its years of remarkable recovery and growth from the 1950s to the 1980s, Japan pursued a pattern of growth that was strongly export oriented, and it directed a substantial part of its exports to the United States. American manufactures were faced with a competitor that was technologically advanced and whose firms appeared to be superior in their production and management methods. The Japanese impact on some U.S. markets was dramatic. Japanese cars, for instance, increased their share of the U.S. market from 4 percent in 1970 to 21 percent in 1980, and if sales of cars manufactured in plants opened up in the United States are included, the share rose to 30 percent in 1989.

The behavior of Japanese imports of manufactures was, however, quite different. Being poor in natural resources, Japan was a large importer of raw materials, fuel, and some foodstuffs; manufactures accordingly did not dominate imports as they did exports. Moreover, the intra-industry pattern of trade that has characterized relations among the other industrialized countries appeared weak in the case of Japan; the exchange of highly specialized and differentiated products from within the same industry occurred less. While this may have reflected differences in Japan's industrial structure, it was taken as further circumstantial evidence supporting the view that there were barriers impeding imports of manufactures into Japan.

These circumstances laid Japan open to the charge that it was pursuing mercantilist policies–taking advantage of open markets abroad for its exports, but restricting access for imports into its own markets. In the 1970s and earlier, the blame for the inability to gain access to the Japanese market was laid mainly at the door of familiar trade barriers, initially tariffs and import restrictions, latterly customs rules and administration. But Japan had participated fully in the multilateral negotiations held under GATT, and as its tariffs were reduced to minimal levels and its customs practices were brought into conformity with strengthened GATT rules, the diagnosis shifted. Opinion in the United States then came to see the barriers to trade as arising not at ports of entry but from within the domestic economy. They were viewed as being generated by a range of governmental and business practices that regulated the conduct of commercial affairs in Japan. These were identified in many different specific forms and were asserted to impede market access for foreign enterprises both through the sale of imported goods or services and through the establishment of subsidiaries. They ran the gamut from government licensing arrangements or administrative guidance to manufacturers' control over distribution channels or cross shareholding among enterprises.[15]

These internal obstacles to trade and investment lay outside the purview of GATT, and the response of U.S. administrations was to initiate bilateral negotiations directly with Japan. The Market-Oriented Sector-Specific (MOSS) negotiations of 1985–86 were the first in a series of attempts to reach agreement on the removal of impediments to competition in particular sectors.[16] The Semi-Conductor Trade Agreement of 1986 was a similar attempt to gain for American producers greater access to a specific sector. Such sector-specific negotiations explored possible impediments at a level of great detail and were necessarily tortuously slow. They were investigating long-standing governmental and business practices that were, for the most part, rooted in the market structure and institutional conditions within which Japanese business was conducted, and while structural relations and institutional conditions can change, they generally change only slowly and in response to internally generated pressures.

In a further attempt to alleviate trade tensions between Japan and the United States, the Structural Impediment Initiative was launched in 1989–90. This initiative addressed macroeconomic conditions in both countries, and it countered the popular view that Japanese mercantilism was clearly proven by the huge trade deficit that the United States ran mostly with Japan and by the equally large trade surplus that Japan ran mostly with the United States. Though it seemed intuitively correct to many, the trade imbalances had nothing to do with any differences between the United States and Japan in the degree of openness of their economies. Japan's surpluses reflected the persistent tendency for domestic saving to exceed domestic investment, leaving a balance to be invested abroad. (In other words, to absorb the earnings from exports of goods and services, Japan purchased foreign assets as well as imports of goods and services.) Conversely, the United States found domestic saving insufficient to finance domestic investment and borrowed from abroad, and this capital inflow financed the deficit in the trade balance. The solution to the trade imbalances lay in macroeconomic policies, not in trade measures. It was hoped that if the imbalances could be reduced, some of the heat might be taken out of the American resentment stirred up by the persistent trade deficit with Japan. The Structural Impediment Initiative also had the advantage that it had an air of reciprocity about it: Japan was to encourage higher levels of domestic consumption (and so raise imports and reduce saving), and the United States was to reduce its chronic budget deficits (and so raise savings and reduce its trade deficit). In 1993, yet another endeavor was launched in the Framework for a New Economic Partnership, which was something of a hybrid arrangement containing joint macroeconomic aims as well as sectoral and structural programs.

These bilateral negotiations were viewed by other countries as a possible threat to multilateral trade cooperation. Despite reassurances by the United States that any concessions made by Japan would be extended on a most-favored-nation basis, the EEC feared that the United States might gain preferential treatment for particular goods or services. Thus, in resisting U.S. pressures, Japan had silent allies in other trading partners of the United States. The larger concern, however, was that the bilateral negotiations appeared to signal a loss of confidence by the leading trading nation in the effectiveness of the multilateral trade regime.

In sum, the three key elements in U.S.-Japanese trade relations in the 1970s and 1980s were the success of Japanese manufacturers in the American market, the difficulty experienced by major American manufacturers in penetrating the Japanese market, and the huge U.S. trade deficit with Japan. Together, these elements created what appeared to be a lack of reciprocity. But since perceived reciprocity is the political condition of trade cooperation, in its absence, American manufacturers were able to win substantial political support for unilateral action against Japan.

The actual commercial benefit derived from the market-opening measures wrested from Japan by such action appears to have been quite limited. After reviewing agreements reached between 1980 and 1995, Theresa Greaney found that their effects on actual trade flows were generally modest and that where the effect was significantly positive, as in autos or semiconductors, it was sometimes so at the cost of trade diversion.[17] Individual manufacturing firms doubtless benefited substantially, but the gain in foreign trade for the nation as a whole was slight and was diminished by the cost of unilateral action in lessening the general trust in multilaterally agreed rules of conduct.

In the latter part of the 1990s, U.S.-Japanese trade relations receded from center stage in Washington, D.C. Certainly, the United States and Japan had trade disputes, which one or the other took to the WTO Dispute Settlement Body; certainly, the United States continued to press for more market-opening measures, negotiating agreements that set out monitoring and enforcement arrangements for changes in Japanese laws, regulations, and practices.[18] But in these years when American industry had entered a period of exceptional economic growth and prosperity while that of Japan languished, the political concern with the perceived lack of reciprocity fell away, even though the U.S. trade deficit did not diminish.[19]

8 The Developing Countries

Changing Attitudes toward Trade Policy

From the 1970s onward, a great many of the developing countries revised their attitudes toward trade policy, altering the nature of their participation in multilateral trade cooperation. What lay behind this change was a more pervasive shift in general economic policies. Governments began to place greater reliance on private markets and to move away from direct state management of economic activity.[1] As part of this shift, reforms in trade policy were widespread in the 1980s and 1990s. Many countries both substituted tariffs for quantitative import restrictions and unilaterally reduced their tariffs. They also relaxed restrictions on the inflow of foreign capital for direct investment.

For developing countries in general, a consequence of the shift in trade policy was their heightened interest in the operation of the multilateral trade regime. It was symptomatic of the change that the solidarity the developing countries (the Group of Seventy-Seven) had shown in United Nations forums in the 1970s in their call for the New International Economic Order quietly evaporated in the early 1980s. Intergovernmental arrangements for the management of international trade were no longer the preferred solution. As I will discuss in chapter 9, the developing countries initially expressed opposition to the launching of the Uruguay Round in 1986, but once it was underway, many developing countries soon assumed a very active role in the negotiations. Moreover, numerous countries previously not willing to become members of GATT now sought to accede to the agreement.

All this indicated a growing recognition among governments of the value that greater integration into the world market system held for their own economies. It would, however, be a gross error to see it as an ideological victory for the free trade doctrine. Most countries were far from adopting free trade as their goal. Tariffs had formerly often been at very high levels, and the use of nontariff barriers at the border, most notably import licensing, had been widespread; reducing tariff and nontariff barriers, even substantially, by no means meant abandoning protectionist practices. Moreover, most countries, though lowering their trade barriers, retained numerous internal laws, regulations, and administrative practices that allowed them to differentiate between domestic and foreign producers or investors. Trade policies were no longer so inward-looking, but they were generally cautious in their embrace of more open markets.

REASONS FOR THE SHIFT IN POLICIES

When we look for the reasons behind the shift toward more open trade policies, we are forcefully reminded how closely these policies are integrated with broader economic policies. A weakness of the specialization that exists among commentators and researchers is that trade policy is often discussed as an issue that is to be decided on its own merits. The truth is, however, that its main contours and general direction emerge from broader decisions about economic policy as a whole.

This fact makes it easier to understand why the shift in trade policies, though varying among countries in timing and extent, occurred so widely. Most developing countries–and certainly all the semi-industrialized countries–experienced a similar change toward more market-oriented policies within the same ten to fifteen years. The common characteristics were twofold. First, the shift was preceded by a generation or two of slowly accumulating dissatisfaction with existing state-oriented policies, mainly because the unintended consequences of these policies were proving increasingly unacceptable. Second, the shift was almost everywhere precipitated by a crisis–brought on by external or internal events–that caused a sharp deterioration in economic conditions and opened the way for drastic policy revision.

The Origins of State-Directed Policies

It helps to recall that in the years before the 1970s, a familiar characteristic of economic policy almost everywhere–in the industrially more established countries as well as in the developing world—was that a significant role was assigned to government in directing or regulating economic activity. This was true no matter whether governments leaned toward the right or the left in their ideologies. It was partly a reaction to the disastrous experience of the 1930s, which was widely interpreted to have had its roots in the failure of unregulated market capitalism. The skill with which the Western governments marshaled their economies to fight the Second World War and managed the transition to peacetime production only reinforced the belief in the effectiveness of state management.

These experiences were shared by the developing countries. During the 1930s, the slump in primary commodity markets and the collapse of capital markets left most members of political circles with a deep mistrust of the international market economy and a desire to seek to insulate their countries from it. It strengthened the conviction of such socialist leaders as Pandit Nehru of India or, later, Julius Nyerere of Tanzania that they had to find a third way for their societies that was neither capitalist nor communist.

But the earlier postwar policies of developing countries were not only a response to recent economic history. Also motivating their leaders and elites was a new spirit of nationalism, not only in the countries that had gained their independence after the Second World War, but also in the older, independent nations of Latin America and elsewhere. It became a matter of national self-respect for such countries to assert their economic, as well as their political, sovereignty. Almost everywhere, governments insisted on full command over their own natural resources; they nationalized foreign-owned industries, such as banking, utilities, or mines; and they established new manufacturing industries owned by the state or by private nationals. The political classes in developing countries not only wanted to see the modernization of their economies and the lessening of their galling state of dependence on the Western industrial countries; they also wanted their own nationals to be both the agents and the beneficiaries of the modernization. For some, the way forward was through central planning and the establishment of state-owned enterprises to spearhead the modernization of their economies; the private sector and foreign capital were, at best, reluctantly tolerated. For others, state direction was more a mix of state-owned enterprises and an array of policy measures designed specifically to support new, nationally owned private enterprises. Almost everywhere, inward-looking trade polices that gave protection to national enterprises and did little to enhance trade links with other countries were seen as an integral part of these strategies. Though the nationalist pride that infused these strategies was often carried to excess or was abused to favor politically influential cliques, it is doubtful that the spread of industrialization around the globe would have taken place as rapidly in its absence.

The Movement toward More Market-Oriented Policies

By the 1970s and 1980s, however, circumstances were substantially different. For one thing, cumulative economic and social changes were becoming apparent. The transformation from peasant or semisubsistence societies to commercial, urbanized economies had begun in a few countries before the Second World War, but it gathered momentum throughout Asia and Latin America in the latter half of the twentieth century (see table 5). The industrializa-

TABLE 5. Urban Population as Percentage of Total Population, Selected Developing Countries, 1965 and 1995

	Percent of Total Population	
Country	1965	1995
Brazil	50	76
Chile	72	85
China	18	26
Colombia	52	71
Egypt	41	44
India	19	28
Iran	39	58
Korea, Republic of	34	76
Mexico	54	74

Source: United Nations 1980, 1997.

Note: The definitions of urban population vary according to national censuses. In some cases, the years on record differ slightly from the years shown here; for example, for Brazil, the data shown under 1995 are for 1991.

tion that had been going on for several decades changed a number of developing countries into semi-industrialized economies by the early 1980s. With the economic change emerged increasingly influential social groups of businessmen and middle-class professionals. Moreover, a new generation, with a different experience behind it, was taking the place of the earlier postwar leaders and opinion makers. This shift was exemplified, for example, in changing attitudes toward foreign direct investment, where extreme nationalist sensitivities were gradually moderated by greater pragmatism.

It is of immediate relevance for trade policy, too, that industrialization was altering the pattern of comparative advantage within countries, whether or not they pursued inward-looking policies. Not a few countries had left behind the days when they were very largely producers and exporters of primary products. As I noted in chapter 1, the share of manufactures in total exports rose for a great many developing countries between 1965 and 1985; in some countries, the proportion had become substantial, amounting to 30 percent or more (see table 3, in chap. 1). It would certainly not be true to say that this was invariably a spin-off from domestic industrialization. For many of the smaller countries, the rising exports largely reflected their success in attracting foreign capital to take advantage of their low wage costs and to manufacture for export. But for larger countries, rising exports of manufactures were also an outgrowth of a diversified industrial base primarily rooted in the domestic market.

Accompanying the decades of industrialization was an accumulating skepticism in many countries about the capacity of government to oversee effectively the current activities and the investment decisions of productive enterprises, whether publicly or privately owned. Particularly in countries that relied on extensive and detailed licensing and controls, the burden on governments in managing the many markets for goods and services proved increasingly onerous as the economies became more complex. Inefficiencies and inequities multiplied, as did the opportunities for evasion or corruption. Moreover, since state licensing protected established private enterprises from competition, the incentive to improve efficiency through cost reductions—

or, still more important, through innovations—was dampened. State-owned enterprises, in particular, revealed major flaws inherent in their close ties to the political authorities. The management of their operations and their investment decisions were almost inescapably subject to political interference, and they were accordingly prone to disregard commercial discipline in the conduct of their business. Managements lacked the incentive to improve efficiency, since it was more rewarding to cultivate political allies in government. If the enterprises ran losses, as they often did, they received support from public revenue. They were consequently often a major reason for the chronic budget deficits of central government.

Such sources of dissatisfaction found champions in the growing school of economists—identified as liberal economists in Europe and as neoclassicists in North America—who presented a powerful critique of the limitations of state intervention. In the industrially more established countries, they found sympathetic ears in new governments, such as those of President Reagan and Prime Minister Thatcher. In the world of development policies, there was a comparable, if more gradual and diffuse, reassessment of the effectiveness of past state-oriented policies.[2] There was, moreover, the experience of South Korea and Taiwan that was widely quoted as evidence that faster economic growth and more open trade polices were interrelated. (This experience is discussed more fully later in this chapter.) Finally, though it occurred long after the skepticism had gained momentum, the abandonment of central state planning by the former Soviet Union and other Eastern European countries was a late confirmation that extensive state ownership and control could become a large obstacle to economic growth.

THE TIMING OF THE SHIFT

Dissatisfaction with existing policies alone does not explain the timing or the extent of the shift in policies in individual countries. Some sort of crisis—usually in the form of deteriorating economic conditions—was needed to evoke a strong response from political leaders. Sometimes, the politicians' response was not reform at all; it was a further tightening or extension of existing policies. But in the climate of growing skepticism about past state policies, political leaders in many countries had both the opportunity and the incentive (or at least the legitimizing rationale) to break with past policies and set out in new directions. External pressures also played a significant role in bringing about the change. Faced with balance-of-payments crises, numerous countries had to negotiate emergency loans from the International Monetary Fund (IMF), the World Bank, and other official sources; they found themselves under heavy pressure not only to adopt orthodox stabilization measures but also to agree to programs of market-oriented reforms, including more open trade policies. However, while the power of the external agencies was considerable, the primary condition of sustained reforms was the changing internal climate of political opinion that made them acceptable.

Dramatic Change in Some Latin American Countries

More often than not, the precipitating crisis had its origin in external economic relations. But it was sometimes of a purely domestic character. Chile was among the first and the most radical in its reforms, which occurred after General Pinochet overthrew the Allende government in 1973 and established an authoritarian regime. For most Latin American governments, however, reform came in the aftermath of the commercial debt crisis that broke in the early 1980s.

In Mexico, policy reforms took place in response to a complex of forces–long-term structural changes in the economy affecting the balance of political interests, changing ideas about the role of the state, and the trigger of an economic crisis. The policy shift had its origins both in the debt crisis of 1982 and in a growing business and middle class dissatisfied with state policies. (Among the dissatisfied were the owners of private export-oriented businesses that had been strengthened both by devaluations and by the establishment of duty-free zones–the maquiladora–along the U.S. border.) During the presidency of Hurtado de la Madrid from 1982 to 1988, the dissatisfied found an outlet in a new, right-wing party that was a breakaway for the Partido Revolucionario Institucional (PRI), the party that had governed Mexico since its revolution. At the same time, the Hurtado administration, partly as a result of its pursuit of orthodox stabilization policies, had lost popular support among wage earners, and another breakaway group formed a leftist party. The PRI, which had both working links with private enterprise and populist roots in labor and the peasantry, was forced to make a choice between these wings, and it moved toward support for business.

Some steps were taken toward a more market-oriented approach. A number of state enterprises were privatized. In trade policy, import licensing was replaced by a system of general tariffs, and in 1986, Mexico, deciding to give up its long-standing freedom to set trade barriers as it saw fit, submitted an application for accession to GATT. It thus accepted that its trade policy would thereafter be constrained by international norms and rules.

When President Salinas, a Harvard-trained economist, took office in Mexico in 1988, he continued the reform of policies along more market-oriented lines. Moreover, Mexico actively set about cementing its new economic strategy by forging very close trade and financial ties with the United States and Canada. It did so by stating its desire to join with these countries in the North American Free Trade Agreement (NAFTA). The shift in trade policy was evidently only one component–albeit a major one–in a larger political and economic strategy to enhance the confidence of the business community, to encourage foreign investment, and to rely more heavily on private enterprise for future growth.

In Argentina, it took more than the debt crisis to create the political conditions that brought about a shift in the direction of policy. More than once since the early 1970s, Argentina had attempted trade reforms but had reversed its reforms when economic conditions deteriorated. In the years succeeding the debt crisis, the country was overwhelmed by bouts of severe inflation in conditions of economic stagnation. Following the election in 1988 of President Menem, who drew his support from the labor-oriented Justicialista Party, capital flight caused the exchange rate to plummet, and inflation reached a new pitch. By early 1990, prices were rising at an annual rate of more than 20,000 percent. Faced with a traumatic threat to social cohesion, the president appointed a new economics minister, Domingo Cavallo (another

Harvard-trained economist). To stabilize the currency, the government established a currency board, fixing the value of the peso in dollars and allowing the central bank to create money only against gold or foreign exchange. This was accompanied by other stabilization measures and by a radical program of privatization of state enterprises, extensive deregulation, and trade reforms. Such a radical program proved politically feasible only because it was preceded by years of economic decline, by growing popular despair over an ever more bloated and inefficient state sector, and by an encounter with hyperinflation. Similarly, in Brazil, years of recurrent inflationary bouts culminated in hyperinflation and a radical monetary reform to stabilize the currency. But Brazil's market-oriented and trade reforms were more modulated.

More Restrained Reforms in India and Elsewhere

India was another country where many people expressed dissatisfaction with state-oriented management of the economy for many years but had little effect on policy. Since its independence in 1947, India had pursued the modernization and industrialization of its economy through an extensive system of state management and planning that tightly controlled the activities, especially the investment, of the private sector. As part of this system, tariffs were kept high, import licensing was severe, and foreign direct investment was restricted. Some tentative steps were taken toward liberalization in 1977 after the Janata Party defeated the long-ruling Congress Party, and further steps were taken in the 1980s. But it was not until 1991 that a major shift in direction first took place. Again, the occasion was a sharply deteriorating economic situation that demanded a strong policy response. In the 1980s, political competition had driven state spending up sharply, fiscal deficits had grown, and the trade deficit had widened. When the Persian Gulf War caused oil prices to escalate, India came close to defaulting on its external debt. The new reformist government of Narasimha Rao came to power in 1991, and an IMF-backed stabilization program was linked with major reforms in the management of the economy. Numerous regulations that controlled economic activity in the private sector were swept away, and market incentives were given freer play in determining business decisions. As part of these reforms, import licensing was sharply curtailed, tariffs were reduced, and sectors previously closed to foreign investment were opened up (see Haggard 1995, 106). Further, though cautious, reforms took place in the course of the 1990s.

In numerous countries, the shift in direction, though real, was restrained. Countries with long social democratic traditions, such as Costa Rica and Uruguay, exhibited less dissatisfaction with past policies than some of their larger neighbors, and their reforms were accordingly less dramatic. In other countries, major segments of the established business community put up strong resistance to trade liberalization. In the Philippines, which also suffered badly from the aftermath of the debt crisis in the early 1980s, liberalization measures introduced by the government of President Aquino received general support; they struck at the Marcos regime's highly selective and egregious use of state powers to favor family and friends. However, the business community did not want to dispense with state support and protection, so the economic liberalization moved forward very slowly.

The Special Case of Sub-Saharan Africa

Trade reforms were also widely introduced in African countries in the 1980s and 1990s. But in the countries south of the Sahara, the motivation did not stem from dissatisfaction with excessive state management of industrialization. The subregion includes many low-income countries whose economies were still moving out of a precapitalist phase and whose commercial sectors were predominantly engaged in primary production. Severe economic difficulties in the 1980s compelled many of these countries to seek emergency assistance from the IMF, the World Bank, and other official agencies, and the countries effected market-oriented reforms largely in response to pressures from these bodies. Through these reforms, tariffs and other barriers to imports were widely reduced. In the case of these countries, however, the argument that greater openness would enhance the competitive efficiency of domestic industry and promote industrial exports did not apply, since the countries lacked the established manufacturing sectors. In fact, without a comparable depreciation of exchange rates, imports rose strongly, and in quite a number of countries, the share of manufacturing in total domestic production declined.

THE MIX OF OUTWARD ORIENTATION AND PROTECTION

In their unilateral trade reforms, most developing countries moved toward a more outward-oriented stance.[3] It was a stance similar to that long pursued by the group of East Asian countries known as the "Four Tigers"–South Korea, Taiwan, Hong Kong, and Singapore–which, at least until the 1997 financial crisis, had achieved remarkably high rates of economic and export growth.

South Korea and Taiwan, in particular, have been famous for the dramatic growth in their exports of manufactures since the 1960s.[4] This growth was the consequence of deliberate policy choices made around the early 1960s, when both countries faced the combination of acute trade deficits and the cessation of foreign aid to finance them. At that time, both decided to follow the example of their more advanced neighbor, Japan, and pursue a strategy of export-oriented, industrial growth. Relying mainly on private enterprise (but not on foreign direct investment), they accomplished their aim through industrial policies that did not entail detailed planning and control but were nonetheless strongly interventionist. As part of these polices, care was taken to ensure that production was oriented toward exports. This meant that when all the measures available to government were taken together–tariffs, subsidies, the exchange rate, fiscal and credit policies–their net effect on the system of incentives facing private enterprise was to favor exports. Several other East Asian countries (e.g., Malaysia, Thailand, and Indonesia) set foot on the same path in later years, though they differed in the particular ways in which their governments influenced the business communities.

The export orientation of policies did not mean that these countries eschewed trade protection as an instrument in the promotion of their industrialization. South Korea and Taiwan actively pursued industrial strategies to foster the development of new industries. Like Japan, these countries had decided that industries with a comparative advantage in international trade should not simply be allowed to emerge from the existing pattern of production and costs; that would have condemned them to specialize in labor-intensive, low-technology products. The policy was to create a comparative advantage in higher-value industries by encouraging the establishment and growth of new industries that would move the country up the technological scale. Since the two countries differed considerably in their forms of industrial organization—with large-scale *chaebols* (conglomerates) dominating industry in South Korea and with small-scale and medium-sized firms being the pattern in Taiwan—their particular ways of carrying out their industrial policies were often dissimilar. But for both countries, the protection of new industries was one important instrument for realizing their aim.

In South Korea and Taiwan, protection was practiced within the context of an export-oriented strategy, with a sensitivity to the effects of protection on domestic costs—a sensitivity not evident in countries pursuing more inward-looking policies. The costs of industries that might supply inputs to the export sector had to be internationally competitive. Protection was thus granted to industries on a conditional basis; the new industries were expected to bring down their costs to international levels within a reasonable period of time. Thus, over the long term, protection went hand in hand with export promotion in fulfilling the policy of sustained, export-oriented economic growth.

The trade policies of South Korea and Taiwan underwent significant reforms in the 1980s and 1990s. To some degree, the pressure for reform came from within; as the export sector had grown, so had the ties of many enterprises and individuals to a prosperous foreign trade, and they became advocates for a more liberal trade policy. Another reason for reform in these countries was quite different from the experience of most other developing countries. It sprang from the success that South Korea and Taiwan had in the 1970s and 1980s in expanding their exports to the industrially more established countries. This success had evoked, on numerous occasions, a protectionist response from the industrially more established countries. Action was repeatedly taken to restrict imports of specific manufactures through the negotiation of voluntary export restraints or by other means. In the 1980s, when U.S. trade policy shifted in emphasis from the imposition of unilateral import restrictions to gaining greater access to the markets of other countries, South Korea and Taiwan came under a new kind of pressure, namely, to ease access to their domestic markets. Threatened with action under Section 301 of the U.S. trade law, Taiwan made tariff cuts in the late 1980s. More protectionist, South Korea initiated a five-year program of reductions in trade barriers in 1984, followed by a second five-year program. By 1994, South Korea's average tariff rate was down to below 8 percent, and more than 90 percent of its rates were bound (see Haggard 1995, 51).

The governments of South Korea and Taiwan took a pragmatic approach to their trade policies, seeking, in a very dynamic situation, to maintain a balance between different aims. On the one hand, it was essential to deal diplomatically with the industrially more established countries whose markets were so important for their exports; unilateral concessions were the price of safeguarding that access. On the other hand, if an industrial policy was still to be pursued, some leeway had to be retained to protect particular industries or services. The dilemma was made even more acute in the 1990s when the industrially more established countries—particularly the United States—pressed for the opening up of financial markets to their financial services firms and for the dismantling of external capital controls. The issue had consequences not simply for the domestic financial industry but, more broadly, for the stability of currencies and for levels of economic activity at home (as the financial crisis of 1997 demonstrated). Stated more generally, South Korea and Taiwan paid a price for their success as exporters: they were expected increasingly to adjust their trade policies to the norms and standards to which the industrially more established countries themselves conformed in their own trade relations.

THE SHIFT IN POLICIES AND MULTILATERAL COOPERATION

In the years between the ends of the Tokyo and Uruguay Rounds, the governments of a great many developing countries chose to intervene less in private markets and to allow more business decisions to be made in response to the free play of market forces. As part of this shift, they moved in varying degrees toward a greater opening of their markets to foreign goods, services, and capital, thus accepting closer integration in the world economy. It was generally expected that exports, particularly of manufactures, would come to play a more dynamic role in the growth of their domestic economies.

This shift in broad strategy placed the issue of access to the markets of other countries higher on the agenda of national trade policies and heightened the interest in the Uruguay Round. In contrast to earlier decades, when most developing countries argued that they should be granted access to the markets of the industrially more established countries on a nonreciprocal basis, developing countries began to accept that concessions in the reduction of their trade barriers was often a condition of securing the market access that they wanted. In fact, some of the most successful countries found that the tables had been turned completely; in response to bilateral pressures, they were making nonreciprocal concessions to the industrially more established countries.

The vulnerability of the weaker, developing countries to bilateral pressures was an added reason for their heightening interest in a regime of internationally agreed norms and rules. In dealing with the industrially more established countries, most developing countries were only too well aware of their own weakness in bilateral negotiations. A multilateral trade regime with norms and rules that at least constrained, if not eliminated, the opportunistic behavior of the more powerful countries was distinctly attractive to them. The price was that each country's own trade behavior became subject to the same constraints. Most developing countries began to judge the price to be worthwhile.

9 The Uruguay Round

The Uruguay Round was first mooted in circumstances that appeared distinctly hostile to trade cooperation. As I already described in chapter 7, the general economic conditions of the early 1980s–severe recession, exchange rate instability, and problems of structural adaptation–had intensified protectionist demands in the industrially more established countries, who had resorted increasingly to measures that patently evaded or simply disregarded the agreed trade rules of GATT. Governments were "managing" a rising proportion of world trade through quantitative restrictions, whether directly imposed on imports or foisted on the exports of trading partners, and neoprotectionism found expression in the abuse of fair-trade laws. In face of such unilateral actions that flaunted the multilaterally agreed rules and procedures (in spirit, if not always in the letter), confidence in multilateral cooperation was eroding on all sides.

Even after the Uruguay Round had been formally initiated in 1986, negotiations advanced very slowly. More than once, there were fears that they might break down altogether. Circumstances did not appear to augur well for useful negotiations. Urged on by the more aggressive mood of Congress, as exemplified in the Trade and Competitiveness Act of 1988, the U.S. administration continued to resort to the threatened or actual use of unilateral measures. Impatient with the progress of multilateral negotiations, it announced a new interest in bilateral or regional free trade arrangements as an alternative way of gaining greater market access. Also, in the latter part of the 1980s, the European Community was striving to restore the momentum toward closer integration through its Single Market initiative and, when the Soviet empire began its rapid disintegration in 1989, was caught up in the large tasks of German unification and of defining new political and economic relations with the Eastern European countries.[1]

Nonetheless, despite such tensions and distractions, the Uruguay Round was not only brought to a successful conclusion in 1994 but also promised, if its agreements were honored, to stand out as a major landmark in international trade cooperation. Its most immediate achievement was to revive confidence in the multilateral trade regime; there was again a prospect that countries would conduct much of their trade relations in an orderly and predictable way. But the round was no less notable for its enlargement of the multilateral regime to embrace a considerably wider swathe of commercial activities; it both broadened the sectoral coverage of the regime and extended its reach beyond regulations at national frontiers to internal laws and practices.

EARLY POSITIONS ON THE NEW ROUND

The idea of a new round of trade negotiations was fanned into life in the early and middle years of the 1980s. Though there were many opponents, it had a band of vigorous supporters among leading authorities on trade policy. Arthur Dunkel, then director general of GATT, was tireless in his calls for action to restore trust in the multilateral regime, and at the GATT ministerial conference in 1982, trade ministers of several governments appealed for international action to stem the protectionist tide. But the insistent advocacy of the new Reagan administration, which took office in 1981, was the critical force in making the new round a reality.[2]

While the Reagan administration was ideologically well disposed to an open trade policy, it had more pragmatic motives. For one thing, it was concerned about the effects of protectionist pressures at home and abroad on existing trade relations. Bill Brock, then U.S. trade representative, predicted what would happen if multilateral trade negotiations were not initiated: "our business community will be able to accuse us with some justification that we fiddled while the trading system was breaking down around us" (quoted in Preeg 1995, 53). Another motive of the administration was to gain greater market access abroad for present and new export industries. The administration had to deal with a Congress that had become more protectionist in sentiment, and part of the administration's tactic was to deflect such sentiment into the demand for more open markets abroad. This meshed well with the fact that the interest of the American business community in foreign commerce was broadening; it now went far beyond the issue of access to foreign markets for its exports of manufactures. Thanks partly to deregulation both at home and abroad, major service industries, such as financial services and telecommunications, were also actively searching for opportunities in foreign markets, reinforcing the older export interests composed very largely of industrial corporations. The latter not only had continuing interest in the reduction of barriers to market access but also wanted host countries to impose fewer restrictions on their foreign direct investments and were increasingly disgruntled with foreign disregard of their patents and copyrights. Farmers and farming enterprises also added their weight to the other export interests, since the U.S. administration had come to believe that the time was ripe for an assault on the protectionist agricultural policies of the European Community, Japan, and others. From these interests, the U.S. administration put together a coalition that won it the support of the U.S. Congress.

The idea of launching a new round of trade negotiations met with mixed responses from other countries, ranging from qualified support to active opposition. There was one important exception: Japan was a consistent advocate of a new round and, indeed, was the first country to propose it formally. Japan's motives were quite different from those of the United States, however; its special interest was to strengthen GATT disciplines against the unilateral and arbitrary actions to which it had been and continued to be particularly subject. The European Community, which had failed to recover from the 1981–82 recession as vigorously as the United States, was less enthusiastic. It shared the U.S. interest in reducing various obstacles to trade, including trade in services. But like Japan, it pursued a highly protectionist agricultural policy; and it feared a likely American attack on its Common Agricultural Policy.

Most developing countries, led by Brazil and India, were initially antagonistic to the idea of a new round. They argued that issues outstanding from the Tokyo Round should first be settled.

The most notable issue was the need to curtail the practices of the industrially more established countries in imposing restrictions on market access for those of their manufactures that were proving to be highly competitive. Developing countries also feared that full reciprocity would be demanded of them in trade concessions and that their ability to protect nascent manufacturing or service industries would be reduced, and they resented proposals that would require them to modify their foreign investment laws and intellectual property laws.

Still, once negotiations on launching a new round had begun and as the implications of the various proposals became clearer, countries' perceptions of their own interest shifted, and the outlines of a negotiating agenda emerged. Of particular importance were the shifts in position among the developing countries. To a number of these countries, strongly interested in improving their access to the markets of the industrially more established countries (and susceptible to diplomatic pressures from their developed trading partners), it appeared sensible that they should go beyond the formal position of simply insisting on adherence to past agreements. They saw the dismantling of the Multi-Fiber Agreement, the revision of the safeguard clause, and, more generally, greater adherence to the nondiscriminatory rules as aims for which they would be willing to make reciprocal concessions on such matters as trade barriers, services, and intellectual property. These countries worked together with a group of less dominant countries from the north to become leading players in setting out a compromise agenda for the Uruguay Round. Common interest also cut across the old divide between developed and developing countries on other issues. Most notably, exporters of temperate-climate agricultural products–for example, Argentina, Brazil, Thailand, and Uruguay–made common cause with such countries as Australia, Canada, and the United States in seeking reform of the agricultural policies of the European Community and Japan.

The Uruguay Round was launched in 1986. After four years of talks, negotiations between the European Community and the United States stalled, the principal sticking point being agriculture. Negotiations resumed after some internal reforms were made by the European Community to its Common Agricultural Policy. Numerous other issues, however, also remained to be resolved, and a comprehensive deal was not reached until 1993. A final signing ceremony was held in Marrakech in April 1994.

RESTORING AND RAISING CONFIDENCE IN THE RULES

Virtually all countries saw a restoration of confidence in the multilateral trade regime to be in their own interest. While the weaker countries, both developed and developing, had the most consistent interest in reasserting GATT disciplines–wanting to rein in the unilateral and arbitrary actions of the most powerful–nearly all countries looked for some improvement, one way or another, in the system of rules. All countries, including the most powerful, were caught up in the dynamic of a rules-based system–that unless the rules are progressively refined and extended to improve their operation, they fall away into disuse. The negotiators' aims, then, were to curtail the disregard of already agreed rules and procedures and to narrow the persisting scope for autonomous and arbitrary action. The endeavor took several forms. It was manifest partly in revision of such specific measures as the dispute settlement machinery, the safeguard clause, customs and related rules, and subsidies and dumping. The most general action, however, took an institutional form through the establishment of the new World Trade Organization.

The New WTO

First proposed by Canada, the creation of the World Trade Organization was, as a broad act, intended to strengthen international respect for and adherence to the rules and procedures of GATT.[3] GATT had been drafted in 1947 as part of the Havana Charter that was to have created a new multilateral trade institution; with the demise of the charter, GATT remained as no more than a provisional agreement. The Canadian view was that formation of a permanent institution to oversee the functioning of GATT and of the related agreements being negotiated in the Uruguay Round would raise the status of the multilateral trade regime and enhance respect for its rules and procedures. For the more powerful, the new institution offered at least one significant advantage. By incorporating all trade and trade-related agreements within a single, overarching, legal framework, it would bring such issues as services and intellectual property rights within the compass of GATT disciplines.[4] The U.S. negotiators were unenthusiastic about the idea; they feared that the U.S. Congress would perceive the new institution as an instrument for the enforcement of multilateral rules that would override the autonomy of a sovereign nation. However, support for the idea came from many other countries, including the European Community, and the United States finally agreed. For the weaker countries, especially the developing countries, there was a price to be paid for a more orderly trading system that helped safeguard them against arbitrary behavior on the part of their more powerful trading partners. They, too, were to be held more rigorously to the trade rules; their infringement of certain rules might no longer be quietly overlooked by the more powerful because of their developing status.[5]

Dispute Settlement Machinery: Making It More Effective

Reform of the existing dispute settlement machinery was likewise closely bound up with the aim of restoring and strengthening adherence to the agreed multilateral rules and procedures. In the arrangement that had been set up under GATT, countries could employ procedural tactics that might indefinitely delay the review of a complaint or frustrate the adoption of a recommendation. This was widely regarded as unsatisfactory, and during the Uruguay Round negotiations, many countries pressed for a reformed and strengthened machinery. The United States, with its traditional emphasis on legal process, had long supported adjudicative procedures for the resolution of disputes (even if it chose to thwart the rulings). Numerous other countries, however, had to overcome their predisposition to regard trade disputes as a matter for diplomatic conciliation between the interested parties. The European Community had been among those preferring this more discretionary approach; it had resisted the use of adjudication within GATT, on the grounds that disputes reflected policy differences and were not matters to be settled legally. But its position shifted radically in the Uruguay Round. One reason for its change in outlook was the codification of law taking place within the European Community itself as it integrated national commercial practices (see Woolcock 1991, 114). A more immediate reason was the European Community's rising concern about the "aggressive unilateralism" being displayed by the United States. With its increased use of Section 301 in its trade legislation and with the reinforcing of unilateral action in the Trade and Competitiveness Act passed by the U.S. Congress in 1988, the United States was apparently bent on acting unilaterally in passing judgment about whether trade rules had been broken and in deciding whether to take retaliatory action.[6] Thus, it seems fair to say that the American unilateralism of the 1980s provoked other countries into demanding a more legalistic dispute settlement process under GATT.[7]

An improved machinery emerged from the negotiations. Countries making a complaint against a trading partner were assured prompt consideration and an early recommendation; the trading partner could no longer easily frustrate the process. The United States was not required—as the European Community had wanted—to rescind its national legislation authorizing unilateral action, but it accepted that disputes would be adjudicated and settled within the new GATT procedures. Of course, the decision to abide by a recommendation still rested with the individual countries. If a country failed to comply, the most that the WTO Dispute Settlement Body could do was to authorize the complainant to retaliate by withdrawal of a trade concession. As with GATT in the past, the WTO still rested on an expectation on the part of each country about the behavior of others; each member country was willing to abide by its obligations as long as it believed that others would do likewise.

Outlawing Voluntary Restraints

Other steps to strengthen confidence were taken during the Uruguay Round. For numerous countries, one of the worst breaches of the rules-based system was the practice of the powerful—particularly the European Community and the United States—to evade the rules of GATT altogether by resorting to voluntary export restraints and orderly marketing agreements. These measures had first emerged as a means of restricting trade in textiles and clothing and had swelled into the Multi-Fiber Arrangement; as I described in chapter 7, their use had later spread to trade in other products. From this practice of evading GATT rules grew a network of discriminatory agreements—varying over time in both country and product coverage—that generally embraced a substantial segment of world trade. The acceptance of a commitment to dismantle these various agreements was a significant achievement of the Uruguay Round. Broadly, existing voluntary export restraints and orderly marketing agreements were to be phased out over three years,[8] though, in the case of the Multi-Fiber Arrangement, the process was spread over ten years.[9] At the same time, the right of countries to protect themselves from disruptive surges of imports continued to be recognized.[10] The safeguard clause that expressed this right was substantially modified in the hope that countries claiming material injury in the future would no longer take action outside the provisions of the WTO. The new safeguard clause nonetheless continued to affirm that any restrictions imposed in response to a surge of imports had to be applied in a nondiscriminatory way. This was an important formal gain for the newer manufacturing exporters of the Third World and for Japan, which had been the main targets of action by the industrially more established countries in curbing imports of specific products. It was disregard of the nondiscrimination principle that made the newer exporters so vulnerable to external pressures.[11]

Other steps taken to strengthen confidence in the regime were largely clarifications and refinements of existing rules and procedures, intended to remove ambiguities or to resolve large differences in interpretation. Their lack of transparency left substantial room for arbitrariness in their administration. They included such matters as import licensing procedures, sanitary and phytosanitary measures, customs valuation, rules of origin, and technical standards (see Preeg 1995, 200–201; Croome 1995). They also included a substantial revision of the subsidy code for nonagricultural products.

Revising Subsidy Rules

The issue of subsidies and their effect on the competitiveness of manufactures had long been a source of international disputes. In particular, the United States had frequently expressed concern about the overt or hidden use of subsidies by Western European countries. At its insistence, the subject of subsidies had been put on the agenda of the Tokyo Round. The agreement that emerged from that round unequivocally recognized the right of countries to defend themselves against export subsidies that caused material injury to their domestic industries. However, the agreement was much vaguer about subsidies that gave domestic industries a price advantage over competing imports. In view of this asymmetry, American concerns about unfair trade were not assuaged. Indeed, during the 1980s, in a milieu when the American trade deficit—especially with Japan—had escalated, many American commentators thought the United States was losing its competitive edge as governments of other countries pursued industrial policies that involved the support and subsidization of new, technologically advanced industries. This only added to the American desire to return to the issue in the Uruguay Round.

A more complete set of rules on subsidies was successfully negotiated during the round. Subsidies were classified into three categories: subsidies that were prohibited outright, subsidies that were permissible, and subsidies that might not be permissible. Prohibited subsidies included all export subsidies. Clearly permissible subsidies included subsidies to finance industrial research and development, to promote regional development, or to finance the adaptation of plants and equipment to meet environmental standards. Other subsidies might not be permissible if they had adverse trade effects—a condition carefully defined. In such a case, the injured country could impose countervailing duties.[12] Thus, countries could initiate complaints against a much wider range of subsidies than had been the case in the past. Easing the way toward this broadening of the understanding about subsidies—in which European and other countries moved significantly closer to the American position—was a general shift toward more market-oriented, less interventionist policies. The paradigm underlying GATT—that of a freely competitive market—was being translated more fully into the rules.

In sum, the negotiators participating in the Uruguay Round were quite successful in restricting opportunities for governments to take trade actions that appeared arbitrary and unfair to their trading partners but that could nonetheless be claimed not to be inconsistent with the agreed GATT rules and procedures. At least in terms of their formal international commitments, governments were accepting a narrowing down in the scope for unilateral action. Most important, they were depriving themselves of some nontariff instruments that they had formerly often used to provide ad hoc relief to domestic industries complaining of import competition.

The Antidumping Loophole

One major loophole largely escaped the reformers' net: the antidumping code. As part of the defense against unfair trade practices, the national legislation of most of the industrially more established countries had long contained provisions authorizing their governments to impose duties on imported products whenever it was judged that the products were being dumped. (In principle, exports were being dumped if they were being sold at less than "normal value" and were causing material injury to a domestic industry.) GATT had laid down some general rules about dumping and the use of antidumping duties. However, the working definitions of what constituted dumping and the evidence required to substantiate allegations of dumping were largely matters decided by the national legislation and administrative practices of each country. This fact assumed new importance in the 1980s, when antidumping legislation in some developed countries, especially Australia and the United States, was increasingly invoked by industries seeking protection from foreign competition. The looseness in the definitions presented domestic industries and their trade lawyers with the opportunity to exploit the legislation for protectionist purposes.

The Uruguay Round was the third occasion in which international trade negotiators had attempted to devise antidumping rules less open to abuse. In this round, Japan took the lead, supported by South Korea and Singapore. The rules were modified, but while some conditions were made tighter, others were relaxed. Though many countries favored more rigorous rules, the United States was particularly opposed to substantial amendment. Indeed, the retention of substantial national autonomy in deciding the conditions under which antidumping duties could be imposed was politically so important that a large delegation of leading politicians from the U.S. Congress arrived in Geneva during the negotiations to lobby against major changes. To underline how they felt, senior members of the U.S. Senate threatened to vote against ratification of the final agreement if their position on dumping was not accepted (see Preeg 1995, 170).

THE BROADENING OF THE MULTILATERAL TRADE REGIME

In the seven rounds of multilateral trade negotiations that had taken place under GATT before the Uruguay Round, the primary focus of participants had been on improving market access for trade in manufactures, mostly through reductions in tariffs. Reductions in tariffs and in nontariff barriers on manufactures remained a major part of the agenda in the latest negotiations. (For the developing countries generally, the most significant single issue on this score was the agreement to dismantle the Multi-Fiber Arrangement, mentioned earlier in this chapter.) But what marked the Uruguay Round as a new departure was, first, the extension of its sectoral coverage to include services and agriculture and, second, its inclusion of rules relating to intellectual property rights and foreign direct investment. In these areas of commercial relations, the United States sought major new concessions from other countries. With the outstanding exception of agriculture, the European Community shared the same interest.

Easing Market Access for Service Industries

The aim of improving market access for the service industries had important consequences for the multilateral regime; it took the negotiation of multilaterally agreed rules and procedures beyond the formal barriers imposed at national frontiers, to laws and regulations applying to internal trade. The multilateral regime had certainly extended its reach into internal laws and regulations in the past; the provisions relating to government procurement negotiated during the Tokyo Round were just such an incursion. Because of the different nature of trade in services, however, the step taken in the Uruguay Round was decisively larger.

What kept foreign suppliers of services from competing in the markets of other countries was not customs barriers (since services were mostly traded internally) but the fact that foreign suppliers did not enjoy national treatment in domestic markets. Major service industries everywhere have operated within a framework of national laws, regulations, and institutional arrangements that have been put in place to protect customers or investors, but these have had the consequence, often not deliberate, of virtually or wholly excluding foreign suppliers. The simplest and most extreme examples are in industries, such as communications and aviation, where the response to monopolistic or oligopolistic conditions in the past has been a degree of state ownership or regulation that impedes the entry of new enterprises, whether domestic or foreign. But there are other, subtler forms of exclusion. For example, in the banking or insurance industries, national concerns over control of monetary policy or the need for prudential supervision have bred regulations that virtually excluded foreign-owned enterprises. To complicate matters further, in drawing up an agreement that covered services as a whole, it was evident that there are different modes of providing services: in some service industries, such as tourism, the consumers move to the place of production; other services, such as accounting services executed over the Internet, entail no presence in the importing country; still other services, such as the services of construction contractors, require the movement of natural persons across borders to provide the service; finally, most major service industries necessitate investing in establishments in the importing country to provide the service.

The negotiation of market access for foreign suppliers of services thus posed problems that were evidently very different from those affecting trade in merchandise. These were largely uncharted waters, and a lot of information gathering and analysis had to be done to identify and define the issues to be negotiated.

The United States initially favored a comprehensive agreement for trade in services that would spell out a set of obligations regarding market access and national treatment and to which relatively few exceptions would be allowed. The European Community and the developing countries, however, were more cautious; they preferred an agreement containing very few general obligations and within whose framework more specific sector-related obligations would be negotiated over time. What finally emerged as the General Agreement on Trade in Services was closer to the latter. Besides some general obligations, it contains specific, negotiated obligations that apply only to those sectors that a country has chosen to identify. The conditions applying to several key sectors–including financial services, telecommunications, aviation, and shipping–were covered by annexes to the agreement. In these sectors, the differences among countries in the concessions they were willing to make or to accept could not be resolved during the Uruguay Round and were left to later negotiations. A principal source of difficulty arose from the reluctance of the United States to accept that the nondiscrimination rule should apply to trade in services.[13] As I will show in chapter 11, this difficulty was later overcome. In brief, the immediate effect of the General Agreement on Trade in Services was limited, but it established a framework for the extension of market access in the future.

Small Steps in Reducing Agricultural Protection

Agriculture was the other major sector to which the United States sought to have GATT disciplines applied. In calling for some liberalization of trade, it was supported by the Cairns Group, a mix of developed and developing countries exporting temperate-climate agricultural products.[14] By so doing, they were challenging the Common Agricultural Policy of the European Community, as well as the policy of Japanese governments, which accorded high levels of protection to their rice farmers. They met with a deep reluctance. Though not unexpected, the opposition to change was, to say the least, perplexing to most outsiders. Large-scale migration from the rural to the urban areas has taken place in the Western European countries and in Japan over the last fifty years and might have been expected to lessen the strong commitment to agricultural protection. By 1990, employment in agriculture had fallen to 4.2 percent in Germany, to 5.6 percent in France, and to 7.2 percent in Japan–though, in all cases, still remaining higher than in the United States (where it amounted to 2.9 percent of total employment). However, the protection of domestic food production, like the production of clothing, has run tenaciously through the history of most countries (except for the major exporters of these products). It is a policy whose rationale has usually been linked to national security but that seems to have deeper, more obscure roots in domestic political and social life.

The results of the negotiations on agriculture were, at best, limited. One accomplishment was the tariffication of all border measures, a step that could facilitate any future negotiations to reduce levels of protection (although for that reason, countries erred on the side of setting high tariffs). Some agreement was also reached on restricting the subsidization of exports, which was the most pressing American demand. Moreover, a measure of discipline was introduced into the use of domestic agricultural subsidies. Countries committed themselves to reduce over time their measures for domestic agricultural support.[15] But since trade liberalization in agriculture was a one-sided concession by the European Community and Japan (not clearly balanced by reciprocal concessions from the United States or other countries) and since protection was so closely woven into their internal political affairs, it should not be surprising that the extent of the liberalization was modest.

The Inclusion of Intellectual Property Rights

Along with trade in services and agriculture, the Uruguay Round was notable for bringing two other aspects of international commercial relations into the multilateral trade regime: the issues of intellectual property rights and of foreign direct investment. While both had, over many decades, been subjects of international discussion and even some international action, they were mainly matters that had been addressed, if at all, in bilateral treaties.

The issue of intellectual property rights was a particular concern of American and European multinational corporations. It was nothing new for corporations to see their patents being violated or their copyrighted materials being pirated in countries outside of Western Europe or North America. But as the new wave of information-based technology swept through the world and as other areas of research and development, such as medicine and pharmaceuticals, continued to make extraordinary advances, the flow of intellectual property across borders was increasing dramatically. In this more interrelated world, the assignment of intellectual property rights on a territorial basis appeared increasingly unsatisfactory to the holders. The case of American rights holders was taken up forcefully by the U.S. Congress in its Trade and Competitiveness Act of 1988, which authorized the U.S. administration to retaliate against countries failing to respect American intellectual property rights.

At the international level, governments had long worked through the World Intellectual Property Organization (WIPO)—whose origins dated back a century—to establish rules for different elements of intellectual property. But there was little uniformity in the rules; not all countries subscribed to them; and, most important from the point of view of rights holders, there was no sanction against countries that failed to abide by them.

Developing countries, led by Brazil and India, wanted the issue to remain a matter for WIPO. They were concerned that any new multilateral agreement on intellectual property rights should not impede the transfer to their countries of the technology that was so necessary for their development, and they feared that the licensing, royalty, and other fees that they would have to pay to corporations and individuals in developed countries could constitute a substantial financial burden. Moreover, the linking of intellectual property rights with GATT opened up the possibility of some form of sanctions being applied against countries that chose not to respect foreign-held rights. Nevertheless, the Agreement on the Trade Related Aspects of Intellectual Property Rights (TRIPS) was concluded. In effect, the developing countries agreed to TRIPS in exchange for the phasing out of the Multi-Fiber Agreement.

TRIPS defined the intellectual property rights that could be legally protected and the time limits of protection. It required all member countries to put domestic legislation in place that would uphold the rights defined in the agreement and would enable rights holders to take legal action against any infringement of their rights. This was a pathbreaking step for GATT. In the 1883 Paris Convention, the signatories had agreed to accord foreign-owned intellectual property the same treatment as domestic intellectual property. The new agreement went beyond national treatment to establish common, minimum, international standards to which domestic policies had to conform.

Foreign Direct Investment: Differing Views

The proposal to extend the scope of the multilateral trade regime to include foreign direct investment was another initiative of the industrially more established countries–originating in the first instance with the United States–that met with opposition from the developing countries. There had been a continuing international debate on the status of foreign enterprises in their host countries virtually since the end of the Second World War, and repeated efforts had been made to reach agreement on codes setting out the conduct that both the enterprises and the host governments should follow. The general thrust of the codes proposed by the industrially more established countries had been that foreign investment should not be treated differently from domestically owned enterprises but should enjoy national treatment. However, in considering the treatment of foreign enterprises, the developing countries started out from an entirely different premise. For both nationalist and developmental reasons, their primary objective has been to promote the development of their own productive resources–their own entrepreneurial skills, their own workforce, their own capital and natural resources. This certainly has not excluded the use of foreign capital to advance the modernization of their economies. But it has meant that the ability of these countries to give preference to indigenous productive resources has lain close to the heart of their economic policies.

In the face of these different points of view, negotiations during the Uruguay Round narrowed down to measures affecting foreign direct investment that might be trade distorting and therefore incompatible with GATT. Thus, the Agreement on Trade

Related Investment Measures (TRIMS) dealt with certain practices that only foreign enterprises were required to meet, such as nationally imposed conditions with regard to export performance or the local content of production.

Further Tariff Reductions

Though notable for its broadening of the multilateral regime, the Uruguay Round did not neglect the more familiar task of previous trade negotiations, namely, the reduction of tariffs. It differed from its immediate predecessors, the Tokyo and Kennedy Rounds, in how it approached the task. In the two preceding rounds, substantial headway had been made by an agreement to make across-the-board tariff cuts. This agreement eliminated the detailed bargaining in which mutual concessions had to be matched on an item-by-item basis to satisfy the requirement of reciprocity, and it was particularly welcomed by the smaller countries with less bargaining power. However, in the Uruguay Round, the United States was insistent on employing the older, item-by-item approach, partly to allow more flexibility in protecting sensitive industries, such as textiles. In these circumstances, the ambitious target set for the round—a 30 percent cut in the tariffs of the industrial countries—could have proved difficult to realize. What helped to make substantial progress possible was the introduction of the idea of zero-for-zero tariffs to cover trade in particular, agreed sectors. In eight major sectors, including pharmaceuticals and agricultural machinery, import duties were eliminated, and zero tariffs were introduced. The proportion of nonagricultural imports into the industrially more established countries subject to zero duty rose from 20 to 44 percent. Overall, these countries cut their tariffs by 40 percent on a trade-weighted basis, and the developing countries reduced theirs by about 20 percent. The developing countries also undertook substantial tariffication of nontariff barriers and bound a much larger proportion of their tariffs (see Preeg 1995, 191).

A GENERAL APPRAISAL

The Uruguay Round differed from its predecessors both in the much wider range of issues that were negotiated and in the participation of the developing countries as a significant negotiating group. All the major countries or groups of countries gained from others some concessions that they wanted. The developing countries won agreement that the Multi-Fiber Agreement would be gradually dismantled and, more generally, that the industrially more established countries would submit to more rigorous discipline their use of quantitative restrictions for protectionist purposes. The industrially more established countries gained the prospect of improved access for their service industries, greater protection for their intellectual property rights, and lowered barriers on merchandise trade. They went furthest in trade with each other, reducing tariffs for some industries to zero and substantially opening up most, if not all, their markets for service industries. They also clarified rules on subsidies that had been a source of disputes. However, the United States and the countries that comprised the Cairns Group did not obtain the concession on agriculture that they had hoped for, and many developing countries felt that they had been pressured into making more concessions than were justified by the benefits they had won.

A characteristic of the round was that it moved away from negotiations based largely on a narrow balancing of mutual concessions. The changes that were proposed or asked for were too diverse–and often too general in their effects–to allow any such careful balancing. At the end of the negotiations, countries were faced with a package of measures arising from some concessions received from others and some granted to others, which they had to accept or reject as a whole. Certainly, within their own confines, the bargaining in several areas conformed to the familiar pattern; on tariffs, for instance, reciprocity based on the idea of equivalence was the basis for negotiations among participants of comparable economic power. But the concessions made and received in the different areas were linked, and their combined net benefit determined the acceptability of the overall package. Market-opening measures were weighed together with the rules-enhancing measures that made for a more orderly and predictable trade regime. For many medium-size or poorer countries lacking the political or economic power of the leading trading nations, the prospect that all nations would adhere more closely to the multilateral trade rules and would refrain from the arbitrary use of their power was a valuable benefit.

The Uruguay Round initiated a new phase in the trend toward more open markets that had spread through much of the world. The lowering of barriers to foreign competition was extended from merchandise trade in industrial products to major service industries and, much more tentatively, to agricultural products from temperate climates, and a new discipline on intellectual property rights and some relaxations of restrictions on foreign direct investment were included in the package. Among the industrially more established countries, the round was another step in the cumulative reduction—proceeding since the end of the Second World War—of barriers to the free movement of goods and services and of capital. For many developing countries, it marked a relatively new development in the linking of their markets to the world economy.[16] However, whereas the round obviously facilitated the development of a global market economy, centered on the United States and Western Europe, it was far from ushering in a world where goods, services, and capital could flow freely across national frontiers. Even after the changes introduced by the Uruguay Round were fully implemented, governments generally still had ample means at their disposal to restrain foreign competition in many segments of their domestic markets, and national sentiment was everywhere strong enough to insist, from time to time, on the use of these means to accord protection from foreign competition for particular industries, whether to appease sectional interests or for broader reasons of national well-being. Developing countries retained more extensive means, since they were mostly persuaded that some protection of domestic enterprises from foreign competition was a necessary condition of national development.

For the developing countries, the Uruguay Round was a new departure in multilateral trade negotiations. The developing countries no longer insisted on nonreciprocity as part of the special and differential treatment that they had long sought; they came to accept that the principle of reciprocity in the reduction of trade barriers was a condition of market access. Moreover, their obligation to abide by the multilateral rules substantially increased, since the codes that had been negotiated among the industrially more established countries in the Tokyo Round became generally applicable under the WTO agreement. The developing countries did, however, retain the "differential and more favorable " treatment that they had enjoyed in the application of a number of other GATT clauses, and with some success, they sought comparable flexibility in the application of new WTO clauses.[17]

The strengthening and extension of the rules of trade conduct was a notable outcome of the round. Formally, the round narrowed down the room for maneuver that countries, particularly the powerful countries, had for evading or sidestepping the agreed multilateral rules. Just this restriction on unilateral action had caused the U.S. negotiators to insist on leaving governments with a large measure of discretion in how they interpreted the antidumping rule; this remained the major route through which relief could be afforded to individual industries for politically expedient reasons. It was also the major reason why some members of the European Union emphasized at the end of the round the need for the Union to revise and strengthen its own antidumping laws. (As a later response to these positions, a number of developing countries introduced antidumping legislation into their own trade laws.)

If the scope for independent, unilateral action was formally narrowed by the Uruguay Round, this did not necessarily mean that the trade conduct of individual countries, particularly that of the most powerful countries, was increasingly going to conform to the multilaterally agreed set of rules. At the core of the multilateral regime has always been the idea of nondiscrimination–that in trading relations with others, each country treats all of its trading partners in identically the same way. This idea has differentiated multilateral agreements from regional or bilateral agreements and has insulated commercial relations from the kinds of arbitrary political intervention that raise the business risks for foreign trade and investment. The economically most powerful countries have by no means always been convinced that adherence to nondiscrimination best advances their own commercial interests, and throughout the modern history of trade cooperation, they have repeatedly departed from its observance. The Uruguay Round had considerable success in closing doors to de facto discrimination, but the course of events during the round left doubts about the strength of the commitment to a nondiscriminatory multilateral system. Though eager to include trade in services within the multilateral regime, the United States had not wanted to apply the most-favored-nation rule to its concessions. The European Union was likewise insistent that the new safeguard rule should still allow discrimination in certain circumstances. Outside the Uruguay Round negotiations, both the European Union and the United States had become much more active in proposing or concluding regional and bilateral free trade agreements. As I shall discuss in chapter 10, while these were not necessarily discriminatory in intent, they were so in effect.[18]

In sum, while the Uruguay Round formally strengthened the multilateral regime in several ways, its central role in shaping the trade conduct of nations remained fragile. Respect for the norms of the regime rested on how the powerful countries saw their own interest, and that perspective was prone to reinterpretation in changing political and economic circumstances.

10 Regional Trading Arrangements and Multilateral Cooperation

Regional and bilateral trading arrangements–most notably customs unions and free trade areas–greatly multiplied in number during the latter years of the twentieth century.[1] Some commentators, especially economists, have been critical of this development. They have been concerned that these arrangements often constituted no more than preferential trading areas and that they were a possible threat to multilateral trade cooperation.[2] Others have taken a more sanguine view. They have stressed that the arrangements enlarged the geographical areas in which trade in goods and services–and sometimes also in labor and capital–move freely, thus contributing to the same broad aim as multilateral trading arrangements.[3] In fact, GATT and the WTO recognize that authentic customs unions or free trade areas are quite consistent with their own intent. The issue is complex, and though it is hard to do the subject justice within the confines of one chapter, the tensions that have arisen between regional and multilateral arrangements should at least be outlined.

A GENERAL PERSPECTIVE

Regional or bilateral trading arrangements have been no less a part of the history of trade cooperation than has the gradual emergence of a multilateral trade regime. The former developed as forms of trade relations among states long before multilateral relations took shape, and they have remained major instruments of national trade policy. Virtually all members of the WTO today are also participants in some separate regional or bilateral trading arrangement (though some of these arrangements are more putative than actual).[4] The persistence of a large and shifting constellation of regional and bilateral trading arrangements over the last 150 years suggests that these arrangements have not, on the whole, proved to be an impediment to the development of multilateral trade cooperation.

However, national trade policies in support of regional or bilateral arrangements have at times appeared as courses of action seriously in conflict with multilateral cooperation. The spread of preferential trading arrangements among countries contributed to the fragmentation of the world trading system in the interwar years; the leading trading nations sought to create protected trading areas that excluded competition from each other. Many have suspected that the same motives may have been at work in more recent years.

The essential source of concern lies in the fact that while, by definition, regional or bilateral trading arrangements among countries discriminate against outsiders, the success of the multilateral trade regime has rested heavily on the idea of nondiscrimination. The acceptance of nondiscrimination as a rule governing the conduct of national trade policy has restrained the leading trading nations from using their power to vie with each other in gaining preferential access to third countries' markets.

Of course, the motive behind many regional or bilateral trading arrangements has not been simply a desire to gain short-term economic or commercial advantage over other countries. Throughout history, political aims, such as the unification of states or the formation of alliances for reasons of national security, have lain behind numerous arrangements. Perhaps especially in the last fifty years or so, the economic benefits of integrating national markets into larger economic areas have also gained recognition as a powerfully persuasive reason for regional or bilateral trade arrangements.

THE ARRANGEMENTS OF THE EUROPEAN UNION AND THE UNITED STATES

Both the European Union and the United States were leading actors in setting the new trend, but the former played the larger role, as much for reasons of geography as anything else. Nowhere in the last twenty years has there been more activity in the formation of regional and bilateral agreements than in the European Union (known as the European Community before 1992).[5] Since its formation in the 1950s and throughout its subsequent expansion from six to fifteen members, it has defined its trading relations with a number of other countries on the basis of preferential agreements. In the earlier years, a notable instance was the Yaoundé Convention signed in the 1960s with former colonial territories; it was later continued as the Lomé Convention, which granted these territories preferential, nonreciprocal access to the European Community's markets. In 1975, the European Community also signed a free trade agreement with Israel.

In the 1980s and 1990s, the number of agreements began to multiply rapidly.[6] The primary cause was the transformation that took place in the European political scene as a result of the end of the Cold War and the breakup of the former Soviet bloc. One consequence was an increase in the size of the European Union itself as some former members or associates of the European Free Trade Association, no longer concerned about asserting their political neutrality in the East-West conflict, became full members (these include Austria, Finland, and Sweden). Another result was the emergence of a group of Central European countries eager to establish firm political links with the Western European countries and intent on carrying out market-oriented reforms of their economies.

In the new political configuration of Europe, both the European Union and the United States responded positively to enlargement of the established political, military, and economic alliances. In contemplating the possible further enlargement of the European Union, however, its present member countries were–and still are–confronted with the question of where the boundaries of the Union as a political entity should be drawn. In trade policy, the provisional response to this "unanswerable question" (as J. M. Roberts dubs it) was to draw up free trade agreements with the individual countries, leaving the issue of full membership of the Union to be decided on a case-by-case basis sometime in the future.[7]

The European Union also entered into free trade agreements with a number of other countries outside of Europe. In most cases, political considerations played a major role. Free trade agreements with the countries on the southern shores of the Mediterranean were favored by the European Union, in part because concerns about the potential flow of illegal immigrants from these countries heightened interest in their economic development. The agreements coupled trade with economic aid and served as instruments for encouraging internal reforms. Agreements with more distant countries (e.g., Mexico and South Africa) appear to have had more mixed motives. In the case of the agreement negotiated with Mexico (and of the failed negotiation for a similar agreement with the Mercosur customs union), the evident motive was more strictly commercial; the measure was a defensive one designed to gain preferential access to a market in which a key competitor, the United States, already enjoyed (or might enjoy) that access.

Unlike the European Union, the United States entered the 1980s with virtually no postwar record of participation in regional trade agreements.[8] It had, after all, been the champion of the principle of nondiscrimination when the new, postwar, multilateral trade regime was established. Its policymakers were long convinced that universal adherence to the principle was in the best interest of all. Indeed, the United States was the last of the industrial countries to introduce a scheme under the Generalized System of Preferences in the 1970s, partly because it objected to the violation of that same principle.

However, another generation of leaders was now in command, and a new pragmatism entered into the making of American trade policy. In the depressed economic conditions of the early 1980s, American efforts to initiate a new multilateral round of trade negotiations in order to enhance market access for its enterprises met with limited support from most other countries, and even when a new round was launched, progress was very slow. In addition, the European Community had come to be characterized in the United States as "Fortress Europe," partly because of misplaced fears about the Single Market program that the European Community was initiating. Business complaints about the difficulty of gaining access to the Japanese market were also loud and many at the time. In this climate, the U.S. administration made clear its impatience with the slow progress of multilateral negotiations and, no doubt partly to cajole other countries into responding more positively, stated its readiness to consider regional trade agreements as an alternative to multilateral trade liberalization. Besides the U.S.-Israeli free trade agreement signed in 1985, the new attitude of the United States found its early expression in the formation with Canada of the Canada-U.S. free trade agreement in 1988, and this agreement was later joined by Mexico in 1994 to form the North American Free Trade Agreement (NAFTA).[9] In addition, in 1990, President Bush proposed the formation of the Free Trade Area for the Americas (FTAA). Later, the United States also participated in the establishment of the Asia-Pacific Economic Cooperation (APEC), whose members were a group of countries around the Pacific Rim; these countries agreed in 1994 to create an open trade and investment area. (The Asian members insisted, however, that reductions in trade barriers should be on a most-favored-nation basis, so they did not intend to create a preferential trading area.)

THE ARRANGEMENTS OF OTHER COUNTRIES

While the European Union and the United States were the largest actors accounting for the recent trend toward regional or bilateral agreements, most other countries were also active in one way or another. While their motives varied, a rough distinction can be drawn between, on the one hand, those countries that entered into agreements with either the European Union or the United States and, on the other hand, those other countries that formed arrangements independently from these two major trading centers.

Arrangements with the European Union or the United States: Why Countries Entered into Them

Among the countries that entered into agreements with either the European Union or the United States, a strong political rationale was present more often than not. Concerns about national security or a belief on the part of governments that close, formal ties with the European Union or the United States would protect and strengthen domestic political and market-oriented reforms were evidently factors in the agreements between Central European and Mediterranean countries and the European Union and between Mexico and the United States. It was not, however, so obviously the case with regard to the agreements between Mexico or South Africa and the European Union.

The countries that entered into agreements with either the European Union or the United States also hoped for significant economic benefits. In earlier decades, the most obvious benefit expected from a free trade agreement would have been the stimulus to exports from the preferential tariff margin gained under the agreement. However, most tariffs of both the European Union and the United States had been reduced to very modest levels by the 1990s, especially since the completion of the Uruguay Round in 1994. Indeed, in the European Union, most imports from the developing countries–leaving aside agricultural products, textiles, and apparel–were duty-free. While tariffs on some products of special interest to newly industrializing countries (e.g., textiles) were still quite high, making tariff preferences on these products valuable, the greater security of market access was at least equally as important. The hope was that in the application of nontariff barriers where administrative discretion is exercised, partners in free trade agreements would receive more favorable and consistent treatment.

Another significant economic benefit that partner countries expected was a greater inflow of foreign capital. Among the countries linked to the European Union, substantial official economic aid was associated with most agreements. More broadly, countries also expected the inflow of private capital to increase. The grounds for such hope were that the multinational corporations would want to take advantage of the developing countries' lower wage levels and of their free access to the large market of the more developed partner. In the past, this expectation certainly appears to have been realized in some countries. For instance, after joining the European Community in 1973, Ireland achieved a rapid diversification of its productive structure, with the consequence of substantial gains in its standard of living. While the flow of official funds to Ireland helped, the inflow of foreign direct investment played the major role in this transformation. Mexico hoped for a similar enhancement in the inflow of foreign direct investment as a consequence of its membership in NAFTA, and the flourishing maquiladora (free trade zones) that it had initiated along its border with the United States gave its some grounds for optimism. However, for partner countries generally, it was an open question whether in a world where the tariff levels of the major countries were now very low, tariff preferences in the major markets would be a major influence in the decisions of multinational corporations about where to locate their production facilities. It was true, however, that foreign investors might be reassured by the investment provisions often included in these free trade agreements. In some agreements, moreover, provision was made for easier access to certain service sectors (e.g., financial services and telecommunications) in the partner countries—a separate inducement to foreign investment.

Not all countries entering into trade agreements with the European Union or the United States have been primarily motivated by the prospect of political or economic benefit. For some, the motivation has been more the fear of economic loss, arising from the fact that their neighbors, being exporters of competing products to the same market, had already gained preferred access through a free trade agreement. This was most evidently the case with the countries in the Caribbean region that suffered losses when Mexico joined NAFTA and replaced them as a cheaper source of supply. A World Bank study suggested that as much as one-third of the Caribbean Basin's exports to the United States could suffer from such trade diversion.[10] The Caribbean countries responded by appealing to the United States for "NAFTA parity," and in May 2000, the U.S. Congress passed an act that augmented the list of exports from these countries that would receive preferential treatment in the U.S. market.[11]

Mixed Motives in Other Arrangements

The motives of the many countries entering into regional trade arrangements that had no connection with the European Union or the United States were likewise mixed. Some were responding to the perception that the major trading powers were forming trading blocs that might become exclusionary, that might intensify trade rivalries, and that could cause multilateral cooperation to recede. The clearest instance of such a response occurred when the member countries of the Association of Southeast Asian Nations (ASEAN) signed an agreement in 1992 for the gradual introduction of free trade. In commenting on the agreement, Indonesia's foreign minister pointed to several warning signals: the European Community's Single Market initiative, NAFTA, and the regional and bilateral trading arrangements in Latin America and Central Europe.[12] More recently, ASEAN entered into discussions with Australia and New Zealand on establishing links with the latter's free trade area. China, Japan, and South Korea also began annual consultations with ASEAN on trade and financial issues, and Japan, so long a firm advocate of the multilateral principle of nondiscrimination, began actively pursuing some form of preferential trading arrangement with Chile, South Korea, Singapore, and Mexico.[13]

For other countries, regional trading arrangements have been strongly influenced by economic considerations. In the 1960s and 1970s, a number of developing countries recognized that the small scale of their domestic markets was a constraint on the growth and diversification of domestic industry. In Africa, Asia, and Latin America, several customs unions or free trade areas were formed. However, these earlier trading arrangements generally failed to take root. Developing countries that were still largely agricultural or mineral producers traded little with each other. They lacked the industrial bases that create the possibilities for specialization and trade. Moreover, they experienced severe distributional conflicts as they vied with each other for the establishment of the same new industries in their respective territories. In the late 1980s and 1990s, however, interest in regional trading arrangements revived quite strongly in parts of the developing world. The same motive of promoting industrialization through integration of regional markets was evident. The difference was that countries were more industrialized than before and had greater possibilities for specialization and trade. Mercosur, the customs union embracing Argentina, Brazil, Paraguay, and Uruguay, quickly came to constitute one of the most advanced of these arrangements, though several others also emerged in Africa, Asia, and Latin America (as well as in Oceania, where Australia and New Zealand implemented an extensive free trade agreement).[14]

THE EFFECT ON MULTILATERAL TRADE COOPERATION

How did all this activity in the spread of regional and bilateral trading arrangements appear to have affected multilateral trade cooperation? The worst possible consequence would have been an intensification of political and economic rivalry among nations in seeking to gain preferential access to the markets of third countries. This possibility was reflected in the fear, so often expressed in the late 1980s and early 1990s, that the world was fragmenting into three trading blocs centered on the European Union, Japan, and the United States. But though the number of preferential trading arrangements certainly multiplied, this did not happen. The fundamental reason it did not was that the two major trading powers, the European Union and the United States, were at no time willing to pursue policies that seriously risked their access to each others' markets; their economies had continued to become increasingly integrated, not only because of expanding trade flows, but even more because of a dramatic increase in mutual cross-border investment. The European Union and the United States each granted preferential status to third countries in their own markets, but that did not cause any significant diversion of import demand from either to the third country. Their tariffs were generally low, and the third countries were not, for the most part, exporting competing products. What could have been more irksome was the preferential status that the European Union and the United States each gained in the markets of the third countries. The trade barriers of the third countries were generally considerably higher, and the margin of preference that each enjoyed in their markets was therefore greater. For instance, in the early 1990s, the unweighted average tariffs of Egypt, Morocco, and Tunisia, with which the European Union negotiated free trade agreements, stood at 34, 23.4, and 28.5 percent (see Pelkmans and Brenton 1999, 106). But since the trade links of most of the third countries were, in any case, predominantly with one or other of the two major partners, diversion from the other was probably minor. In addition, if a free trade agreement threatened to divert trade from one or the other of these powers, there was always the possibility that the adversely affected power could also enter into an agreement (as the United States did with Israel and as the European Union did with Mexico). This placed both the European Union and the United States in a preferred position vis-à-vis other industrial exporters, most notably Japan and other Asian countries. Finally, there was the compelling reason that most of the preferential arrangements into which the European Union or the United States entered either had the active political support of the other or, at very least, were politically inoffensive.

Historically, it appears broadly true that states have quietly accepted the emergence of regional or bilateral trading arrangements among their trading partners when the perceived intent of the arrangements has been closer political alliance or economic integration. It has been the formation of preferential trading arrangements exclusively for commercial advantage that has provoked the trade rivalries dangerous to multilateral cooperation. It is, of course, always a matter of judgment whether or not particular trading arrangements are exclusively commercial. But economically successful customs unions or free trade areas have generally shared quite distinctive characteristics. They have normally been composed of contiguous countries, usually with roughly similar levels of per capita income and with sufficiently diverse productive structures to allow mutual specialization.

While this is not the place to assess the economic rationale of the many recent trade arrangements, some of those favored by the leading economic powers did not conform to the pattern just described and aroused misgivings.[15] Particularly suspect was the kind of "hub-and-spoke" network of bilateral free trade agreements drawn up between one or other of the leading economic powers and several weaker countries in a region. The separate free trade agreements drawn up between the European Union and the different Central and Eastern European countries were of this kind; they threatened to divert the latter's trade with neighboring countries to the European Union.[16] Concern about the emergence of this kind of relationship in Asia was expressed in the early 1990s. Australia feared that the United States might seek to negotiate a series of bilateral trade deals with Asian countries offering preferential access to NAFTA, partly to gain a competitive advantage over Japan; in 1992, the then Australian prime minister, Paul Keating, warned the United States of "accumulating resentment and resistance."[17] It was also alleged that in proposing the formation of a Free Trade Area for the Americas, the United States initially suggested a series of negotiations with individual countries (beginning with Chile); however, the United States later accepted simultaneous, collective negotiations.

Some have argued, with good reason, that the existence of regional or bilateral trading arrangements, whether actual or proposed, has sometimes served to advance multilateral trade cooperation.[18] The launching of the Kennedy and Uruguay Rounds certainly owed something to concerns that regional arrangements might otherwise become exclusionary. The claim can also be made that regional trade arrangements have sometimes set precedents in establishing new rules for trade conduct that have later been followed in multilateral negotiations. However, the recent proliferation of regional and bilateral trade agreements tugged in the opposite direction, too. For one thing, it can only have multiplied the instances of trade diversion. Though the evidence suggests that the adverse economic effects of trade diversion were, in general, not substantial, they were sometimes significant for particular countries or exporters. In any case, at issue was not only loss in economic efficiency but also the damage that discrimination caused to external relations.[19] Most obviously, such agreements allowed the more powerful countries to differentiate among their weaker trading partners on political grounds when pursuing commercial policies. Further, they added to the complexity and opaqueness of customs procedures, since it became important to determine the country of origin of imports. Many imported products contain materials or components that come from third countries, so it becomes necessary to apply rules about how much local content there should be in a product before it qualifies for preferential treatment. Such rules—being applied administratively and often differing among trade agreements—have been a fertile source of friction.[20]

It was fortunate for multilateral trade cooperation that the recent proliferation of regional and bilateral trading arrangements took place in a period of relatively buoyant economic growth in most areas of the world. In more difficult economic conditions, the pursuit of these arrangements might have degenerated into more nationalist rivalry.

11 From Marrakech to Seattle

In the short span of years from the signing of the WTO agreement at Marrakech in 1994 to the end of the twentieth century, much of the world experienced a period of relative peace and prosperity. The great political event of the 1990s was the unexpected demise of the Soviet Union, bringing with it an end to the polarization of the world into two bitterly opposed camps. The United States emerged from this event as the supreme and undisputed military power and the sole claimant to global hegemony. Barbaric, armed conflicts erupted in the Balkans, in parts of Africa, and in Afghanistan, but they remained regional or local. Only the Persian Gulf War in 1991 was in any sense global; American military power, supported by that of its allies, was used to repel the Iraqi invasion of Kuwait and to protect Gulf oil supplies.

The economic performance of the European Union and the United States–the two main drivers of the world economy–was buoyant throughout most of the 1990s. This was particularly true of the United States. After experiencing a minor recession in 1991, it entered its longest period of uninterrupted economic growth since the end of the Second World War; employment rose strongly, unemployment declined to levels not known since the 1960s, and gains in productivity accelerated in response to recent technological advances. For the developing world as a whole, the pace of economic growth was also generally healthy. China continued to report an exceptional growth rate of around 10 percent per annum, and India improved on its own past record of moderate growth. The performance of the Southeast Asian countries and of Latin America was marred by the effects of the Asian financial crisis that struck the former in 1997 and was echoed in Brazil in 1998. However, the recovery of most of these countries was unexpectedly rapid. Only in formerly dynamic Japan, in sub-

Saharan Africa, and in the countries within the former Soviet Union's sphere of influence did economic performance in the period generally prove disappointing.[1]

Under these global conditions of diminished international tensions and of solid economic growth, the accelerated expansion of world trade and investment, spurred on by the liberalizations negotiated during the Uruguay Round, was hardly surprising. With the almost universal shift in the direction of more market-oriented policies, the trend toward liberalization of trade and capital flows throughout the world, and the shrinkage of time and distance made possible by the new advances in communications and information technology, the world moved to a new level of economic interdependence. The 1990s became known as the decade of globalization. Some went so far as to proclaim a new dawn in international economic relations.

GLOBALIZATION: A TRANSFORMATION IN COMMERCIAL RELATIONS?

Globalization can be viewed from many aspects. Its most general economic characteristic has been the worldwide dissemination of new technology, greatly aided by the spread of education. It has had positive effects in improving the material well-being of masses of human beings. But it has also exposed countries and communities to wrenching social changes and to the mores and ideas of the technologically ascendant nations. There is a wide appreciation that the political and social consequences of the economic change are probably very large, though these are far from clear at the present time.

In the sphere of commercial relations among countries, however, the changes are tangible, are more readily defined, and even have a historical precedent. Many commentators have observed that the world knew a comparable surge of globalization in the pre-1914 years.[2] However, the degree of global interdependence that has been recently attained appears to be quite unparalleled.[3]

Compared with the pre-1914 world, there are some important respects in which interdependence has recently reached new levels. In the production and sale of goods, the world's markets almost surely have become more interwoven than ever before. As a percentage of world output, merchandise exports reached a level of 22.4 percent in 1998, much higher than any number recorded for the pre-1914 world (see table 1, in chap. 1). Moreover, a substantial part of that trade has been conducted by multinational corporations, partly reflecting the remarkable internationalization of production within these corporations themselves.[4]

Perhaps the claim of greater interdependence is shakier for trade in services. Comparison is difficult because the pattern of trade in pre-1914 was almost the reverse of what it is today. In the former period, there were few impediments to the foreign provision of services in the developing world. The foreign ownership of commercial banking, insurance, and large retail enterprises, for instance, was common, and the shipping industry was largely in the hands of a few developed countries. However, restrictions on foreign access to the service industries in the industrially more established countries were numerous; by contrast, in the recent past, such restrictions have been progressively removed.

When it comes to the movement of labor and capital, the pre-1914 era may appear to have been more liberal. There were formally fewer restrictions on the migration of workers, and the era of the gold standard was also notable for the free movement of finance among capital markets. But if equity and loan capital circulated even more freely then than in the 1990s, the opposite is probably true of foreign direct investment.

Like the pattern of trade in services, that of foreign direct investment was radically different in the two periods. In the pre-1914 world, most such investment was directed toward natural resource production, the service industries, and infrastructure, in the developing world or the regions of recent European settlement. In the years after the Second World War, it took a different character, being focused primarily on industrial investment in the industrially more established countries themselves. When the volume of foreign direct investment–originating very largely from Europe, Japan, and the United States–rose to an entirely new level in the 1980s and 1990s, part was still directed toward the developing world. (China, in particular, attracted heavy foreign investment–including substantial investment by businessmen from the Chinese Diaspora). However, what was most striking about this new surge of investment from the industrially more established countries was that it was dominated by their investments in each other's markets. Mainly through mergers and acquisitions, but also through strategic alliances, licensing, and other arrangements, firms in these areas were seeking to extend their scale of operations by entering the markets of the other industrially more established countries (see Lipsey 2000). Such interpenetration among these countries in the ownership of productive assets took the integration of their economies further than had been the case in the pre-1914 era.

Despite widespread impressions to the contrary, governmental policies in the 1990s favored the progress of economic interdependence more than did pre-1914 policies. Some commentators have been inclined to characterize the pre-1914 world as a golden age of free trade and of free movement of labor and capital—buttressed by the gold standard and the Pax Britannica. But as I discussed in chapter 3, before 1914, all of the leading trading nations except Britain were protectionist in some degree, and sizable internal obstacles to foreign trade and investment were generated by industry practices, such as cartels, and by domestic laws and regulations.

Moreover, in the range and diversity of intergovernmental (and nongovernmental) institutions intended to facilitate economic cooperation, the world has changed substantially since before 1914. In the 1990s, many doubts were legitimately expressed about the effectiveness of the international arrangements and institutions designed to protect international monetary and financial stability; financial crises were not less endemic then than in the pre-1914 era, and exchange rate instability was greater. But in the world of commercial relations (especially since the establishment of the WTO), no one questions that these relations are conducted within a more solid institutional framework than before. One indication of the confidence in the regime is that nearly all the countries that had not previously participated in GATT sought membership in the WTO in the 1990s.[5] (By far the largest and most significant of these countries was China.)

But as the fate of the last period of globalization should remind us, there has been no assurance in the more recent past that conflicts of interest among or within nations would always be resolved in favor of multilateral trade cooperation. The most powerful states might still be impatient with a multilateral discipline that abjures them from taking unilateral action to relieve internal, political, or economic stresses, and the weaker states remain fearful of being caught in a set of rules biased against them. In fact, many developing countries began to express such a view not long after the WTO agreement was reached in Marrakech; they felt that the conditions that they had to meet under the agreement were onerous and that its benefits for them were slow to materialize. The powerful countries, who were experiencing a period of relative prosperity free from the stresses generated by adverse economic conditions, largely abided by the new rules in the 1990s; but even so, they were not immune to disruptive behavior. The European Union and the United States engaged in confrontations with each other that sorely tested the WTO discipline. In addition, they viewed the formation of preferential trading areas as an active policy choice, and they showed little restraint in resorting to antidumping measures (though the developing countries collectively became the greatest users of antidumping measures). Further, a new, popular opposition to globalization began to take shape in the industrially more established countries as labor, environmental, and other groups joined to protest perceived contradictions between social aims and trade cooperation.

Still, on the whole, the period following the signing of the WTO agreement was marked by the robustness of the multilateral trade regime. Some of the business outstanding from the Uruguay Round was substantially completed, the new rules and procedures of the WTO were largely upheld, and some new trade initiatives were taken.

COMPLETING UNFINISHED BUSINESS

For numerous negotiators, the major pieces of business still outstanding from the Uruguay Round were the new issues of liberalizing trade in agricultural products and services. On these issues, many negotiators considered that the round had accomplished little more than to break ground. On agriculture, both the member countries of the Cairns Group and the United States had been disappointed by the outcome, and part of the final agreement was that discussions on agricultural trade should be resumed in the year 2000. In the new and complex area of services, countries also agreed that a review of the General Agreement on Trade in Services (GATS) should be initiated in the same year. More immediately, on the three service sectors of financial services, telecommunications, and maritime shipping, about which negotiators had been unable to come to an agreement in the course of the Uruguay Round, it was understood that negotiations should nonetheless be continued and brought to a conclusion.[6]

Financial Services

Financial services comprised a major service sector given particular importance by the industrially more established countries; it included not only the long familiar commercial banking and insurance industries but also the more recently thriving worlds of brokerage houses, investment banks, and asset management firms. In the earlier phases of the Uruguay Round, negotiations focused primarily on relations between the European Community and the United States. Large differences in banking laws at the time made it difficult to find a basis for reciprocal concessions; in particular, in the United States, federal laws segregated the banking and securities businesses, and state laws impeded access to the national market. While the United States wanted access to be accorded on the basis of national treatment, the European Community argued for "mirror-image reciprocity." But the latter later moved toward acceptance of national treatment, and later changes in U.S. banking legislation also brought the range of permissible activities of American banking institutions closer into line with European practice.

In the later stages of negotiations, both during and after the Uruguay Round, the main stumbling block to reaching an agreement was American dissatisfaction with the offers made by developing countries to liberalize access to their financial markets. American financial institutions were particularly eager to gain easier access to the markets of the rapidly industrializing countries of Southeast Asia and to certain Latin American countries.

Still relatively underdeveloped but being gradually liberalized, the financial services sector of these countries offered substantial, long-term business opportunities. For their part, the developing countries were not unaware of the benefits that foreign participation could bring as a vehicle of innovation and in establishing closer links with international capital markets. But at the same time, they wanted domestic firms to be substantial participants in the evolving domestic market.

Thus, the issue was over the pace at which markets should be opened up to foreign participation (see Cornford 1997). The United States pressed for more liberalization than was initially offered by the developing countries. In the course of the lengthy negotiations on financial services, the United States more than once asserted that it was withdrawing from the multilateral negotiations and resorting to bilateral discussions; in other words, it was not willing to apply the nondiscrimination rule to its own offer of market access. Considerable pressure was brought on the developing countries to make more liberalized offers. For the Southeast Asian countries, the onset of the Asian financial crisis in 1997 heightened their vulnerability to external pressure as they sought to restore the international financial community's confidence in their economies. After the developing countries had tabled enhanced offers, an agreement on financial services was reached in December 1998. In one opinion, the agreement did little more than lock in reforms that countries had already been introducing in the banking sector,[7] though it did result in some liberalization of the insurance and securities sectors in a few developing countries.

Telecommunications

The negotiation of an agreement to liberalize trade in telecommunications services had some similar characteristics. The core of the agreement was the market liberalization agreed between the United States and the European Community (later the European Union), and delaying the conclusion of the negotiations was the dissatisfaction of the United States with the offers of liberalization made by other countries. Until the 1980s, the telecommunications sector in virtually every country of the world either had been run by state-owned monopolies or was tightly regulated by the state. This began to change in the 1980s and 1990s, mainly because technological innovations in telecommunications opened up the possibilities for competing suppliers of the services. The United States was among the first to deregulate, followed closely by a number of Western European countries. But many nations were reluctant to undertake the dismantling of state ownership or control required by deregulation, and their offers to liberalize their trade in telecommunications services were accordingly limited. Canada, for example, held out against foreign majority ownership of telecommunications enterprises operating within the country, on the grounds that it wanted to maintain control of its "information highway."[8] In the end, however, countries made liberalization offers that were not inconsistent with their own domestic pace of deregulation and that were acceptable to their more powerful trading partners.

Maritime Shipping

Negotiations on maritime shipping petered out in 1996 without conclusion, when the United States announced that it would not table an offer of concessions. A principal reason for this was the refusal of the U.S. administration, in the face of opposition from the unionized maritime industry, to ask the U.S. Congress to rescind a law that restricted trade between American ports to American ships.

GREATER RESPECT FOR THE MULTILATERALLY AGREED RULES?

There is no doubt that the negotiators from a great many countries worked hard during the Uruguay Round to improve the prospect that the multilateral rules would be universally respected. One major step took place when their governments agreed to refrain from actions–such as the use of voluntary export restraints–that evaded the rules of the WTO; this clearly narrowed down the possibilities for resorting to trade measures that might seem arbitrary and harmful to others. At the same time, the negotiators introduced improved procedures for the settlement of disputes, in the hope that disagreements about adherence to the rules would no longer be decided unilaterally.

At least in the few years from the establishment of the WTO in 1994 to the end of the twentieth century, the hopes of the negotiators appeared, by and large, to be realized. However, in a world of states that are recurrently infected with "mercantile jealousies" and "national animosities"—to use Adam Smith's phrases (Smith 1937, 463)—and that also differ greatly in their economic power, respect for the multilaterally agreed rules remained a fragile thing. Even in these few, short years, disputes between the two largest trading powers—the European Union and the United States—sorely tested confidence (as I will discuss shortly). Moreover, within the confines of the existing rules, some of which are no more than broad guidelines, there remained large possibilities for unilateral or bilateral actions that, if not resorted to sparingly, could erode confidence in the regime as a whole.

The New Dispute Settlement Machinery and Trade Disputes

In the main, the new dispute settlement machinery worked well; it was respected—for the most part—by the powerful countries, and it accordingly gained the confidence of the smaller and weaker countries. Numerous complaints were received by the WTO Dispute Settlement Body, and consultations between the contending parties were initiated. In some cases, disputes were resolved bilaterally; in others, the WTO was asked to adjudicate. By January 2000, some forty-five dispute panels had been established for this purpose, and the appellate board or dispute panels had presented their findings in twenty-eight cases.[9] Most disputes were over clearly defined issues, on which the appellate board or the dispute panels offered judgments based on a balanced interpretation of the rules. The disputes ranged widely from the application of familiar trade barriers (e.g., quantitative restrictions), through fair-trade issues (e.g., subsidies and antidumping duties), to the new question of intellectual property rights. Only in disputes between the European Union and the United States did compliance with the rulings appear to be seriously in question.

Two disputes between the European Union and the United States took central stage on this score. They concerned the importation of bananas and hormone-fed beef into the European Union, and both disputes dragged on for quite a number of years without satisfactory solutions. In both cases, the actions taken by the European Union, which were the original source of the disputes, were responses to internal, political considerations and were not protectionist in intent; there were no European banana producers, and the European Union's ban on hormone-fed beef applied to domestic, as well as foreign, suppliers. The action on bananas derived from an attempt to protect small-scale banana producers in the Caribbean and elsewhere when a unified import regime was introduced as part of the 1992 Single Market program.[10] The ban on hormone-fed beef was a response to the disquiet among European consumers about chemically or biologically modified foods. However, these actions restricted access to the European Union's market for the banana exports of American multinational corporations and for the beef exports of American farmers. The United States challenged the European Union's actions as against WTO rules, winning rulings in its favor. If trade relations between the European Union and the United States had been less strained, an earlier resolution to the disputes might have been found.[11] But both sides adopted a litigious approach. The European Union contested the rulings. Moreover, it appeared to counter the American action by asking for WTO adjudication on whether certain U.S. legislation, most notably the legislation on foreign sales corporations, was consistent with WTO rules.[12] The United States insisted on full implementation of the rulings in its favor, and it finally went forward with the imposition of punitive, retaliatory duties.

These cases put a strain on the dispute settlement machinery. It was an unfair strain, since a quasi-judicial process was being used as a battleground for the confronting of political differences that could better be resolved through diplomatic conciliation. The danger was that a litigious approach to the resolution of political differences might bring the dispute settlement machinery into disrepute.

The Antidumping Loophole Exploited

Besides failures to resolve disputes, there were two other kinds of trade conduct that carried serious risk for confidence in the multilateral regime. One was the abuse of antidumping legislation for patently protectionist purposes, and the other was the proliferation of bilateral or regional free trade agreements

As I mentioned earlier, during the 1980s and the early 1990s, the United States and the European Community had increasingly resorted to antidumping legislation as a means of providing relief to domestic industries facing intense price competition from imported products. The United States had been particularly insistent during the Uruguay Round that the multilateral rules relating to antidumping practices should not significantly reduce the scope for administrative discretion by national agencies in deciding on complaints about dumping. Since an outcome of the Uruguay Round had been to close down other channels through which relief could be offered, national antidumping legislation assumed a new importance. The number of antidumping measures taken by governments throughout the world steadily increased after the WTO agreement came into effect. There were reportedly 880 antidumping measures in force at the end of 1997 and 1,097 at the end of 1999. About one-third of the measures were taken by the United States, about one-sixth by the European Union. Developing countries also made increasing use of antidumping legislation, perhaps partly as a means of retaliation. India, Mexico, and South Africa, for example, were making quite extensive use of antidumping measures in 1999, together accounting for almost one-quarter of all reported measures in force (see World Trade Organization 2000).

Preferential Trading Areas

As I noted in chapter 10, bilateral and regional trade agreements proliferated in the years before and since the signing of the WTO agreement. By the end of 1999, the WTO Committee on Regional Trade Agreements had seventy-seven regional or bilateral trade agreements before it for review. Other potential agreements, under negotiation or being mooted, were on the agendas of individual governments. As I already stated, these many agreements or proposed agreements were not necessarily inconsistent with the multilateral trade rules. A two-tier system of both multilateral and regional or bilateral agreements was nothing new. What was new was that the major trading nations—especially the

United States and, more recently, Japan–showed a rise in interest in these arrangements; as I discussed in chapter 10, this rise carried the risk that the major trading powers would exploit regional or bilateral trading arrangements to rival each other in the establishment of huge preferential trading areas. Though by no means the sole or even the main reason for these arrangements, it would be difficult to assert that such a motivation was entirely absent. However, rivalry did not break out in the formation of preferential trading areas between the European Union and the United States. One very immediate reason for this was that the Clinton administration's authority to negotiate free trade agreements for the United States lapsed after the congressional approval of NAFTA; in the face of likely congressional opposition, no attempt was made to renew it.

NEW TRADE INITIATIVES AFTER THE MARRAKECH AGREEMENT

After 1994, besides revisiting issues that many saw as not satisfactorily resolved during the Uruguay Round, the members of WTO considered several new initiatives that called for further reductions in tariff or nontariff barriers or that proposed extensions of the existing rules. The new institutional arrangements established by the WTO agreement provided a convenient framework for the discussion and negotiation of such initiatives, since the agreement stipulated that a ministerial conference should be held at least once every two years.

Prior to the Seattle conference of November 1999, when an attempt was made to launch a new round of multilateral trade negotiations, two other ministerial conferences were held, one in Singapore in 1996 and the other in Geneva in 1998. Besides reviewing the operation of the WTO regime, these conferences were the occasions for discussion or negotiation of new initiatives. One major step in trade liberalization, successfully negotiated in 1996, was the Information Technology Agreement, in which countries agreed to move progressively toward the elimination of tariffs on a range of information technology products. Another was the agreement to place a moratorium on the taxation of transactions conducted through the Internet.

Several other proposals were of a more general character, being directed toward eventual modification or extension of the rules of WTO. The WTO agreement itself had established four committees to study matters that members believed to be unresolved. These matters covered the large issues of trade and development, trade and the environment, regional trade agreements, and balance-of-payments restrictions. At the Singapore conference, members also agreed to study some other issues–those concerning the relationship between trade and investment, trade and competition policy, and the transparency of government procurement (all discussed shortly)–which became part of the dialogue about a negotiating agenda that took place at the Seattle conference. A further proposal was made by the United States at the 1996 conference, concerning the relation between trade and labor standards. The decision at the time was that the matter fell within the competence of the International Labor Organization (ILO), not the WTO. But it again became a bone of contention at the Seattle conference, where the United States once more tabled the issue.

CHANGING POPULAR ATTITUDES IN THE INDUSTRIALLY MORE ESTABLISHED COUNTRIES

In the industrially more established countries, the 1990s were remarkable for the surge of popular opposition to the pursuit of more open trade policies or, more broadly, to globalization.[13] The opposition was particularly vocal in the United States, where it became a power to be reckoned with in political decision making: it made for uncertainties in congressional approval of such major policy measures as the formation of NAFTA, the accession of the United States to the new WTO regime, and agreement to the accession of China to the WTO; and it helped to prevent the president from gaining authority to negotiate any new multilateral, regional, or bilateral trade agreements. In the European Union, vocal opposition was perhaps both more diffuse and more specific; some of the opposition to freer trade was focused on the tensions arising from further integration or enlargement of the European Union itself, and some was channeled into such particular concerns as the sale of genetically modified foods or the loss of cultural identity in the audiovisual industry. In both the European Union and the United States, the WTO proved to be an easily identifiable institution against which the expressions of popular opposition to trade policies could be directed, and the street demonstrations in Seattle, Geneva, and elsewhere assured the protesters of exceptional worldwide publicity.

The opposition was a very diverse coalition of groups representing different interests or social concerns. It included labor unions; environmentalists; advocates of human rights, labor rights, and women's rights; and activists with looser and less definable, anticapitalist or even anarchist agendas. For some, the motivation was the long familiar–and legitimate–fear that more open trade led to the loss of employment or the depression of wages in their particular industries. Sharing their sense of insecurity were many ordinary citizens who, though not directly threatened with job or income losses, were also well aware of the social dislocations caused by rapid economic and technological change.

The public argument put forward by the unions, however, turned mainly around labor standards in other countries, particularly in developing countries now emerging as exporters of manufactures. The general tenor of their argument was that such competition was unfair if industries in other countries were not conforming to certain minimum labor standards. It was argued, moreover–and with some justification–that more open, global markets tended to depress the wages of unskilled workers in the developed world, since (like immigration) they made unskilled labor less scarce at home (relative to capital and highly skilled workers).

In some respects, the environmentalists argued in a similar fashion. They saw trade as sometimes undermining the higher environmental standards for which they had fought at home. But they were also expressing more generalized concerns; the expansion in international trade was an overt manifestation of a pace of global economic growth that evoked many valid fears about its adverse effects on the world's natural environment.[14]

There were, in addition, many protesters whose concerns went beyond particular economic or environmental issues. They saw trade policy as one strand in the foreign relations of their nation and believed that these relations should be guided by national, moral values. It was morally offensive, for example, to import products from countries where basic human rights or labor rights were not respected. Thus, they urged that trade policy should be used as a means of advocating or defending these values.

The WTO and Environmental Concerns

Partly in response to the advocacy of environmentalists, the United States, with support from European countries, insisted during the Uruguay Round that the new institutional arrangements for the WTO should include a standing committee on trade and the environment. Since the committee began its work, its main activity has been to explore the relations between the rules of the WTO and the more than two hundred multilateral environmental agreements in existence among governments. Only about twenty of these agreements included trade provisions, and at least by the end of 2000, none of these provisions had become the occasion for any trade dispute within the WTO.[15] This suggests a very large measure of compatibility between environmental measures and WTO rules. Trade disputes of an environmental character arose nonetheless in the WTO in the 1990s, and these disputes demonstrated where the possibilities for conflict existed.

There was never any question that governments were free to pursue whatever environmental policies they chose within their national boundaries; GATT, now the WTO, has long recognized that governments could apply import restrictions or prohibitions to protect environmental standards within their own borders. However, by their nature, some environmental problems cross national boundaries, and the environmental standards adopted at home may be rendered ineffective if these standards are disregarded elsewhere.

Many environmentalists advocated that the WTO should allow the unilateral use of trade measures or sanctions in order to enforce cross-border compliance with domestic environmental standards.[16] In the 1990s, the use of trade restrictions was, in itself, by no means novel; as I just mentioned, about twenty of the existing multilateral environmental agreements included trade provisions. But these were agreements to which countries had committed themselves voluntarily. The unilateral use of trade measures to enforce the compliance of other countries with specified environmental standards, whether they have agreed to these standards or not, would have gone well beyond recent practice, and it raised many objections. Developing countries feared that with their weak bargaining position in the WTO, environmental standards incorporated into the WTO and enforceable through unilateral trade measures would fail to take full and fair account of the poverty from which they are struggling to emerge. Without being less concerned about environmental degradation, poorer countries faced more difficult trade-offs between the betterment of life for human beings and environmental damage than did wealthier countries There was, moreover, the concern that environmental standards could readily be abused for protectionist purposes.

The WTO and Labor Standards

At the 1996 WTO ministerial conference in Singapore, the United States proposed the establishment of a committee, similar to the environmental committee, to study the relation between trade and labor standards. This proposal was fiercely resisted by the developing countries, primarily because they saw it as a first step toward the adoption of rules that would be protectionist in intent. They observed that the international negotiation or surveillance of labor standards had long been and continued to be the business of the International Labor Organization. While the proposal went no further at the conference, it did not go away. It remained at the forefront of American political discussions on trade policy. In 1993, to gain congressional approval of NAFTA, the Clinton administration had negotiated a side agreement with Mexico on labor standards (as well as another on environmental standards), and the U.S. free trade agreement negotiated with Jordan in 2000 included a provision about respect for labor standards.[17] It had become the official position of the Clinton administration that future trade agreements should incorporate a provision relating to respect for "core" labor standards.[18] As will be discussed shortly, this issue assumed importance again at the WTO conference in Seattle.

For those seeking to introduce social standards into the rules of the WTO, the great perceived advantage was that it would become possible to enforce compliance with the standards through the use of trade measures or sanctions. But many others, though also supporting the advocacy of social norms, were highly critical of such a linkage.[19] At the most practical level, the clear-cut definition of social aims in legalistic terms is elusive, and there would inescapably be an element of politically subjective interpretation in any judgment about whether particular countries were meeting specific social standards. The possible misuse of the standards as a cloak for protectionist action could accordingly be large. The most pragmatic objection was that the use of trade sanctions for this kind of purpose has, more often than not, proved ineffective. With a few notable exceptions, the historical record of trade measures or sanctions as a means of persuading individual countries to abide by externally determined standards has been poor. First, there has been the difficulty of ensuring that all other countries collectively enforced the measures or sanctions; otherwise, their effect may simply be to divert trade, not diminish it. Second, unless an offending country has a strong constituency favoring adoption of the standard, its government may do no more than make nominal changes in its practices; may refuse to make any changes at all, out of national resentment against foreign interference; or, if large and powerful enough, may itself successfully use trade measures to undermine the foreign resolve to enforce the measures.[20]

A broader objection stems from the history of the multilateral trade regime itself. From one point of view, this history can be seen as a long endeavor by governments to restrict the freedom that each government has to intervene arbitrarily in its external commercial relations; governments have agreed to let their own trade conduct be governed by an ever widening set of rules that has allowed commercial principles to determine the pattern of trade and investment. Trade measures or sanctions have, by agreement, been used to uphold these rules. But if these measures could be more widely employed for other purposes, at the instigation of individual governments, the discipline so painstakingly built up in trade relations would be eroded. The result, as Chris

Patten has observed, would be a "muddle of objectives and tactics" (Patten 1999, 278). In other words, except in rare circumstances (e.g., the sanctions applied against South Africa because of apartheid), it is preferable to pursue noncommercial aims directly on their own terms, through the many channels that are open for advocacy and moral suasion—not through the use of trade measures.[21]

SEATTLE: "WILL YOU, WON'T YOU, WILL YOU, WON'T YOU, WON'T YOU JOIN THE DANCE?"

Popular demonstrations in the streets of Seattle—organized by a wide coalition of activist groups—briefly propelled the third ministerial conference of the WTO, held in December 1999, to the forefront of the world's attention. What happened among the governmental representatives in the meeting halls, however, was far less dramatic, though almost as confrontational. Led by the United States as the host of the conference, governments put forward diverse sets of proposals for trade liberalization or for the revision of WTO rules, with the aim of constituting the substance of a new round of multilateral trade negotiations. But no consensus on a negotiating agenda could be reached, and the launching of a new round was therefore postponed.

In substantial part, the issues put forward for negotiation were rooted in the Uruguay Round itself. Some were continuations of endeavors made during the round to gain greater market access for exports. Others were proposed revisions or refinements of trade rules adopted during the round but found to be unsatisfactory. Yet others reflected dissatisfaction with the pace of implementation of the new concessions or obligations agreed on during the round. However, some significant new proposals were also made, intended both to improve market access and to extend the rules of WTO to embrace new areas of conduct.

In the continuation of endeavors to enlarge market access, the further liberalization of trade in agriculture and services was at the forefront; the resumption of discussions on these two sectors had indeed been mandated by the Uruguay Round itself. The reduction of barriers to agricultural trade, particularly the elimination of export subsidies, was still high on the list of the United States and of the countries comprising the Cairns Group (though no radical reforms of farm policy had taken place in the European Union, Japan, or elsewhere since the end of the Uruguay Round). In services, both the United States and the European Union sought the expansion of coverage by the General Agreement on Trade in Services to other sectors, as well as the greater liberalization of trade in the sectors already included. The major trading countries also wanted to negotiate tariff reductions on a range of industrial products that were still subject to substantial duties.

In some degree, proposals for the revision of rules agreed during the Uruguay Round were the normal outcome of a rules-based system. The need to elaborate or refine existing rules becomes evident as their use reveals ambiguities that allow differences in interpretation or fail to address circumstances that were unforeseen. One American proposal, for instance, sought to realize greater transparency in the implementation of national rules relating to government procurement. Several countries, including Australia, Canada, and Japan, proposed the establishment of a working group on biotechnology; at heart was the issue of the scientific standards that members–such as the European Union–applied in restricting imports of genetically modified foods on the grounds that they represented a risk to human or plant life. Japan and developing countries, among others, also wanted to revisit the antidumping rules. Despite some revisions during the Uruguay Round, these rules had left countries considerable leeway in interpretation and enforcement of national laws. (This leeway had remained at the insistence of the United States, whose position remained unchanged at Seattle.)

Most developing countries were unenthusiastic about the prospect of another round of trade negotiations. Before coming to Seattle, many already shared a feeling that the results of the Uruguay Round had been unbalanced. They also felt that in the implementation of these results–particularly as regards the liberalization of trade in food and in textiles and apparel, which was so important to them–the industrially more established countries had been delaying action to the latest possible date. In comparison, the developing countries were being pressed to act speedily in redrafting their laws affecting such matters as services, intellectual property, and foreign investment in order to conform them to the new WTO rules. Thus, the developing countries wanted, among other things, to postpone the enforcement of the rules relating to intellectual property and foreign direct investment and to shorten the ten-year time schedule for the removal of restrictions on textile and apparel imports. While the broad response of the industrially more established countries was that agreements already reached could not be reopened, it was understood that "implementation issues" should be part of the agenda.

Not all the proposals made at Seattle were revisitations of issues generated by the Uruguay Round. The United States wanted to broaden the coverage of the Information Technology Agreement that had been signed in 1996, and it also sought to make permanent the internationally agreed moratorium on the taxation of e-commerce transactions. The European Union urged that the formulation of rules on competition policy be included in the negotiating agenda, and it wanted to reopen the negotiation of rules relating to foreign direct investment; on both issues, it had the support of Japan. These were matters that had been raised at the ministerial conference in 1996 and on which the WTO had established committees to study and report.

The relation between trade and competition policy was by no means a new concern in international discussions.[22] There was always a persuasive logic to the argument that agreed reductions in trade barriers could be rendered meaningless if the anticompetitive practices of businesses (or governments) frustrated competition from foreign enterprises. The Havana Charter drafted in 1948 had included a clause relating to restrictive business practices, and numerous other attempts have been made, both internationally (as in the OECD) and bilaterally, to draw up agreed guidelines. The task has proved difficult because of differences among countries in industrial organization, accustomed business practices, and views about what constitutes anticompetitive behavior, and it has been complicated by changes in these views as economists' analyses of business behavior has gained in depth. But the relevance of the problem for trade relations has increased in recent years as trade barriers at the border have fallen and—particularly in trade relations between the European Union and the United States—as huge, cross-border corporate mergers have multiplied. At Seattle, however, the United States expressed skepticism about the possible benefits of introducing competition rules into the WTO, and both the European Union and the United States were concerned that such rules might pose a challenge to their antidumping laws.

On foreign direct investment, the main hope of the European Union at the Seattle conference was to bring the existing WTO Agreement on Trade Related Investment Measures (TRIMS) closer into line with the principles of national treatment and nondiscrimination. These principles were reflected in the Multilateral Agreement on Investment (MAI) that the OECD had recently drafted, but the negotiation of that agreement had been abandoned because some countries had had second thoughts about its intrusive character and because of remarkably effective opposition from trade unions and other antiglobalization groups. Under the circumstances, the United States doubted whether a useful revision of the existing agreement could take place within the WTO.

The United States and the European Union were agreed that the issue of labor standards, as well as that of environmental standards, should be included on the agenda. This seemed an ominous development to the developing countries. It aroused in them fears of the abuse of trade rules (fears discussed earlier in this chapter).[23] Indeed, a speech by President Clinton in Seattle in which he appeared to support the use of trade measures or sanctions to penalize countries not meeting labor standards did much to harden the antagonism of the developing countries toward the negotiations.

In the end, the differences of position both among the industrially more established countries and between them and the developing world could not be bridged. It never became clear to the different parties that a satisfactory basis for reciprocal concessions was being laid, and a resumption of negotiations was left to the next conference in Doha in November 2001.

12 Epilogue

Writing a concluding chapter to a study of contemporary history is like bringing down the curtain on a play that is still being acted. The temptation is to speculate on how the plot may unfold in later scenes. On the stage of international trade relations, most observers seem to expect that states will continue to be drawn ever more closely together. The shrinking of time and distance brought about by technological change, the spread of industrialization, and the rise almost everywhere of some form of capitalist society have combined to sustain the unending search of commercial enterprises for markets and sources of supply beyond national frontiers. This supports the belief that multilateral trade cooperation should continue to gather strength.

The history of trade relations since the mid–nineteenth century does not contest the influence of these large, impersonal forces in advancing trade cooperation. But if we follow the course of these relations from year to year or decade to decade, we know that cooperation has actually traced a very winding and uncertain path. Advances have been interspersed with periods of retreat. Even when governments have moved to enlarge their cooperation, they have everywhere done so in the face of opposition from particular interest groups at home. Severe recessions have been particularly fertile breeding grounds for hostility toward greater cooperation, and recurrent international financial crises—with abrupt contractions in capital flows and large realignments in exchange rates—have stirred up resentment of open trade and investment policies. Moreover, when governments have sought to negotiate trade agreements with each other, they have brought strong nationalist sentiments with them to the negotiating table. Each government has pressed single-mindedly for what it has perceived to be its own national interest, and all governments have feared that others might be taking advantage of them.

The first decisive steps toward the multilateral trade cooperation that we know today were taken in the mid–nineteenth century. In the balanced give-and-take of reciprocity, governments found a means to manage their mistrust of each other and to negotiate—if often cautiously and parsimoniously—mutually advantageous reductions in trade barriers. In agreeing not to treat each other any worse than they did any other trading partner, they almost inadvertently established links among their separate trade agreements. Together, these agreements formed an embryonic system of multilateral cooperation.

But the mutual trust was fragile, and the system was unstable. Governments often reverted to unilateral action; they raised trade barriers in defiance of their trade agreements, either in response to demands from domestic producing interests or because they suspected that their trading partners were not abiding by their agreements. Traders were consequently never safe from seemingly arbitrary interventions of foreign governments, which heightened business risks and constrained trade flows.

The first period of multilateral trade cooperation was abruptly brought to an end by the catastrophic outbreak of the First World War. The war radically altered the economic circumstances of the leading trading nations and their relations with each other. The restoration of stability in the exchange rate system—then seen to be so necessary for cooperation on tariff reductions—proved unattainable on a lasting basis, and the onset of the Great Depression dissipated any last hopes of restoring the trade regime. The difficult and tangled political and economic circumstances of the time, to which governments responded with sometimes ill-conceived policies, sharpened the mutual mistrust familiar among states and left each with no apparent option but unilateral action.

After the Second World War, multilateral trade cooperation moved onto a higher plane of mutual trust. The harsh lesson taught by the bitter experience of the interwar years was well learned. Led by the United States, governments set about deliberately to establish a framework of common institutions that would deter mutually destructive, unilateral behavior. In trade relations, their action took the form of a multilateral agreement embodying norms, rules, and procedures for trade conduct, which became the basis for the more elaborated and extended regime that we know today as the WTO.

Compared with the network of trade relations that prevailed before the First World War, this later phase of trade cooperation is distinguished by its intentionally multilateral character: it has been composed of multilateral rules and procedures to which countries have collectively consented. Its operation has depended on the conscious and common recognition of the mutual advantage to be gained from abiding by these agreed rules and procedures. While the public dialogue among governments has always been dominated by the noise of contentious bargaining or of accusations of bad faith, there has nevertheless been an underlying acceptance of a multilateral process of rule making. The emergent regime not only has facilitated the reduction of barriers to the flow of goods and services across national frontiers but also has progressively lessened the possibilities for governments to intervene in trade relations in ways that, from the point of view of others, appear arbitrary and unpredictable.

We have to recognize, however, that a regime intended to regulate the conduct of states in their trade relations is a fragile invention. Nations have remained independent entities, and there is no superior body empowered to enforce the rules. The most powerful trading nations, especially the United States, have from time to time used their power to cajole or threaten others into conforming with the rules; but as major participants with their own national interests, they have likewise been guilty of abusing their power by disregarding the rules themselves.

States have collectively sought to strengthen respect for the rules through the institution of a quasi-judicial process for the settlement of disputes, and a major value of the process is that it has helped to restrain countries from the kind of precipitate, unilateral action that often escalated into destructive trade wars in the nineteenth and early twentieth centuries. But the fact remains that adherence to the rules—including the dispute settlement process itself—has rested not on any powers of enforcement but on the respect that nations have been willing to accord the rules themselves. That respect has depended on their common perception that participation in the collective arrangement is in their own interest.

The great success of multilateral trade cooperation is that in the conduct of their trade relations, states have gradually accepted an increasing role for common rules in place of the ad hoc use of power. But there is an endless struggle within countries between the desire to act in their own immediate interest and the willingness to abide by common international rules. In changing economic conditions, powerful nations have sometimes found existing rules less acceptable than when they first agreed to them. Not only have they sometimes broken the rules, but they have unsurprisingly been inclined to urge on others new rules that best suit their own interest (and that may well appear eminently fair to them in the context of their own circumstances). When existing rules are disregarded or when new rules are deeply resented, the likely consequence is that other governments exercise their ingenuity in finding ways to sidestep their own formal obligations.

As it has so far developed, the multilateral trade regime can be characterized as a largely successful arrangement that allows the commercial enterprises of countries having some form of capitalist economic system to gain easier and more stable access to each other's markets and sources of supply. It has managed to accommodate within its set of rules and procedures a great many countries that differ widely in their levels of development, their social institutions, and their national aims and policies. Its success derives in large part from the fact that its rules and procedures have been relatively modest in their aim. They have focused on regulating relations among states in the mundane world of commercial activity and have not, for the most part, impinged on larger, noncommercial issues. In the very recent past, however, as negotiations about barriers to commerce have penetrated more deeply into the conduct of business within domestic markets, national sensitivities about the effects of the trade regime on noncommercial issues have more often come into play. The possibilities of conflict between the ever expanding trade regime and noncommercial national aims have thus increased. For instance, recent noncommercial issues on which national and commercial views have differed strongly include making pharmaceuticals available to HIV-infected persons in disregard of intellectual property rights and the protection of consumers against genetically modified foods.

Probably the most persistent dilemma of the multilateral trade regime is its uneasy relation with economic development. This dilemma has two facets. The first stems from the fact that developing countries are fiercely–and understandably–committed to the advancement of their own peoples and resources through the modernization of their economies. This aim has never been easy to reconcile with a multilateral trade regime whose overriding intent is to bring about progressively more open market access for foreign-owned products, services, or capital. The two conflicting aims can only be reconciled with as much good sense as possible.

Whereas the first facet of the dilemma turns around the issue of access to the markets of the developing world, the second is just the reverse. The economic success of many developing countries has intensified their search for access to foreign markets. The industrially more established countries, however, have repeatedly resisted the adjustments in their own economies that would make room for the products of more efficient producers from elsewhere, especially the newer producers in the developing world. The resistance has been most evident in such major industries as agriculture, textiles and apparel, and steel. The more powerful and established countries have manipulated the multilateral trade regime in support of their reluctance, and that manipulation has been a continuing threat to the regime's integrity.

As we enter the twenty-first century, many more developing countries are now members of the WTO–including the huge and powerful trading nation of China. It thus seems likely that sources of conflict between the commercial interests of the industrially more established countries and the developmental aims of the developing countries will come more frequently to the surface.

However, neither the issue of economic development nor the conflicts with social aims necessarily present insuperable difficulties. What has characterized the history of the postwar trade regime has been the largely pragmatic spirit in which its rules and procedures have been designed and applied. It is true that ideas of market efficiency, as expounded and advocated by mainstream economists, have been influential in guiding the formation of these rules and procedures. But it is also fair to say that the WTO and its predecessor, GATT, have not been vehicles for promoting a particular ideology of global free trade. Rather, an accumulating set of commercially oriented rules and procedures, collectively reached, have served to advance the trading interests of all the participating nations. Negotiators have generally recognized that national differences in aims and institutions must be respected if a consensus about these rules and procedures, so important for effectiveness of the regime, is to be sustained.

Appendix

Some Relevant Academic Research on Multilateral Trade Cooperation

Most academic work on trade policy over the decades has addressed itself to the decisions taken by individual, national governments. The unit of analysis has been the nation as an independent entity. One extensive branch of the literature consists of historical accounts of the twists and turns that national trade policies have taken in individual countries; these accounts have been much drawn on in this book, and references to them are scattered throughout. Besides these many narratives, economists and political scientists have built up a substantial body of empirical research on various aspects of national policies. Starting with different simplifying assumptions about the behavior of states and individuals, the perspectives of the economists and political scientists have, of course, not been the same. Though the lines of division in their studies are happily blurred in some places, there remains much room for closer integration. (Robert Baldwin has offered a succinct comparative analysis of the two approaches and has added some thoughts on future common work. See Baldwin 1996.)

Most of the work of economists over the years has focused on the explanation of protection in individual countries. One major line of inquiry has been undertaken at the microeconomic level and has attempted to explain differences among individual industries in their levels of protection or in the changes in these levels over a (usually fairly short) period of years; a common thread has been the attempt to determine how far protection can simply be explained by the manipulation of political power. (For a review of the literature, see Marks and McArthur 1993.) Some research has also addressed changes in aggregate levels of protection over longer periods, to assess the effects of macroeconomic factors, such as recessions, on these changes (see, e.g., Grilli 1988) Taking a more encompassing view, some political scientists have also explored long historical changes in national trade policies. Judith Goldstein, for instance, gave emphasis to the influence of ideas and institutions in altering the timing and content of long-term changes in American trade policy (Goldstein 1993). Peter Gourevitch compared the responses of five industrial countries to three crises in the international economy and was struck by the similarity in responses despite differences in ideology and institutions (Gourevitch, 1986).

None of the research so far mentioned has directly addressed the issue of cooperation in trade policy among nations. The first major attempt to analyze cooperation made after the Second World War was the theory of hegemonic stability put forward by several economists and political scientists (see Kindleberger 1981, 1983; Gilpin 1981). Drawing primarily on the historical experience of the United States in the first quarter century after the Second World War, as well as on that of Britain in the nineteenth century, the theory argued that trade cooperation depended on the existence of a hegemon able to enforce compliance with multilateral norms and rules. Mancur Olson's famous study *The Logic of Collective Action,* published in 1965, drew conclusions that appeared to support this view. He argued that in the absence of a central authority to enforce compliance, the rational pursuit of self-interest would dictate against participation in collective action; the individual would pursue his own interest, hoping to gain (at no cost) from the compliance of others. This argument attacked the conventional wisdom that if a group of individuals would all benefit from some form of collective action, it should be possible for them to arrange that such action be taken. (Olson also argued, however, that if the group of individuals were small enough, voluntary compliance could be feasible.)

The hegemonic theory was later subject to extensive criticism, both on historical and on theoretical grounds. Despite the decline of American hegemony in the 1970s, multilateral cooperation persisted, and that fact called for explanation. In his major study *After Hegemony: Cooperation and Discord in the World Political Economy* (1984), Robert Keohane expounded the answer of a group of political scientists known as the liberal institutionalists. While acknowledging the realism of the view that power and interest profoundly influenced international economic relations, these scholars contended that multilateral rules and institutions could successfully resolve the problem of compliance and allow nations to engage in mutually advantageous collective action. They were considerably assisted in their argument by the postwar development of game theory. Robert Axelrod, for instance, explored how cooperation could arise among rational egoists in the absence of a strong central authority that was imposing its will on them; he concluded (on the basis of a large number of computer-generated trials of the tit-for-tat game) that under certain conditions, cooperation could take place even without prior negotiation among the parties (Axelrod 1984). One key condition was that the participants had to interact repeatedly and had to expect to continue to do so. This condition is well exemplified in multilateral trade cooperation. The behavior of trading partners toward each other has been increasingly influenced by—to use Axelrod's phrase—"the shadow of the future"; partners have refrained from egoistical acts today because of their awareness that these might jeopardize future trade relations.[1]

A number of economists have also recently set out to study directly the rules and institutions of multilateral trade cooperation. Accepting these rules and institutions as an integral part of national trade policies, they have explored their economic rationale. (For a review of this literature, see Staiger 1995.) Kyle Bagwell and Robert Staiger, for instance, have analyzed the principles of reciprocity and nondiscrimination embodied in GATT/WTO, concluding that the framework of rules resulted in a more efficient trade policy for participating countries than would be the case if they pursued a unilateral policy; this conclusion was based on the premise that large countries were tempted to pursue the latter to reap gains from the terms-of-trade effect (Bagwell and Staiger 1997). Alan Deardorff has likewise analyzed several aspects of the WTO, to demonstrate how its rules and procedures encourage countries to pursue trade policies that are mutually advantageous but that they might otherwise be tempted to employ in ways harmful to each other (Deardorff 1996). His approach has drawn on game theory–in particular, the prisoner's dilemma.

Notes

Introduction

1. Robert O. Keohane has a valuable discussion of cooperation in his book *After Hegemony*. He contrasts it with harmony and discord. In the former, no mutual adjustment of policies to achieve common goals is necessary. In the latter, no adjustment is acceptable, and common goals are not realized. See Keohane 1984, 51–55.

2. The phrase "industrially more established countries" is used throughout the book to refer to those countries whose industrialization had already advanced substantially before the outbreak of the First World War. These were principally a handful of countries in Western Europe and North America.

Chapter 1

1. Global data on intrafirm exports between multinationals and their foreign affiliates are far from complete. The estimate extrapolates from data for France, Japan, Sweden, and the United States. See United Nations Conference on Trade and Development 1995, table 9; 1996, 121.

2. In a recent paper on foreign direct investment, Robert E. Lipsey makes the point (among others) that not only has the bulk of such investment been in the industrially more established countries of Western Europe and North America, but their inflows and outflows of direct investment have, for the most part, roughly balanced (Lipsey 2000).

3. Even in seventeenth-century England, such conflict was in full flood, as Thomas Macaulay observed in his great political history of the period: "the manufacturers of Spitalfields, of Norwich, of Yorkshire, and of the western counties, considered trade with the eastern seas as rather injurious than beneficial to the kingdom. The importation of Indian spices, indeed, was admitted to be harmless, and the importation of Indian saltpeter to be necessary. But the importation of silks and Bengals, as shawls were then called, was pronounced to be a curse to the country. The effect of the growing taste for such frippery was that our gold and silver went abroad, and that much excellent English drapery lay in our warehouses till it was devoured by the moths. Those, it was said, were happy days for the inhabitants both of our pasture lands and of our manufacturing towns, when every gown, every hanging, every bed, was made of materials which our own flocks had furnished to our looms. Where were now the brave old hangings of arras which had adorned the walls of lordly mansions in the

days of Elizabeth? And was it not a shame to see a gentleman, whose ancestors had worn nothing but stuffs made by English workmen out of English fleeces, flaunting in a calico shirt and pair of silk stockings? Clamors such as these had, a few years earlier, extorted from Parliament the Act which required that the dead should be wrapped in woollen" (Macaulay 1936, 3:25–26).

4. Sectional interests seeking to protect their domestic production from import competition may well display a power to influence trade policy that appears to far outweigh their economic importance in the national economy. While exporting interests may be vigorous in lobbying for reductions in foreign trade barriers, they are hoping for gains in sales and profits that they can not yet count on. By contrast, when faced with increasing import competition, domestic industries fear losses in profits and jobs that they already enjoy, which lends a vehemence and concreteness to their representations. We should not suppose, however, that domestic industry seeks protection only when losses in sales and profits are already threatening. Since the aim of private enterprises is profit maximization, it is logical that they should seek to gain protection for their domestic markets so far as they legally can. If they succeed, their profits are likely to be higher than they otherwise would be; they are, in effect, enjoying a rent. The manipulation of national legislation to commercial advantage ranks alongside efforts to improve the efficiency of the firm as a way of enhancing profits. (This is what Jagdish Bhagwati dubbed Directly Unproductive Profit-Seeking, or DUP. See Bhagwati 1982.) Political circumstances that make such rent seeking possible—whether it is as transparent as the lobbying industry in Washington, D.C., or takes place through more hidden channels, as in many other countries—present an obstacle to trade liberalization and cooperation.

5. Among political scientists concerned with international relations, those who advance cognitive theories place ideas and beliefs at the center of their explanations of cooperation among nations. See Hasenclever, Mayer, and Rittberger 2000.

6. The historical material in this section draws on later chapters, where it is more fully annotated.

7. Partly for this reason, the United States did not oppose the exemption of developing countries from making reciprocal trade concessions in most of the earlier negotiating rounds held under the auspices of GATT. As the Cold War receded, however, the reluctance to accord such a preferred status to developing countries generally intensified.

8. Among principal exponents of the theory of hegemonic stability were Robert Gilpin (see Gilpin 1981) and Charles P. Kindleberger (see Kindleberger 1981, 1983). Robert O. Keohane provides both an exposition and a critique of the theory in Keohane 1984 (32–39).

9. Peter Katzenstein makes this point in his study of industrial polices in smaller European states (Katzenstein 1985).

10. For a lucid, very readable, and thoroughly researched account of the

arguments of economists for and against free trade over the centuries, see Irwin 1996.

11. Strategic trade theory begins from a recognition, first, that much contemporary trade consists of an exchange among countries of similar kinds of manufactures (it is intra-industry trade, not interindustry trade) and, second, that the competing firms are often very few and certainly not the large number assumed in traditional free trade theory. The explanation as to why a country has a comparative advantage in a specific product is seen to lie not in its natural or factor endowment but in the fact that the firm or firms producing the product have been able, virtually through the accident of history, to gain the advantage of economies of scale, have acquired a special fund of experience, or have made a technological innovation ahead of others. This line of thought has opened up the possibility that, even for neoclassical economists, an activist trade policy might be justified on the grounds that it would yield greater benefit to the country than would strict adherence to free trade principles. The practical difficulty with such an activist policy, which amounts to an industrial development policy, is that it turns out to be very hard to identify the industries that would merit special attention. The national benefit accruing from such a policy, moreover, might be quite modest, and it would carry the risk that it might jeopardize the existing international trade regime because other countries would follow suit. For a range of views on different aspects of strategic trade policy, see Krugman and Elhanen 1985.

12. For a tour of these popular views and for a penetrating but good-humored analysis of why they are misguided, there is no better guide than Paul Krugman in his *Pop Internationalism* (Krugman 1997).

13. Only economists, whose thinking is imbued with hard-won theoretical constructs of how economies function, find the logic of free trade compelling or at least demanding of an equally cogent answer. In his book written with Kenneth Dam, George Schultz, who, as a former U.S. secretary of state and secretary of the treasury, should know something about the minds of those concerned with policy-making, observed, "The gains from free trade strike many well informed people, including members of Congress, as highly abstract if not illusory" (Schultz and Dam 1978, 35).

14. These conditions and responses are described more extensively in chapter 4.

15. What adds to the argument is that the future long-term benefit from an open trade policy tends to get more heavily discounted in a severe recession, when the political need is to do something to alleviate current unemployment.

16. Hamilton also saw the potential exchange of Northern manufactures for Southern agricultural produce as a force for political integration of the country. For a more detailed account of his views and actions, see Miller 1959.

17. The enterprise failed because the workforce was too inexperienced; it lacked an accumulation of managerial and technical skills to draw on.

18. Jagdish Bhagwati and Anne Krueger were principal academic exponents of an outward-looking trade strategy. An informative and balanced account of the contrasts between outward-looking and inward-looking trade strategies is given in World Bank 1987 (chap. 5).

19. Chapter 8 includes a fuller discussion of the policies of these countries.

20. The free trade movement and the movement for parliamentary reform were closely interrelated, drawing their support from the same segments of society and sharing some of the same leaders. See Hinde 1987; McCord 1958.

21. The role of Congress in trade policy from the 1920s on is the subject of comment in several later chapters in this book. On its role in the decades before the First World War, Judith Goldstein provides a directly relevant and insightful analysis (Goldstein 1993). For other, more general commentaries on earlier U.S. trade policy, see Ashley 1904; Eckes 1995.

Chapter 2

1. This characterization of the world economy derives from Immanuel Wallerstein. In his view, the economic power of states has formed a hierarchical structure that has remained relatively unchanged over the last four hundred years. At the center, there has always been one strong and dynamic state: in the fifteenth century, it was Venice; in the seventeenth century, Holland; in the eighteenth and nineteenth centuries, Britain; and today, the United States. But he notes that at no moment has there been a hegemon whose power has gone totally unchallenged. See Wallerstein 1984, 30.

2. For a splendid analytical history of the exchange rate regime from the gold standard era to the present, see Eichengreen 1996.

3. A particularly helpful study of the use of trade measures as an instrument of macroeconomic policy under a flexible exchange rate regime is an empirically based simulation of their effects in solving the major imbalances of five large industrial countries in 1986–92: see Helkie et al. 1989.

4. George Kennan has described nationalism as "the greatest emotional-political force of the age" (Kennan 1993, 76–77). Isaiah Berlin characterized nationalism as an expression of outraged human dignity, a reaction to the past treatment of individuals or communities as inferior. He stated, "To be the object of contempt or patronizing tolerance on the part of proud neighbors is one of the most traumatic experiences that individuals or societies can suffer" (Berlin 1972, 17).

5. Both this introductory section and the following section owe much to the writings of political scientists concerned with international relations, "realists" as well as "institutionalists"—in particular, the writings of Robert Axelrod, Kenneth Gilpin, Robert Keohane, Hans Morgenthau, and John Ruggie. A valuable study of these two different schools of thought, as well as of the more recent cognitivist school, is contained in Hasenclever, Mayer, and Rittberger 2000.

6. For an exploration of the meanings of *reciprocity* in international relations, see Keohane 1986, 1–27. Bernard Hoekman and Michel Kostecki describe

and discuss the technical meanings assigned to *reciprocity* in the context of GATT negotiations (Hoekman and Kostecki 1997, 68–77). Carolyn Rhodes discusses reciprocity mainly in the context of retaliation–negative reciprocity to enforce compliance with trade agreements (Rhodes 1993).

7. Also, for the trade negotiators, the measures have the added advantage of setting quantitative and seemingly objective limits to the extent of the concessions that they can expect both to demand and to grant.

8. For a description of a computable general equilibrium (CGE) model that simulates the effects of tariff reductions on microeconomic variables, see Deardorff and Stern 1986. The limitation of these assessments is that they are largely confined to quantifying the short-term effects of changes in relative prices and are less able to capture the long-term dynamic effects on investment and innovation.

9. The findings of a recent empirical study largely correspond to this interpretation. Michael Finger, Ulrich Reincke, and Adriana Castro recently undertook an analysis of the trade effects of the tariff concessions granted and received by a number of countries during the Uruguay Round; they also interviewed several delegations to ascertain whether they sought equivalence in their negotiations. They found scant evidence, on both counts, that negotiators had been guided by any quantitative evaluation of equivalence. See Finger, Reincke, and Castro 2002.

10. Among political scientists concerned with international relations, the importance of such relative status for the conduct of nations is a firmly held tenet of the realist school. For a discussion of how this affects theories of international cooperation, see Grieco 1990, 36–49.

11. The new interest in rules was first evident in the Kennedy Round, when the antidumping rule was taken up. Not until the Tokyo Round, however, did the strengthening of the regime of principles and rules acquire forward impetus.

12. This is–appropriately enough–a collective definition agreed at a conference. For the full definition, see Krasner 1983, 2. The idea was first introduced into the literature by John Ruggie.

13. Jacob Viner wrote two outstanding articles, one in 1924 and the other in 1931, on the most-favored-nation clause, both a mix of historical and economic analysis. Both are reprinted in his collection of studies (Viner 1951). Sir Arthur Salter likewise had some insightful things to say on the clause in the context of trade relations in the 1920s and early 1930s (Salter 1936). John Jackson, a distinguished scholar in international trade law, has also devoted a chapter to the subject (Jackson 1999, 157–74).

14. For this reason, as I shall discuss in chapter 10, the recent tendency for the industrially more established countries to conclude free trade agreements with individual developing countries is cause for some concern, since these agreements may be misused as a means for the more powerful to gain preferential access in third markets.

15. John Jackson has devoted a chapter to the idea, history, and applications of national treatment obligations (Jackson 1999, 213–28).

16. That reliable data on costs and prices to substantiate allegations of dumping are hard to come by adds to the uncertainties surrounding the allegations.

17. For some political scientists, the issue of compliance has been at the crux of their theories of international cooperation. For them, the central problem in explaining cooperation is that if states act as rational egoists, they will be tempted to cheat to maximize their own benefit. As I indicate in the appendix, these political scientists have put forward answers that solve this puzzle.

18. Adam Smith took an eminently pragmatic attitude toward the use of retaliation. He wrote that retaliation might be a good policy "when there is a probability that [it] will procure the repeal of the high duties or prohibitions complained of." He added, however, "But when there is no probability that any such repeal can be procured, it seems a bad method of compensating the injury done to certain classes of our people to do another injury ourselves, not only to those classes but to almost all the other classes of them" (Smith 1937, 435).

Chapter 3

1. For a succinct and illuminating account of the transition in British trade policy, see Brown 1958.

2. There are several biographies of Richard Cobden. A recent, well-balanced study that has been drawn on here is Hinde 1987.

3. Norman McCord provides a detailed historical account of events leading up to abolition of the Corn Law (McCord 1958). Another, much briefer, but interesting, interpretation of the events can be found in Condliffe 1950 (209–16).

4. This view did not, however, go entirely unchallenged. Torrens, who first set out the argument that a country could benefit from tariffs through their effect in shifting the terms of trade in its favor, maintained that tariffs should only be reduced on the basis of reciprocity. Most economists at the time rejected his view outright. See Irwin 1996, chap. 7.

5. A much more comprehensive account (though similar in interpretation) of the events flowing from the signing of the Cobden-Chevalier Treaty is provided in Marsh 1999. J. B. Condliffe saw the significance of the treaty in the fact that other countries copied the most-favored-nation clause (Condliffe 1950, 220–24).

6. For Europe's export performance throughout the nineteenth century, see Bairoch 1993, table 4.1.

7. On the political and economic policies of Louis-Napoléon, see Ashley 1904; Clapham 1955; Haight 1941.

8. On the period from the signing of the Cobden-Chevalier Treaty to the outbreak of the First World War, three general studies are particularly useful: Bairoch 1993; Foreman-Peck 1995; Kenwood and Lougheed 1983. On individual countries, the studies mentioned in the preceding note are also valuable.

9. While warning against assigning the same meaning to similar statistical data in different historical periods, Joseph Schumpeter observed that, so far as

the figures went, the depression of 1874–77 appeared quite as dark as that of 1929–33 (Schumpeter 1939, 337).

10. J. H. Clapham quotes Bismarck as rejecting the "dream" of free trade (Clapham 1955, 316–17). For a biography of Bismarck that touches on his views of trade policy, see Crankshaw 1981.

11. French trade policy in the latter decades of the nineteenth century and in the early twentieth century has often been characterized as highly protectionist. Joseph S. Nye has challenged this view (Nye 1991).

12. Still, even in the absence of a treaty, France formally accorded Britain most-favored-nation treatment in 1882; thus, a key element of trade cooperation remained in place.

13. There were, however, also some positive developments. Britain and France signed a Treaty of Arbitration that provided, inter alia, for the referral of commercial disputes, if both sides agreed, to the Permanent Court of Arbitration in the Hague. This court had been established very recently, in 1899, to arbitrate in any disputes that countries might choose to present to it. See Barclay 1914, 354; Levi 1976, 68.

14. For an extensive account of these wars, see Conybeare 1987. Conybeare uses a game-theoretic approach to analyze the interactions among the warring countries. The discussion of the Franco-Italian trade war in the present text draws heavily on Conybeare's work. Other accounts of that war can be found in Ashley 1904 and Marsh 1999.

15. It remained the intellectual conviction that this was the right thing to do. W. W. Rostow quotes *The Economist* as saying, in its review of 1879, that the "obscure and contemptible movement (so to call it) in this country in favor of revived Protection in the form of Reciprocity has died out" (Rostow 1949, 213n).

Chapter 4

1. There are a great many accounts of both international economic conditions and international payments problems in the 1920s. For three, see Condliffe 1950, 440–57; Foreman-Peck 1995, chaps. 3–4; Schumpeter 1939, chap. 14.

2. Keynes publicized his views in *The Economic Consequences of the Peace* (1919).

3. For a discussion of the different interpretations of the causes of exchange rate instability, see Eichengreen 1996, chap. 3.

4. In 1918, the French minister of commerce, M. Clemental, declared: "the Government has denounced all commercial conventions which embody the most-favored-nation clause. That clause will not reappear. It will never again come back to place itself at cross purposes with our efforts. It will never again poison our tariff policy." However, France, which insisted on such a pledge from others, found other countries unwilling to negotiate agreements without the clause. Only very small and dependent countries were willing to negotiate on such unequal terms. See Viner 1951, 95.

5. Some experts were forthright in their condemnation of conditional most-favored-nation treatment as grossly inefficient. Jacob Viner, a much respected economist who argued for reform, wrote that "the most-favored-nation clause in American commercial treaties, as conditionally interpreted and applied by the United States, has probably been the cause of more diplomatic controversy, more variations in construction, more international ill-feeling, more conflicts between international obligations and municipal law and between judicial interpretation and executive practice, more confusion and uncertainty of operations than have developed under all the unconditional most-favored-nation pledges of all the other nations combined" (Viner 1951, 25).

6. In commenting on the dismal outcome of the tariff negotiations held at the Genoa conference of 1922, Sir Arthur Salter wrote: "each official was the prisoner of his own national system, each item of which represented a protection to some home industry which was supported by those who had secured its adoption. He was responsible to ministers who were the prisoners of the groups of organized interests in their respective parliaments. Each national representative, therefore, while urging that others should change their policies, felt bound to defend his own and had no authority to agree to change it." What guided each national representative was not "a conception of his nation's interests as a whole, mistaken or not, but a calculation of pressures to which the national government would be subjected by organized interests in the respective parliaments. Consequently, the net result of the Genoa resolutions was rather to endorse and consolidate a system of trade barriers which everyone, looking at it as a whole, recognized to be injurious to world recovery" (Salter 1936, 39–40).

7. In fact, the British and Dutch governments later made use of this tactic. In November 1930, at the Second International Conference with a View to Concerted Economic Action, they together proposed that if other countries reduced their tariffs by 25 percent, they would remain committed to free trade. The proposal fell flat. See Kindleberger 1973, 35.

8. For students of international economic relations, Kindleberger 1973 provides a fascinating record and economic analysis of the depression years. For a briefer general account, see Condliffe 1950. For an analysis that was written at the time and that contains views on commercial policy, see Salter 1932. For a more recent historical analysis that also discusses commercial policy, see Foreman-Peck 1995, chaps. 10–11. On exchange rates, see Eichengreen 1996.

9. For an account of Keynes's thinking about free trade and protection during the 1920s and 1930s and of subsequent critiques of his views, see Irwin 1996, chap. 13.

In 1930, Prime Minister Ramsay McDonald formed a committee of economists to advise on policies to restore the level of economic activity. Keynes served as chairman, and the other members were Sir Joshua Stamp, Arthur Pigou, Hubert Henderson, and Lionel Robbins. There were sharp differences of opinion. Lionel Robbins, in particular, was fiercely opposed to the use of tariffs as a macroeconomic policy instrument. See Skidelsky 1994, 365–87.

10. This view was shared by Keynes, who was among the first to applaud President Roosevelt for his abandonment of a fixed exchange rate. We should not conclude, however, that Roosevelt was pursuing a "Keynesian" policy. Among the aims of his administration was the pursuit of a "fiscally responsible" balanced budget.

11. Many of the elements of a coherent, international recovery program were nonetheless being advanced. Prior to the 1933 conference, Britain and Belgium proposed the creation of an international fund that would provide short-term credits to countries in balance-of-payments difficulties. This was seen as a way toward currency stabilization and the reduction of trade barriers. But the U.S. administration saw no possibility of Congress providing funds for loans to foreign central banks. See Kindleberger 1973, chap. 9.

12. Alfred E. Eckes Jr. has noted that in the 1920s, a young State Department economist, Wallace McLure, proposed a program of reciprocal tariff reductions to be extended to third countries on the basis of the most-favored-nation clause. This was the essence of what was to become the Reciprocal Trade Agreements Act of 1934. According to Eckes's research, McLure and Hull had frequent discussions on the matter over the years. See Eckes 1995, 93–94.

13. In a speech to the House of Representatives in 1916, Hull suggested that after the war, there should be established a "permanent international trade congress" to eliminate trade practices causing international controversies and economic wars and to promote fair and friendly trade relations (Hull 1948, 81–82).

Chapter 5

1. For an engrossing and detailed account of discussions both within and between the United States and Britain on the formation of the international, monetary, financial, and trade institutions, see Gardner 1969. For other accounts, see Penrose 1953; Condliffe 1950. On GATT in its early years, see also Koch 1966.

2. General Agreement on Tariffs and Trade 1986, preamble.

3. For a brief history of these issues before and after the signing of GATT, see Jackson 1999, 150–53, 167, 221.

4. For a brief history of these issue, see Jackson 1999, chaps. 10–11.

5. Opinions have differed on how far it was the intent of the GATT negotiators to establish a quasi-judicial procedure for the settlement of disputes. John Jackson has pointed out that the draft of the Havana Charter called for a "rigorous" procedure, even with appeal to the World Court in some circumstances. For an interesting analysis of the roles of the competing ideas of diplomatic conciliation and of judicial interpretation of rules in the drafting of GATT, see Jackson 1999, 112–17.

6. The reciprocity was, however, less than it seemed. European and other countries were making extensive use of quantitative restrictions for balance-of-payments reasons. Thus, the United States was offering greater access to its markets than was immediately the case with the other parties in the negotiations.

7. According to Paul Bairoch, the average rate of import duty on manufactures in 1950 was 14 percent in the United States, 18 percent in France, 26 percent in Germany, 25 percent in Italy, and 23 percent in the United Kingdom. Rates were lower, however, in Belgium, Denmark, the Netherlands, and Sweden, where they ranged from 11 percent down to 3 percent. See Bairoch 1993, table 3.3.

8. By 1998, WTO members accounted for 90 percent of world merchandise exports (World Trade Organization 1999, table 11.2).

9. The developing countries that signed the original agreement were Brazil, Burma, Sri Lanka (then Ceylon), Chile, China, Cuba, India, Lebanon, Pakistan, Zimbabwe (then Southern Rhodesia), and South Africa. Australia, as a primary producing country industrializing behind high trade barriers, was often counted at the time as another member of this group.

Chapter 6

1. For a broad analysis of the politics of U.S. trade policy at the time, see Destler 1986, particularly chap. 2.

2. For a comprehensive, but succinct, statement of the political considerations leading up to the creation of the European Economic Community, see Roberts 1999, chap. 23.

3. However, neither the United States nor Britain were willing to grant the EEC a waiver to form a preferential trading area. To conform to GATT rules, the new trading area had to be either a customs union or a free trade area.

4. For a more detailed description of responses to the formation of the European Economic Community, see Foreman-Peck 1995, 268–69.

5. Further evidence of the boldness of the new administration is the fact that the new Trade Expansion Act even included a proposal to establish duty-free access for all those manufactures in which the United States and the European Economic Community together accounted for 80 percent of world imports. This proposal was predicated on British membership in the EEC. However, General de Gaulle vetoed the British application in 1963 because he feared the dilution of French leadership and the rise of American influence through Britain's "special relationship," so the proposal fell away.

6. In an earlier understanding reached between France and West Germany at the time of the formation of the EEC, West Germany accepted France's insistence on the Common Agricultural Policy as an essential ingredient of the new community; as a partial quid pro quo, France agreed to support participation in future multilateral trade negotiations.

7. The Europeans objected to the American practice of using the price on the American market as the basis for customs valuation of a limited range of goods. That was a way of setting tariffs that no gains in relative competitive efficiency could beat. See Destler 1986, 63.

8. To square the circle, the industrially more established countries sought a multilaterally negotiated derogation from GATT rules (see Hoekman and

Kostecki 1997, 207). For some further discussion of the relation between these restrictions and GATT rules, see Jackson 1999, 206–8.

9. For a description of the domestic political situation at the time by a key actor, see Ball 1982, 188–93.

10. The European countries had covered themselves legally on this point. In 1955, when they had reluctantly agreed, on the urging of the United States, to Japanese membership of GATT, they had retained the right, under GATT Article 35, not to apply the rules of this agreement.

11. As another component in its program to overcome protectionist sentiment in Congress, the Kennedy administration introduced legislation to provide adjustment assistance to workers displaced by import competition. At an earlier date, Britain had passed the Cotton Industry Act of 1959, which sought to assist businesses and workers in the industry to move into other lines of production or to acquire other skills.

12. David Yoffie argued that although barriers to trade in textiles and apparel grew increasingly restrictive in the 1970s and 1980s, the early East Asian "tigers"—Hong Kong, South Korea, and Taiwan—prospered. He ascribes their success in minimizing the adverse effects of foreign protection on their export growth not only to their flexibility in moving their production upmarket but also to their skill in negotiating relatively porous agreements on export restraints (Yoffie 1983, 159).

13. The desire to uphold the roles vied with the political need to break them, leading to the search for a means of circumvention.

> What thou wouldst highly,
> That wouldst thou holily; wouldst not play false
> And yet wouldst wrongly win.
> (Shakespeare, *Macbeth,* act 1, scene 5, lines 18–20)

14. Several commentators have characterized the conflicting attitudes of Congress and U.S. administrations in this way. See Destler 1986, 76.

15. For a summary of the views of Prebisch and others, see Meier 1970, chap. 8.

Chapter 7

1. For an appraisal of the ministerial meeting and its results, see Low 1993, 190–202.

2. For a discussion of U.S. political attitudes at the time, see Low 1993, 174–78. Low also offers a general analysis of the results of the Tokyo Round (chap. 8). See also Jackson's paper in Cline 1983 (159–87). Several other contributors to Cline's volume also comment on the results of the round.

3. This did not occur before President Nixon and Secretary of the Treasury John Connally had shaken international confidence in cooperation by peremptorily imposing a 10 percent surcharge on imports.

4. GATT had not been without rules that covered these matters. But, as I noted in chapter 5, the original rules had often been loosely drafted in order to accommodate differences of opinion and to gain common consent to the agree-

ment. That had left room for differences of interpretation that later became sources of conflict.

5. For fuller expositions of these codes, see Hoekman and Kostecki 1997; Jackson 1999.

6. There is a large literature on this period, covering both trade policies in general and policies in particular sectors. A very useful general analysis is contained in chapter 8 of World Bank 1987. A valuable collection of papers addressing all the main trade issues of the period appears in Cline 1983. Low 1993 presents a lively description and critique of U.S. trade policy at the time.

7. In Britain, for example, the poor performance of the manufacturing industry induced the Labor government in the 1970s to establish task forces composed of government, business, and labor at the level of individual industries, to work out programs, not excluding trade restrictions or subsidies, to reinvigorate the industries. For a discussion of the change in British official attitudes toward trade policy in the 1970s, see Cable 1983, 10–16.

8. For a regression analysis of the effects of cyclical factors and of changes in real exchange rates on changes in levels of protection, as well as for a review of possible reasons for the rise in protection, see Grilli 1988.

9. See Destler 1986, app. B, where cases submitted to the commission are listed.

10. The OECD's measure of official support to agriculture, its "producer subsidy equivalents," shows that between 1979–81 and 1986–87, support as a percentage of the value of agricultural production rose from 14 to 30 percent in the United States, from 20 to 40 percent in Canada, from 36 to 48 percent in the European Community, and from 60 to 73 percent in Japan.

11. For a fuller historical and economic analysis of the global steel industry, see Walter 1983. For a later analysis of the U.S. steel industry, see Crandall 1987.

12. For more extensive discussions of U.S. trade legislation introduced during this period, see Destler 1986; Low 1993.

13. Bayard and Elliott carried out an extensive study of seventy-two cases pursued under Section 301 of the U.S. trade law between 1975 and 1992. They found that the actions could be judged reasonably successful in about half of the cases. Their criterion of success was that the negotiating objectives of the United States had been achieved. While their study did not directly address itself to the trade effects of the actions, they estimated that in three of the cases–complaints against Japan on beef, tobacco, and semiconductors–the trade gains may have been about $3 billion. For all the other cases together, the gain was probably no more than a few hundred million dollars. See Bayard and Elliott 1994, 334.

14. U.S.-Japanese economic relations were the subject of commentary by a great many people. The views of a number of economists and politicians, both American and Japanese, can be found in Fried, Trezise, and Yoshida 1983. For a fairly representative view of American economists, see Krugman 1990, chap. 10. Several books on the subject, mostly by American journalists who had lived in Japan, also appeared; among the best known were those by Clyde Prestowitz

and James Fallows. These leaned toward a more sociological analysis of the problem, emphasizing not only the role of mercantilist policies in Japan but also the closed nature of its culture and society. Richard C. Longworth has published a more recent commentary in the same vein (Longworth 1998).

15. For a listing of formal and informal trade and investment barriers and an appraisal of the evidence regarding their presence in Canada, Japan, and the United States, see Saxonhouse and Stern 1989.

16. The annual economic reports of the U.S. president, put out together with the annual reports of the Council of Economic Advisors, are a good source of information on the successive agreements negotiated between Japan and the United States. See U.S. Presidents, 1985–95.

17. Greaney directly studied the effects of the bilateral trade agreements on actual trade flows (Greaney 2001).

18. For a detailed and revealing account of U.S. trade relations with Japan in the middle to late years of the 1990s, both multilaterally and bilaterally, see Stern 2002. Stern documents the impressive array of trade measures that the U.S. government has marshaled to exercise intervention in its trade with Japan.

19. The U.S. merchandise trade deficit with Japan was $56 billion in 1987 and approximately $67 billion in 1998 (in current prices).

Chapter 8

1. A substantial literature analyzes the political economy of these policy changes in individual developing countries. Among the books and papers that have proved most helpful in the preparation of this chapter are, on Latin American countries, Frieden 1991, Krugman 1999 (chap. 3), Thorpe and Whitehead 1987, and Williamson 1990; on Latin American and African countries, Nelson 1990; on South Korea and Thailand, Kwon 1998 and Wade 1990; on India, Dhar 2000 and Jalan 1992. A more general, particularly valuable study, which is also a good source of information about specific countries, is Haggard 1995, which analyzes policy changes in developing countries in the recent past to assess the nature, extent, and consequences of their closer economic integration into the world economy. Another more general, informative study is Waterbury 1993, which is focused on the performance of public enterprises in selected developing countries. Grindle and Thomas 1991 studies changes in economic policy in developing countries, particularly in the 1980s, to assess the roles of decision makers and policy managers, as well as the choices they make.

2. For a forceful critique of development theory and policy from a neoclassical point of view, see Lal 1983.

3. For a general discussion of inward-looking and outward-oriented policies, as well as an account of trade liberalizing measures in the 1970s and 1980s, see World Bank 1987, chaps. 5–6.

4. How far the exceptional economic performance of South Korea and Taiwan was an outcome of state-directed or free market policies was, for a time, a matter of heated controversy among Western economists. Robert Wade's 1990

book, which is an extensive, empirical study of policies in Taiwan—with forays into South Korea and Japan—focused attention on the effectiveness of the mix of public and private initiatives. For a more recent, retrospective, and balanced analysis of performance in both South Korea and Taiwan, see Kwon 1998.

Chapter 9

1. The Single Market program was initiated in the 1980s for completion in 1992. It contained over 280 legislative measures intended to ensure the free movement of goods, persons, services, and capital within the European Community. One major area it addressed, for instance, was the harmonization of technical standards or of standards applied to protect public health and consumer safety; another was the harmonization of value-added tax imposed within countries. For more background and information, see Bainbridge 1998.

2. For comprehensive accounts of the Uruguay Round negotiations, see Preeg 1995; Croome 1995. Both accounts explore the substance of the negotiations and the shifting positions of the different parties in considerable detail. Preeg, a former U.S. trade negotiator, also provides a valuable commentary on political ideas and interests in the United States that bore on the American position. Croome, a former GATT official, offers an evenhanded account of the positions of all the main parties.

3. Shortly before the idea of the organization was taken up in the Uruguay Round negotiations, it was extensively developed by John Jackson, a well-known American authority on GATT legal issues (see Croome 1995, 272).

4. It thus opened up the possibility of cross-retaliation; this meant that if a country failed to abide by, for example, the terms of the agreement covering intellectual property rights, it could be penalized by retaliatory action taken against, for example, its merchandise exports.

5. For example, the use of import restrictions ostensibly to defend the balance-of-payments but actually to protect domestic industries would be challenged. In the course of the Uruguay Round, a number of developing countries—including Brazil—announced that they would remove such restrictions. See United Nations Conference on Trade and Development 1994, 159; Preeg 1995, 134.

6. Frans Andriessen, then trade commissioner for the European Community, warned the United States against unilateral action, arguing that effective dispute settlement machinery was not possible if one party had its own way of dealing with disputes (see *The Financial Times,* April 6, 1990).

7. This was not a ploy in a subtle American strategy to strengthen GATT dispute settlement. American negotiators favored strengthened adjudication and enforcement machinery, but they were reluctant to relinquish the power to act independently.

8. However, each country was allowed to grandfather one agreement. For a fuller account of the new conditions, see Preeg 1995, 199.

9. Over the course of the ten years, quotas on individual textile and apparel products were to be gradually eliminated, and imports under the quotas were to be increased by stated amounts. However, by the end of the ten-year period, only about half of the quotas on individual products would have been eliminated. This back-loading of the process of elimination left the importing countries with a huge reduction to make in the last year, and many wondered whether their governments would muster the political determination to confront protests from domestic industries.

10. Adam Smith long ago recognized the legitimacy of such protection. He noted that when the free importation of goods has been interrupted for some time and when competing domestic producers have come to employ many people, "humanity may in this case require that the freedom of trade should be restored only by slow gradations and with a good deal of reserve and circumspection" (Smith 1937, 435).

11. Discrimination was still permitted, however, under certain exceptional circumstances.

12. For more detailed descriptions, see Croome 1995, 302–3; Preeg 1995, 197–98.

13. At one point in the negotiations, the United States rejected the idea of a general obligation (see *The Economist,* December 1, 1990). This was tantamount to saying that it did not want multilateral rules for trade in services and that on services, it would negotiate bilateral agreements with individual trading partners.

14. The group included Argentina, Australia, Canada, Chile, Colombia, Fiji, Hungary, Indonesia, Malaysia, the Philippines, New Zealand, Thailand, and Uruguay.

15. Unlike in subsidies of manufactures, however, where the wrongful subsidization of individual products could be penalized by the imposition of countervailing duties, countries expressed their commitment in terms of aggregate budgetary outlays on subsidies and in quantities of products benefiting from subsidies. Subsidies deemed to have minimal trade-distorting effects, such as production-limiting programs or income support programs, were excluded from the expenditure to be reduced.

16. For a fuller discussion, see Wolf and Winters 1996.

17. For a fuller discussion, see United Nations Conference on Trade and Development 1994, 158–59. For a discussion of the U.S. position on special and differential treatment for developing countries, see Preeg 1995, 70–74.

18. During the round, Japan and India, supported by other countries, such as Australia, New Zealand, and South Korea, had questioned the relation between these regional or bilateral agreements and the multilateral rules (see Croome 1995, 99). The underlying fear that these efforts of the economically most powerful to gain market access for themselves might lead to discriminatory practices was not assuaged.

Chapter 10

1. Both members of customs unions and members of free trade areas eliminate all, or most, of their tariffs in trade with each other. However, members of a free trade area retain their own external tariffs, whereas members of a customs union adopt a common external tariff. Customs unions and free trade areas are, in principle, differentiated from other preferential trading arrangements by the fact that the elimination of tariffs on members' trade with each other is comprehensive. Complete elimination has, however, been more the exception than the rule—at least in the earlier phases of a new arrangement. There is, moreover, the question of how far nontariff barriers are eliminated or reduced. In other words, there is no sharp line of differentiation between customs unions or free trade areas, on the one hand, and preferential trading arrangements, on the other. For a succinct discussion of both theory and GATT practice relating to this issue, see Bhagwati 1991, chap. 5.

2. For the views of one leading scholar, as pungently expressed in the media, see Bhagwati 1998.

3. For a forceful expression of this view, see the letter by Rudiger Dornbusch in *The Economist,* May 4, 1991, 67.

4. For a comprehensive review and analysis of postwar regional trading arrangements, see World Trade Organization 1995. For arrangements made in the most recent years, see the WTO's annual reports. (Member countries are required to notify the WTO of arrangements that they are entering into.)

5. For two synthesizing descriptions and economic appraisals of the European Union's network of free trade agreements, see Messerlin 1999; Pelkmans and Brenton 1999.

6. The preferential arrangements made by the European Union under its Generalized System of Preferences are not discussed here; they are not contractual trading arrangements among countries.

7. See Roberts 1999. There has been a considerable gradation in the European Union's agreements; they have ranged from association agreements that imply the promise of full membership at some time in the future to limited free trade agreements (see Pelkmans and Brenton 1999, table 4.1).

8. An exception was the free trade agreement drawn up with Canada in 1965 covering trade in cars and car components.

9. The main economic argument used by the U.S. administration in support of the U.S.-Israeli agreement was the need to counter trade diversion. Phased reductions in Israeli tariffs on European goods were in the process of being implemented under the free trade agreements signed between Israel, on the one hand, and the European Community and EFTA, on the other. (See the comment by Alfred Tovias in Memedovic et al. 1999, 41.)

10. See *New York Times,* February 4, 1997.

11. The Caribbean Basin Initiative Enhancement Act of May 2000 modified the Caribbean Basin Initiative. The latter, introduced by the United States in the 1980s, had already extended preferential treatment to certain products.

12. See *The Financial Times,* January 27, 1992.

13. For an analysis of developments in the region in the late 1990s, see Bergsten 2000.

14. Mercosur threatened to unravel after the Brazilian financial crisis of 1998. Brazil devalued substantially, while Argentina continued to maintain its dollar-peso parity under its currency board system. With this radical shift in the exchange rate relationship between the two countries, the competitive position of each country's export industries in the other country's market changed dramatically.

15. For appraisals of the economic benefits for Latin American countries of free trade agreements with the United States, see Agosin and Alvarez 1994; Erzan and Yeats 1992. Both appraisals are skeptical of the benefits for most countries. The former concludes that, leaving aside Mexico and the countries around the Caribbean Basin, the benefits would, at best, be modest and that the costs of diversion could be significant.

16. The Central and Eastern European countries responded to this situation by negotiating a network of free trade agreements with each other.

17. *The Financial Times,* January 2, 1992.

18. For one exposition of this view, see Bergsten 1997, 4–5.

19. For a review of the literature on trade diversion, see Frankel 1997; for an update, see Anderson 2001.

20. For an analysis of this problem, see Krueger 1997, 9–24.

Chapter 11

1. In the United States, annual growth in total output rose to 3.4 percent between 1991 and 1999. The European Union recorded a lower, but still respectable, rate of expansion, at 2.3 percent. In Japan, the rate was less than 1 percent. For the developing countries as a group, the pace of growth was 4.3 percent per annum. South Asia improved on its own past performance, reaching 5.5 percent per annum (United Nations 1999).

2. When writing in 1921, J. H. Clapham, a distinguished British economic historian, was equally impressed by the growth of interdependence during the nineteenth century. Britain had become highly dependent on food imports, as had other European countries on imports of raw materials. But the interdependence extended beyond trade. Through share ownership, foreign participation in ownership of companies had increased, and many companies had foreign affiliates. Moreover, a variety of cartel and cartel-like agreements among concerns of different countries divided up international markets and even fixed prices internationally. Clapham observed: "With the railway and the telegraph the world had become one market. With the spread of a fairly uniform company law and of a uniform commercial practice, it was tending to become a single economic organism" (Clapham 1955, 401).

3. As a general proviso, I note that the structure of the world economy has changed greatly in the interim, which may invalidate judgments based on simple statistical comparisons.

4. The foreign trade data, moreover, take no account of the production and sale of goods and services in foreign countries by the affiliates of multinational corporations. For the United States, for example, the gross product of majority-owned foreign affiliates in 1998 amounted to $610 billion. This measures the contribution of these corporations to the gross domestic product of the host countries. Though not a strictly comparable figure, U.S. exports of goods and services in the same year amounted to $1,191 billion. (See U.S. Bureau of Economic Analysis 1999.)

5. By the end of 1999, the WTO had 135 members.

6. The progress of negotiations on these issues is recorded in the annual reports of the WTO.

7. This was the opinion of Wendy Dobson and Pierre Jacquet, who carried out a detailed study of the effect of the new agreement on the financial sectors of a few countries (Dobson and Jacquet 1998).

8. See *Wall Street Journal,* February 5, 1997.

9. For summaries of the disputes and the rulings, see the WTO's annual reports. For a commentary on how institutional changes have affected the number of disputes submitted to GATT and the WTO, see Barfield 2001, 32–36.

10. Prior to completion of the Single Market program in 1992, the member states had different import regimes for certain products. Britain, France, and Spain had quota systems for banana imports, which provided a protected market to former colonies and overseas territories. The Single Market program introduced a unified regime that, in effect, restricted the access of Latin American producers to their former markets in Germany and other countries.

11. Both issues and personalities played their parts in souring relations. The Helms Burton Act was one serious irritant. This act threatened to penalize Canadian or European firms that had bought property in Cuba formerly expropriated from American enterprises. For a lively report on the conflicts among the leading personalities engaged in the disputes at the time, as well as for an analysis of the underlying causes of the trade disputes between the United States and the European Union, see de Jonquières 2001.

12. The European Union argued that the U.S. legislation, which provided export income with relief from income taxes, was an export subsidy.

13. For one collection of essays expressing such opposition, see Nader et al. 1993. The collection also includes essays by writers from developing countries, putting forward their points of view.

14. For a balanced statement of these concerns, see Bronk 1998, chap. 8.

15. Among the more important of these agreements are the Montreal Convention on Chlorofluorocarbons (CFCs), a chemical damaging the ozone layer, and the International Whaling Convention, which protects an endangered species. Recently signed, in 2000, was the Cartagena Protocol on Biosafety, which deals with trade in genetically modified substances. All three agreements place restrictions on trade.

16. For one statement of this position, see Sierra Club 1994.

17. Also, following the signing of a bilateral trade agreement with Cambodia in 1996, the United States apparently assigned Cambodia a textile import quota that was to be subsequently increased on condition that Cambodia met "core" labor standards. See *New York Times,* July 12, 2001.

18. International agreement has been reached on a set of "core" labor standards. In 1998, the member countries of the International Labor Organization adopted the Declaration on Fundamental Principles and Rights at Work, which obliged them "to respect, to promote and to realize" the principles of seven ILO conventions defining "core" labor standards. These included conventions relating to the prohibition of forced labor, the rights of association and collective bargaining, nondiscrimination, equal remuneration, and a minimum working age.

19. For another discussion of this issue, see Brown, Deardorff, and Stern 2001.

20. Chris Patton, the last British governor of Hong Kong, has given a forceful description of such a response in Chinese-American relations. The U.S. Congress annually held a debate on whether to extend most-favored-nation treatment to China for another year. This was seen as an opportunity to exert leverage on China, and a range of issues running from human rights to nonproliferation was discussed. But China countered with hints about diverting major commercial contracts from the United States to other countries, and the threat to withhold the extension was never carried out. See Patton 1998, 264–65.

21. The traditional channel has been the diplomatic representations of individual governments. But in recent decades, numerous citizen groups and some business groups–particularly in the industrially more established countries–have become very active in promoting broader international acceptance of various social standards. An influential tactic in the field of labor rights has been the use of consumers' buying power to boycott or threaten to boycott the products of corporations tolerating sweatshop conditions in the factories of their overseas suppliers. On a more general plane, the United Nations–on the initiative of Kofi Annan, the secretary-general–brought together about fifty multinational corporations and twelve international labor organizations to sign a "global compact" in support of nine broad principles addressing human rights, labor rights, and the environment (see *New York Times,* July 27, 2000).

22. For studies on competition policy in the global economy, see Scherer 1994; Graham and Richardson 1997.

23. The Egyptian trade minister famously remarked at Seattle: "Why, all of a sudden, when Third World labor has proved to be competitive, do industrial countries start feeling concerned about our workers?" (quoted by David Sanger in "All the World's a Mall," *New York Times Book Review,* April 30, 2000).

Appendix

1. The theories of the liberal institutionalists have been subject to criticisms from the political scientists who hew closer to the older school of realism. For a comparative analysis by a realist, see Grieco 1990.

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Index

INDEX

INDEX

INDEX

INDEX

INDEX

INDEX