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The International Politics of Trade

The discussion thus far has emphasized the domestic factors that influence the choice of trade policy by nations, especially the degree to which free trade is tempered by elements of protectionism and export promotion. The choice among these three strategies inevitably highlights the distributional and values dilemmas, most notably the extent to which nations pursue the liberal goal of maximizing aggregate consumption at the expense of alternative values such as equality and security. However, most contemporary trade issues also involve elements of the fourth strategy identified in chapter one, the effort to forge conditions abroad conducive to expanding exports. At the center of those foreign policy efforts are the international institutions designed to facilitate trade, without which no national policy is likely to be very successful. But they inevitably pose a dilemma concerning state goals, because these institutions function principally by prohibiting those policies of its member states that negatively affect other members. This limitation on national autonomy may be necessary to secure the benefits of trade, but it is also strongly resisted as an intrusion on state sovereignty. The dynamics surrounding this delicate balancing act can be best appreciated by sketching how this dilemma was resolved in the initial creation of the chief international institutions that govern trade today. Subsequent changes in the rules and membership of these institutions, which trigger this dilemma anew, have constituted the major trade issues of recent years. Furthermore, their operating principals must be understood because they provide the legal and political context for contemporary controversies in bilateral relations and the options available to nations in response to them.

THE ORIGINS OF BRETTON WOODS

The ... foundation of the postwar international economic system was laid in July 1944 at a meeting of Allied ministers in Bretton Woods, New Hampshire. The institutions created there remain at the core of the global economy today: the International Monetary Fund, **the International Bank for Reconstruction and Development** (IBRD, but known as the **World Bank**), and the General Agreement on Tariffs and Trade. They are collectively known as the Bretton Woods institutions even though the GATT was actually created two years later to replace the abortive **International Trade Organization** (ITO)that was originally designed as the third leg of the liberal order.The legal document now referred to as GATT 1947 remains the basis of international law with respect to trade, though it has been much amended and extended, most recently in 1994. The ad hoc international organization which grew up around the GATT has been replaced by the World Trade Organization (WTO), a broader institution that commenced operation on January 1, 1995.

...To appreciate the role that these institutions play today, we must return to their founding to discover the principles that motivated their architects. We will see that the foundations of Bretton Woods were laid directly over the fault lines between liberalism and mercantilism—and between the interests of different nations. What we see today as trade policy disputes are the surface rumblings of these older seismic forces.

The Great Depression and World War II shaped Bretton Woods by profoundly affecting the forces that created it: the prevailing state of theory and values, the condition of markets, and the balance of power among actors. These events made economic growth and global peace the twin values sought most ardently by policymakers. By discrediting protectionism, they also strengthened liberal theory as a model of how to structure economic relations in order to achieve these values. The disastrous state of the global economy—especially the collapse of trade markets—contributed to the belief that the international system required greater management along liberal lines. It also convinced policymakers everywhere that a prosperous national economy was impossible without a well-designed international system. Finally, World War II left the United States as the dominant global power, capable of mobilizing other nations to create such a global system and willing to provide the leadership required to make it a success. The result is Bretton Woods, the most liberal global trading order the world has yet seen, created in the wake of the most protectionist period in the modern era.

Efforts to return the global economy to free trade began with bilateral approaches in both Britain and the United States. However, because of protectionist pressures on national governments, it was widely acknowledged that free trade required powerful international institutions to ensure global cooperation and sustain stable financial arrangements. It was equally obvious that such a system would require leadership that could be provided only by a single dominant nation, called a **hegemon**. **Hegemonic stability theory** posited as the requisites of a world leader attributes possessed only by the United States: economic size, military might, political power, ascribed status, and the political will to lead.

Hegemonic stability theory and American global leadership

The central tenet of hegemonic stability theory is that cycles of global liberalism and protectionism coincide with cycles of hegemonic leadership and decline.[1] As a hegemonic power is in its ascendancy, it pushes the system toward greater liberalism, but as it declines the system tends to revert to regionalism and protection.

Indeed, nineteenth-century free trade was initiated by the championing of liberal principles by Great Britain, tentatively in the 1820s and decisively with the repeal of the Corn Laws in the 1840s. Britain's leadership, which rested on its increasingly dominant economic and military power, contributed to global liberalization in several ways. British diplomacy induced movements toward liberalism in Europe through a series of bilateral agreements, beginning with the Cobden-Chevalier Treaty of 1860, which freed trade between Britain and France. Britain encouraged nations to emulate its successes with an open economy by serving as a market for their goods, especially continental grains. Finally, Britain provided the financing that would facilitate trade: Sterling became an accepted medium of exchange and the City of London offered extensive credit.

By the early twentieth century, however, the relative decline of British power eliminated the hegemon that enforced the rules of global liberalism. The theory of hegemonic stability predicted the result: The system slipped slowly into protection and regionalism, then rapidly and violently into instability, depression, chaos, and war. A liberal system could not reemerge until championed by another ascending hegemon, a role played by the United States in fashioning the Bretton Woods system after World War II.[2] By that time the United States was three times larger than its nearest rival in total production, with twice the per capita income and trade volume of the next nation and seven times greater foreign investment flows than its nearest rival. In conformity with the central tenet of hegemonic stability theory, the United States assumed the mantle of global leadership, championing Bretton Woods in the 1940s and sustaining liberalism through the 1960s. Since the early 1970s, however, American dominance has declined, and as predicted by the theory, both mercantilism and regionalism have reemerged to challenge the expansion of global liberalism.

A global liberal regime backed by hegemonic leadership is needed to overcome the natural inclination of most nations to retain their own trade barriers while inducing other countries to lower theirs. Such a free rider can take advantage of open markets elsewhere to expand exports but avoid the painful (if ultimately beneficial) adjustment to import competition. Even though all nations would benefit from global free trade, very few will adopt it unilaterally without assurance of reciprocity. To break this logjam requires a hegemon to take the lead and induce other nations to follow. The hegemonic nation will usually have to subsidize the organizational costs and also offer recalcitrant nations a more favorable deal than strict reciprocity would require. In fact, a hegemon frequently offers side benefits in exchange for cooperation in creating an international regime, such as the massive infusion of foreign aid provided to Europe by the United States under the **Marshall Plan** in the late 1940s.

American hegemonic leadership was especially critical in this period because conditions were not favorable for free trade in most major trading nations. In particular, depression-depleted and war-ravaged Europe could not be optimistic about its competitiveness, especially vis-à-vis the United States. Nor were the free trade tenets of liberalism unchallenged. One dissent emerged from within liberal theory itself. Known today as the **optimum tariff** argument, it shows that a tariff can sometimes improve national income by forcing foreign producers to lower their export prices.[3] However, this benefit, which comes at the expense of trading partners, accrues only to countries whose large market gives them leverage on total global demand. Following Keynes's influential analysis, many also contended that protectionism could "export unemployment," contrary to the assumption of full employment used by Ricardo to generate the gains from comparative advantage. Together these arguments refuted the free traders' contention that the gains from protectionism were illusory, a position strengthened by recent analyses suggesting that British protectionism actually benefited the British economy. Moreover, government control over trade was a logical corollary to then-prevailing sentiment in Europe, which favored government supervision of the domestic economy, especially during its transition from a wartime orientation to a peacetime equilibrium.

Furthermore, although prosperity and peace were dominant values in the postdepression, postwar world, two devastating wars within twenty-five years also inspired a desire for national security and autonomy. Europe feared economic dependence on the United States, particularly because of the widely held view that the Great Depression had been caused by poor management of the American economy. Since another U.S. recession would also spill over into other economies, Europeans insisted that the ITO include a full-employment mandate to prevent the contractionary policies to which the United States seemed prone. Thus, together with the ever present distributional implications of trade policies, these dilemmas ensured that global liberalism would face opposition.

However, several factors unique to the era made it easier for the United States to foster agreement. Most significantly, Europe was unusually susceptible to the side benefits that a global hegemon could offer. It badly needed the American market for its exports, American capital to rebuild its infrastructure, American dollars to finance trade and investment, and American military protection in the chaotic world of the 1940s. As a result of such undeniable dependence, European nations had little choice but to resolve the dilemma over national autonomy by accepting the constraints on its economic policies inherent in membership in the Bretton Woods institutions. The presence of the Soviet Union as a military threat and global communism as an ideological threat reinforced the common interests of Western nations. Not only would Bretton Woods strengthen Western forces against the Soviet Union by promoting rapid recovery and cementing closer ties, it would also reduce the appeal of communism at the same time that it highlighted the attraction of democracy, capitalism, and alliance with the United States. A final factor was especially conducive to founding a liberal regime—the conviction that **multilateral liberalism** and the resulting interdependence would lead to peace.

LIBERAL INTERDEPENDENCE AND PEACE

Policymakers saw several ways that an institutionalized liberal trading system could promote peace among nations. The growth of global institutions could weaken the hold of nationalism and mediate conflict between nations. Trade-induced contact could break down nationalistic hostility among societies. **Multilateralism** (nondiscrimination) would tend to prevent grievances from developing among states. Interdependence could constrain armed conflict and foster stability. The economic growth generated by trade could remove the desperation that leads nations to aggression.

Despite previous American indifference to international economic cooperation, this promise of peace inspired the United States to assume economic leadership and motivated Europe to follow it.[4] President Franklin Roosevelt's secretary of state, Cordell Hull, held an extraordinary belief in the efficacy of free trade as a guarantor of peace, largely because he ascribed to trade disputes a major role in promoting conflict. This view has been neatly summarized by the slogan "If goods can't cross borders, soldiers will." As early as 1916, Hull even went so far as to contend that bitter trade rivalries were the chief cause of World War I. Though few historians would accord them such importance, economic tensions were certainly present: Between 1890 and 1914, tariff wars erupted between Switzerland and France, between Italy and France, between Germany and Spain, between Germany and Canada, between Germany and Russia, and between Russia and the United States.

Each was precipitated by discriminatory trade policies in which different quotas or duties were imposed on the products of different nations. Trade barriers became tools of foreign policy rather than economic policy. Preferences offered to one nation but not to others (i.e., positive discrimination) were used to create spheres of influence, as Germany did before World War I; to build empires, as Japan and Italy did in the 1930s; and to reinforce existing colonial ties, as Britain and France had done for years. Negative discrimination directed against particular nations was useful as an element of statecraft, but it created commercial rivalries and exacerbated national tensions. Such politicized trade could lead to tariff wars, but Hull believed that free multilateral trade would build bridges rather than create chasms between peoples and nations. As Harry Hawkins, Hull's deputy, said in 1944, "Nations which are economic enemies are not likely to be political friends for long."[5]

Indeed, even as late as 1938 Hull apparently believed that war could be prevented by negotiating a trade agreement with Nazi Germany. The Axis powers contended that discriminatory trading arrangements restricted their ability to export on equal terms, and because they were therefore unable to earn the foreign exchange necessary to purchase raw materials, they were forced to go to war to secure access to them. Thus, Hull championed the nondiscrimination principle, which had also been contained in the third of President Wilson's Fourteen Points for promoting peace at the end of World War I. In fact, because Hull's vision of the postwar order emphasized nondiscrimination in trading arrangements even more than expansion of trade volumes, multilateralism became the cornerstone of the GATT.

By contrast, the British valued free trade more than nondiscrimination, arguing that tariff reduction produced economic growth and that prosperity encouraged peace. Certainly interwar Europe illustrated that mercantilism could lead to economic failure, which in turn could generate dangerous levels of domestic instability. Such instability could foster antidemocratic and anticapitalist forces, as witnessed by the rapid rise of one-party governments throughout Europe in the early 1930s. Some of these were committed to economic and political programs—Nazism in Germany, fascism in Italy—that were bound to threaten international peace.

Liberals also borrowed an argument that had been developed a century earlier by Ricardo: that extensive trade among nations created a powerful incentive to avoid war that would disrupt it. Proponents of the Corn Laws had cautioned that to rely upon others for key commodities would compromise the autonomy of the nation's foreign policy, especially because one could not threaten war against nations that supplied essential food. Ricardo noted, however, that if free trade created a permanent need for England to import grain, then other nations would permanently arrange to produce a surplus to meet that demand. Eventually, England's reliance upon trade for consumption would be balanced by the other nation's dependence upon trade for export revenues, jobs, and profits. Therefore, domestic interests would exert enormous pressure on both governments to maintain friendly relations. Since then, interdependence theorists have used this argument to claim that free trade contributes as much to national security as self-sufficiency does.

For a combination of these reasons, policymakers in many nations came to share the view, expressed by President Roosevelt in a 1945 address to Congress, that an open trading system was necessary to make "the economic foundations of peace ... as secure as the political foundations."

The ideals and institutions of the Bretton Woods system

Specific historical factors sharpened the appeal of liberalism by accentuating the values of economic growth and international peace that liberalism emphasizes. Because the primary threats to those values— instability, protectionism, and discrimination—emanated from uncoordinated national policies, the Bretton Woods institutions were created to impose on national governments a liberal discipline they were incapable of achieving on their own. That is, each nation agreed to some loss of national autonomy in exchange for limitations on those policies of other nations that were most harmful to them. Each institution was designed to prevent one of the three forms of beggar-thy-neighbor policies that abounded in the 1930s: tariff barriers (GATT), competitive exchange-rate devaluations (IMF), and capital controls (IBRD). Although a liberal trading order was the paramount objective of Bretton Woods, mercantilist concerns never disappeared, and as a result, the tensions and discontinuities embodied in these two visions became imbedded in the system itself.

The Principles of GATT/WTO

The Bretton Woods conference envisioned an International Trade Organization that would facilitate negotiations to reduce trade barriers, govern trade between negotiating sessions, and resolve other trade disputes. However, its aggressive quest for trade expansion, which went well beyond dismantling direct trade barriers such as tariffs and quotas, brought it into conflict with other national goals.[6] For example, recognizing that trade levels were determined not only by explicit barriers but also by general macroeconomic conditions, the ITO charter called on nations to maintain full employment policies. But powerful opposition, especially in the United States, viewed this provision as a violation of national sovereignty, arguing that each nation should be free to choose its own domestic economic policy. In America, this issue aroused great passion, in part because opponents were convinced that the full employment policies urged by Britain were a product of European beliefs influenced by socialist values. Thus, though the ITO charter was adopted at the United Nations Conference on Trade and Employment in Havana in 1948, it was never ratified in either the United States or Britain, the two chief negotiators.

Because the ITO was never created, the GATT organization, originally set up as a temporary secretariate to facilitate global tariff-reduction negotiations under the GATT agreement, assumed a somewhat larger role. Still, its principal activity was the facilitation and supervision of a series of "rounds" of multilateral negotiations to reduce trade barriers, beginning with the 1947 Geneva negotiations involving twenty-three countries. By 1949, the GATT had thirty-three signatories and governed four-fifths of global trade. By August 1999, the WTO had 135 members which together account for more than 90% of world trade. Thirty others were in the process of negotiating accession, or entry, among them China, Chinese Taipei (Taiwan), Saudi Arabia, Vietnam, and several former Soviet republics, including the Russian Federation.

The ultimate goals of GATT/WTO are classically liberal—the expansion of trade and the maintenance of a trading system free of political conflict—but the means used to accomplish them reveals an underlying philosophy that contains both liberal and mercantilist assumptions. After all, if nations accepted the liberal proposition that unilateral reduction of trade barriers is beneficial regardless of the policies of trading partners, negotiations would hardly be necessary. In fact, in contrast to the nineteenth-century British stance, the Bretton Woods philosophy assumes that beggar-thy-neighbor trade barriers can sometimes benefit a nation more than unilateral free trade, especially by exporting unemployment. This possibility was especially significant because the high unemployment experienced by all nations in the 1930s left policymakers wary of the simple Ricardian models that assumed full employment. It also left them unwilling to adopt free trade without some assurance that the expansion of exports would boost their employment as much as the growth of imports would erode it. Indeed, policymakers have come to think of employment growth as a more significant embodiment of the gains from trade expected of liberalism than lower import prices.

Thus, under the GATT/WTO, any nation that lowers an import barrier is deemed to have made a "concession," because reduced protection risks the loss of jobs and profits in that sector. That concession produces a benefit to other nations that can seize this export opportunity to expand production. Negotiations are necessary to induce one nation to grant concessions to others. The actual negotiating procedures were not laid out in the initial agreements and have varied considerably in the various rounds of negotiations.[7] However achieved, the negotiations must meet two basic principles of GATT—**nondiscrimination** and **reciprocity**—while allowing exceptions for the third basic principle, the freedom to retain certain **national safeguards**.

In theory, reciprocity is exceedingly simple: Each nation is expected to offer concessions equivalent to the benefits it derives from the concessions of others. For example, each nation's tariff reductions are expected to generate the same export revenue for other nations as the first will enjoy from the tariff reductions of others. There are at least two major drawbacks to bilateral bargaining under the reciprocity principle, however.

First, it would not permit tariff reductions when trade patterns were "triangular." Suppose, for example, that Barbados exported sugar to the United States but not to Britain (because of shipping costs), that the United States exported computers to Britain but not to Barbados (because the demand was small), and that Britain exported autos to Barbados but not to the United States (because the steering wheel is on the "wrong" side). In such a circumstance, bilateral bargaining would fail because although the United States would be willing to lower its tariff against sugar from Barbados, Barbados would have nothing to offer to the United States in return. Likewise, Britain would be willing to increase its imports of American computers in return for equivalent concessions by the United States, but in this example, it sells nothing in the United States.

Second, bilateral bargaining would lead to as many tariff schedules for each product as there were trading partners. The United States would charge one duty for Haitian sugar, another for Jamaican sugar, and a third for sugar from Barbados—with the rate calibrated to the concessions offered by each. This complex system would invite deception by misrepresenting a product's origin or even by transshipping it through a third party to secure the lowest possible duty. Moreover, it would violate the liberal precept that a product should be exported by the most efficient producer—not the best negotiator.

Still, if the only goal had been to increase trade, such a system would have been workable. However, there was a more fundamental objection to it: Charging different duties to different nations constitutes discrimination—and that would inevitably politicize trade. Recall that the nondiscrimination principle was key to Hull's vision of a trading order that engendered peaceful political relations as well as efficient economic relations. Indeed, the importance of this principle may be gleaned from its location at the very beginning of the GATT, where it is embodied in Article 1's most-favored-nation (MFN) clause: "Any advantage, favor, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating or destined for the territory of all other contracting parties." In other words, each signatory nation of GATT is prohibited from discriminating against any other signatory—either positively or negatively—by maintaining different trade barriers for different countries.[8] Similar provisions had been contained in all American treaties negotiated bilaterally since 1934 and most treaties negotiated by European nations since 1860.

This system has undeniable appeal, but it considerably complicates the negotiation process. If a single tariff schedule applied to all trading partners, strictly bilateral negotiations could not be very effective because any concession granted to one nation would automatically be enjoyed by all the others as well. In effect, a nation would have an incentive to free ride by refusing to offer concessions that would meet its reciprocity obligations because under the nondiscrimination principle, it would still be able to benefit from the concessions granted by others. By contrast, without the nondiscrimination principle, reciprocity would be self-enforcing in the sense that nations unwilling to offer concessions would find themselves unable to achieve access to the markets of other nations. Though this free-rider problem never completely disappears, the unconditional MFN principle has been retained, in part because a certain degree of free riding has been considered preferable to enduring the economic costs and political consequences of discrimination. Since the hegemon is usually the principal victim of free riding, it can exercise either its tolerance or its power to mitigate the problem. Furthermore, various negotiating arrangements have been found to reduce the severity of free riding.

In the first five GATT rounds (Geneva, 1947; Annecy, 1949; Torquay, 1950–1951; Geneva, 1955–1956; and the Dillon Round in Geneva, 1960–1961), bargaining began with a series of bilateral negotiations using the principal-supplier rule to identify the parties to a negotiation. That is, each pair of nations would exchange requests for item-by-item tariff reductions on those products for which each was a principal supplier of the other. Each pair would then negotiate an agreement that achieved bilateral reciprocity by granting equivalent concessions to each side. Of course, because these tariff reductions would become available to all nations under the MFN clause, no nation could accurately assess the balance of concessions and benefits until all the preliminary agreements involving all pairs of nations had been concluded. At that point, the preliminary agreements would be amended through multilateral negotiations to take account of the indirect benefits received by each nation from the generalization of the bilateral agreements reached by other parties. This approach was adequate for the initial round in 1947, which achieved large nominal cuts (about 20 percent, covering about 78 percent of total imports), because many 1930s-era tariffs were too high to serve any real protectionist purpose and nations were thus willing to give them up easily.[9] However, the next four rounds produced very small gains (2–3 percent each, covering products that made up only about 10 percent of global trade) because the item-by-item approach permitted domestic interests to rally support for protection. The principal-supplier method resulted in a relatively low incidence of free riding, however. A nation that attempted to free ride usually found that tariffs on its leading exports remained high because other nations were not willing to offer concessions in exchange for benefits that they would share with a free rider. The last three rounds (the Kennedy Round, 1962–1967; the Tokyo Round, 1973–1979; and the Uruguay Round, 1986–1994) successfully used a formula approach that began with an across-the-board cut followed by negotiations of item-by-item exceptions....

However, Bretton Woods is far from a pure free trade system. Old tariff barriers remain because complex negotiations to remove them take time, and new nontariff barriers have arisen in recent years. Moreover, significant antiliberal features—exceptions to the nondiscrimination and reciprocity principles—were built in to Bretton Woods from the outset. Of course, the very definition of import liberalization as a concession under GATT's reciprocity principle is a mercantilist, not a liberal, conception.

In fact, the GATT contains so many of these escape clauses that they may be said to collectively constitute a safeguard principle, which acknowledges that certain national interests are so essential that no international agreement could—or should—prevent nations from defending them. Thus, GATT accommodated these deviations from liberal principles because few nations could have accepted the agreement without such assurances. Three of these provisions are especially striking—though none has much import today—because they permit behavior that was central to classical British mercantilism. Under the grandfather clause of Article 1, paragraph 2, the British were permitted to retain the imperial preferences of the old British Empire. In extreme **balance of payments** deficit situations, Article 14 allows nontariff barriers (which otherwise would violate Article 11's prohibition of import quotas), even discriminatory ones (which would otherwise violate the MFN clause).[10] Under Article 21, a nation may take any action it "considers necessary for the protection of its essential security interests ... in time of war or other emergency in international relations."

A more important exception to the non-discrimination provision is found in Article 24, which permits regional tariff preference areas such as the European Union and the North American Free Trade Agreement. A member of such a regional organization may apply a tariff schedule more favorable than the most-favored-nation rate to other member countries, but these discriminatory arrangements must meet three conditions to be considered GATT-legal. First, they must lower barriers inside the region rather than raise the others. Second, they must be completed over a "reasonable amount of time." Third, they must cover "substantially all" products. Although no regional arrangement has ever fully met these standards, all have been tacitly permitted.

Other escape clauses include Article 19, which permits nations to "suspend the obligation of the GATT in whole or in part"—that is, they may reduce or delay tariff reductions—if imports threaten domestic industries with "serious injury." Nations invoking this clause must offer equivalent compensation to affected parties, who are free to take retaliatory measures if they do not.[11] Under Article 35, a member need not recognize GATT obligations toward new contracting parties, a provision originally included at India's request in anticipation of South African entry but used by fifteen nations upon the accession of Japan in 1955. Finally, Article 25 authorizes the contracting parties, on a two-thirds vote, to grant waivers of GATT obligations "in exceptional circumstances not elsewhere provided."

The sum of these exceptions compose a significant mercantilist element within a structure that is ostensibly liberal. Indeed, business interests in the United States opposed the Havana Charter in part because they felt that these provisions would have made the agreement "a step away from, not toward, the goal of multilateral trade."[12]

The financial institutions of the Bretton Woods system

The financial institutions of Bretton Woods—the IMF and IBRD—were designed to facilitate this new trading order. To do so, they had to resolve the problems that led to a disintegration of the international monetary order of the interwar years, which in turn contributed greatly to the collapse of trade. ... For our purposes, the most significant difficulty concerned the inability of nations to finance trade through the easy conversion of their currencies into acceptable media of exchange, especially during periods of trade deficits.[13]

Conventionally, economists divide the challenge of maintaining an adequate international financial system into three interrelated problems: **liquidity**, adjustment, and confidence. In order to finance trade, the international financial system must provide a medium of exchange, that is, some "liquid" asset that traders will accept as money. Without such liquidity, private actors could exchange goods only through barter. National currencies do not provide a complete solution, since firms resist accepting payments in a foreign currency unless assured that it can be easily converted into the currency in which they conduct most of their business.

Ordinarily, the central banks of individual nations provide this assurance—and thus facilitate trade—by exchanging national currencies for one another. However, they are willing to perform this exchange function only if they have enough confidence in the values of these currencies to hold sufficient stocks of them. Just like private firms, central banks are reluctant to accumulate foreign exchange unless they are assured that it is liquid, that is, that it can be easily exchanged at a reliable and predictable price. Unless the system provides some basis for this confidence, banks will not maintain a large enough inventory of currencies to provide the liquidity necessary to accommodate a large volume of trade.

From 1870 to 1914, the mechanism that solved these two problems was the **gold standard**; central banks accepted gold as the ultimate liquid asset and individual national governments guaranteed a fixed conversion rate between gold and their national currency. Since each nation maintained a reserve of gold to back its currency—each nation's central bank agreed to exchange its currency for gold at a fixed price—the system worked well to facilitate trade and investment transactions. In fact, so long as the supply of gold was adequate and confidence was high that national monetary authorities would redeem currency for gold as promised, ...even temporary trade deficits presented no problem, because excess currencies would be willingly held by national treasuries, central banks, and even commercial banks and other firms. Any successful system must tolerate such temporary imbalances because it is inevitable that levels of imports and exports will fluctuate in the short term as prices and other economic conditions change.

Of course, there are limits to the confidence one can have in national monetary authorities and thus limits to the tolerance for disequilibrium. These limits are a function of the size of the deficits that are accumulating, the size of the gold reserves nations maintain to settle those deficits, and the ability of national governments to adjust their economies in the event that it becomes evident that those deficits result from long-term rather than short-term factors. For example, if a nation's exports continually lag behind its imports—presumably because its production is not competitive with firms in other countries—it has available three methods of adjustment. First, it may lower the price at which it agrees to exchange its currency for gold. This devaluation of the exchange rate makes it more expensive to purchase foreign currency and therefore foreign products, so imports should decline. Devaluation also makes a nation's own currency cheaper for others to purchase, so its exports should grow. Second, a nation may erect barriers to inflows of goods (imports) and outflows of capital (foreign investment). Third, it may contract the domestic economy so that citizens have less money to spend and consequently purchase fewer imports. In all three cases, a new equilibrium should be reached in which imports and exports once again balance each other. Confidence in the system is better maintained if trade stability causes disequilibria to be temporary and small, if liquidity is high enough to make adjustment relatively rare, and if a hegemonic actor can force countries to adjust responsibly when adjustment becomes necessary. During the period of British hegemony, the latter role was played effectively by a combination of the political power of the British government and the economic power of the City of London, whose banks controlled a large portion of the world's gold supply and influenced a still larger portion of the capital available for investment and loans.

Responsible adjustment is important to the system because any form of adjustment by one nation is inevitably disruptive to all others. Rapid or massive exchange-rate adjustments undermine the predictability of transactions and discourage trade. Devaluations especially arouse the ire of foreigners who are holding a currency when its value declines—and makes them wary of holding it in the future. Other nations are also resentful of any form of adjustment that shifts competitiveness more than required to reestablish equilibrium. Of course, they are particularly opposed to forms of adjustment, such as import barriers and capital controls, that restrict their ability to trade.

The gold standard worked efficiently so long as the gold supply was adequate to the routine liquidity needs of the system, so long as confidence in the pound sterling was sufficient to augment that liquidity in an emergency, so long as confidence in the hegemony of Britain to manage the system was unquestioned, and so long as the imbalances to be financed were small enough in relation to gold reserves that adjustments were modest and infrequent. After World War I, none of these conditions held. Severe inflation eroded the purchasing power of gold so that it no longer provided enough liquidity to facilitate trade, let alone the enormous amount required for payment of huge German war reparations owed to European nations and massive war debts incurred by European nations to the United States. Aided by the dislocations of a global economic downturn and considerable speculation in currency markets, rapidly shifting supply and demand for currencies left nations unable to maintain exchange-rate stability. The gold standard was abandoned, leading to a period of sharp volatility in the relative prices of currencies that discouraged trade.

Britain's ability to manage the system waned because its economic power declined. Further, international norms broke down as an increasing variety of national political systems arose—from the New Deal in the United States to fascism in Europe—each dominated by different values and committed to different economic theories. Nations selected adjustment policies in keeping with their own domestic needs, seemingly indifferent to the disruptions these adjustments caused abroad.

Specifically, nations adopted protectionist trade policies and beggar-thy-neighbor exchange-rate policies in which they devalued their currencies in order to encourage exports and discourage imports. These competitive exchange-rate devaluations, like the tariff increases and export subsidies that they mimicked, elicited retaliatory responses from other nations that soon degenerated into a spiral of chaotic rate fluctuations. The resulting instability in exchange rates increased the uncertainty and risk of trade, which in turn inevitably led to falling trade levels. Nations also restricted the external flow of capital both to better control their exchange rates and to keep investment at home, where it was needed to rebuild the economy. Just as trade declined enormously, so did financial flows. Hence, the Great Depression had roots in monetary chaos as well as the collapse of trade. Further, national hostilities generated by beggar-thy-neighbor monetary policies exacerbated those stemming from trade disputes.

Thus, a new international financial system had to be created that would solve the problems of liquidity, confidence, and adjustment against the backdrop of new political and economic realities. Some of these economic realities—such as the increase in liquidity required by the meteoric rise in trade, investment, and loan levels—posed greater challenges, but the political reality of a powerful United States committed to hegemonic leadership offered a greatly enhanced capacity to meet them. The method chosen was the Bretton Woods system, centered around the dollar-gold standard, an IMF-enforced system of fixed exchange rates, and massive capital flows provided by the World Bank and the United States.

Liquidity was provided by a combination of gold and the U.S. dollar, which were linked by the U.S. Federal Reserve's commitment to freely exchange gold and dollars at the rate of $35 per ounce. Given the gold shortage, nations held most of their international reserves in the form of U.S. dollars, the system's reserve currency. This meant that the liquidity of the dollar-gold standard rested on huge U.S. gold stockpiles and the willingness of the United States to export enough dollars—through balance-of-trade deficits, investment flows, loans, and Marshall Plan aid—to maintain reserve assets and facilitate trade. Confidence in this system also rested on trust in the United States because the dollar could be debased at any time through irresponsible action by U.S. monetary authorities or miscalculation of the system's liquidity needs. Hegemonic stability theorists correctly note that only the U.S. dollar commanded sufficient respect to guarantee the confidence of most observers and that only the United States had sufficient political and economic power to silence those that did not share it.

It was still necessary, however, to restrict the ability of nations to choose adjustment policies that harmed others, especially the trade barriers, capital controls, and competitive exchange-rate devaluations that had contributed to the collapse of the 1930s. In particular, the International Monetary Fund was created to supervise a new system under which the **par value** of each currency was defined in relation to the U.S. dollar. Each nation was required to use its reserves in order to maintain this par value by buying or selling dollars in exchange for its own currency until supply and demand once again balanced at the agreed upon rate. Furthermore, governments were prevented from undertaking a unilateral change in this exchange rate without IMF approval, which was considered a means of last resort to resolve persistent balance-of-trade deficits. Neither could nations "adopt any monetary or general price measure or policy" that would threaten the balance-of-payments equilibrium of other nations without a four-fifths vote of IMF member states. Thus, in the hope of preventing the wild currency speculation, capital flows, and bank failures that were common during the Great Depression, the IMF was empowered to constrain extreme and illiberal macroeconomic policies of governments.

But the cost—in terms of sacrificing national sovereignty—was high. In practice, these restrictions encouraged adjustment to trade deficits by contractionary domestic policies, including high interest rates and either high taxes or low government expenditures. Although these policies would slow the economy enough to restrain imports and would restore equilibrium with minimal impact on others, they were also likely to promote domestic unemployment, slow economic growth, and diminish the resources of the state to respond to the social problems that resulted. Given the political sensitivity of these effects--which were bound to undermine the domestic popularity of governments and doom the political careers of leaders--it was no small compromise for states to willingly relinquish the authority to choose alternative means of adjustment. Only the extraordinary conditions of the time can explain this unprecedented trade-off of state sovereignty for the benefits of a stable international trading system. However, since these pressures on national governments ...were well understood, the system also provided means by which major adjustments could be delayed as long as possible in the hope that the disequilibrium would prove to be temporary or that minor adjustments would work given enough time.

Those means involved short-term loans from the IMF ... and long-term loans for war-recovery purposes from the IBRD. The latter provided a financing facility to repay war debts, provide for reconstruction, and aid balance-of-payments difficulties. The motivation for the World Bank was not only to provide an option for nations tempted to control trade and investment; it was also predicated on the assumption that the loan-induced prosperity of Europe would contribute to trade that could raise the prosperity of all the nations of the globe together. The same logic later applied to the Third World, where the bulk of IBRD loans have been directed since the 1950s. Thus, the Bretton Woods system was an attempt to encourage nations to maintain liberal trade policies while allowing some measure of national autonomy.

For many years the system worked; global trade increased at an unprecedented historical rate and the global economy expanded rapidly. Since its founding, however, the Bretton Woods system has undergone major changes, especially with respect to finance. Confidence in the dollar eroded as the persistent American balance-of-payments deficits documented in chapter one dumped more dollars onto international currency markets than could be redeemed by U.S. gold stocks, eventually forcing the United States to abandon the commitment. Just as the link between gold and the dollar was broken in the early 1970s, which compromised the only source of liquidity that could command any confidence, the increase in trade and, especially, the huge trade deficits associated with spiking oil prices, required even greater liquidity. Most developed nations, unable to stabilize their currencies' values, ceased to peg them to either gold or the dollar. Instead, most major currencies have been allowed to "float," that is, their exchange rates are determined by supply and demand in global currency markets, with minimal intervention by states.

Increasingly, however, the source of that demand for currencies lies not primarily in the need to finance trade, but rather in facilitating the flow of investment and, especially, in speculation on the future values of the currencies themselves. These changes stem partly from the technological advances in communication and information transfer that permit instantaneous exchanges across the globe. They also reflect the rise of multinational corporations that generate large flows of capital and the emergence of a class of capitalists that earn rewards from the transactions themselves. Underlying all of these factors, however, is the effect of the Bretton Woods institutions in spreading liberal ideas about the benefits of free markets and in dismantling barriers to flows of both capital and goods. These changes have had enormous impact on the ability of the state to insulate its economy from external forces. With states no longer able to control the value of their own currency, rates can fluctuate so wildly that trade--once the principal purpose of foreign exchange markets--is now impeded by them. Indeed, as we shall see in chapter six, the EU has responded to the trade disruption caused by fluctuating currency values among its members by moving to replace the various national currencies with the Euro.

All of the Bretton Woods institutions have adapted to changing circumstances, not least those they themselves have brought about. Changes in the trade dimension of Bretton Woods can be seen in the Uruguay Round of trade negotiations, which not only continued the process of lowering trade barriers, but also created a new institution to govern global trade, the WTO.

THE URUGUAY ROUND OF GATT

The eighth round of GATT negotiations, the so-called Uruguay Round, was launched in September 1986 with the Punta del Este Declaration. After the longest and most difficult bargaining in GATT history, the Marrakech protocol was signed in April 1994 by 123 nations. *The Marrakesh Agreement Establishing the World Trade Organization* and its annexes are comprised of 29 individual legal texts and 28 additional documents, altogether about 430 pages long. Most notable among them are the revised GATT (now referred to as GATT 1994), the General Agreement on Trade in Services (GATS), Sanitary and Phytosanitary Measures Agreement (SPS) and the Agreement on Trade-Related Intellectual Property Rights (TRIPs). These agreements are accompanied by more than 20,000 pages which detail each member's schedule of tariff concessions and service commitments. The agreement entered into force in January 1995 after protracted ratification fights in several nations, especially the United States.

The difficulties and delays were due in part to a continuing deterioration in three conditions that had once been helpful in achieving trade agreements. First, the interests of the various parties ... have diverged. The major trading nations are now trade competitors rather than allies in either hot or cold wars. Further, they no longer share the values and theories that once underpinned both national policies and the multilateral system. Second, the distribution of power among nations has fragmented. The erosion of American preeminence has left the system without hegemonic leadership, and the ascendance of Third World nations to positions of greater competitive danger in markets has increased their influence. Negotiations became much more complicated as membership expanded from 23 to 123. Third, global growth has slowed and the political pressure on national governments to improve economic performance—especially when threatened from abroad—has correspondingly risen. As a result, the agenda of trade negotiations must now reflect many more perspectives.

At the same time, the issues discussed produce greater rancor, especially because they touch the fundamental dilemmas of trade more deeply. In this, the trade liberalization process suffers from the legacy of its own success: Because the first seven rounds of negotiations had already accomplished the easiest tasks, the remaining ones represented challenges to the global trading system that were both profoundly different and substantially more difficult than those surmounted previously.

For example, the across-the-board tariff cuts that had formed the centerpiece of previous rounds did not occupy the core of the Uruguay Round negotiations. After previous GATT rounds had lowered tariff rates to about a 4 percent average on most industrial products, they were no longer a significant barrier in most products and in most markets. However, the tariffs that remain, which are concentrated in a few "peaks" surrounded by virtually zero rates on most products, are very resistant to further reduction. Because decades of negotiations have rooted out most tariffs, the remaining ones are invariably those that pose the most serious dilemmas and thus command the strongest political support. Thus, across-the-board tariff reductions were a high priority only in relation to a handful of newly industrializing countries (NICs), especially South Korea and Brazil, whose protectionist policies are no longer tolerated now that they compete effectively with more developed nations. Still, further progress was made with average tariff reductions of 36 percent (including at least 15 percent in all categories) phased in over six years.

However, the Uruguay Round negotiations were dominated by two other agenda items. First, GATT principles and procedures were extended into sectors not previously covered, especially agriculture and services. Second, the rules of trade were clarified and the procedures to deal with disputes that arise under them were institutionalized by creating the World Trade Organization (WTO).

The extension of trade liberalization into new sectors reflects both changes in the nature of modern economies and shifts in the power balances among nations. For example, the inclusion of textiles and tropical products reflects the growing importance of less developed countries (LDCs), but U.S. bargaining power minimized the changes they sought.[14] At the insistence of the United States, the service sector, which now accounts for about two-thirds of the American economy, was addressed for the first time. Several areas were liberalized, especially accounting, advertising, computer services, telecommunications, engineering, and financial services. ... The United States achieved some successes in trade-related aspects of intellectual property (so-called TRIPs) but failed in others. Because pirating currently costs Americans between $40 and $60 billion annually, the United States sought to guarantee that other nations would honor patents, copyrights, trademarks, and designs, especially in the software, chips, biotechnology, and entertainment sectors. For example, computer programs are now treated as literary works that require copyright fees. However, barriers to trade in services remain, such as French restrictions on the percentage of radio and television content that originates abroad or in languages other than French, restrictions that were challenged by Hollywood and by American rock musicians. The United States also pressed trade-related investment measures (TRIMs), contending that regulating foreign investment by multinational corporations unfairly restricts access to markets.

The most challenging new sector to be addressed in the Uruguay Round was agriculture. On the one hand, liberal theory makes an especially compelling case for free trade in agriculture: Agricultural policies in industrial countries cost consumers between $200 and $300 billion per year.[15] However, trade dilemmas have also enlisted the support of an unusually formidable collection of political forces. Indeed, many countries wanted agricultural trade on the agenda, but only a small group of highly efficient exporters (headed by Canada's and Australia's grain-exporting interests) unequivocally supported free trade in agriculture. Most of the rest, including the United States, wanted liberalization only in their main export crops. As a result, agriculture produced the most difficult bargaining of the Uruguay Round, resulting in so many delays and missed schedules that many doubted that an agreement could ever be reached.

Agriculture presented a unique challenge because its special role in most political economies ensures that any liberalization in this sector will induce extensive distributional consequences and uncomfortable trade-offs with other values. Nearly all nations are committed to sustaining a healthy agricultural sector because a relatively large, geographically concentrated and occupationally inflexible population is dependent upon it. Many cultural and political issues also swirl beneath the surface, exemplified by the Japanese symbolic commitment to self-sufficiency in rice production. Moreover, because agricultural policy in most nations is a complex combination of various subsidies and nontariff barriers (NTBs), it is difficult to compute its actual protective effect. As a result, the agreement requires that all nations replace NTBs with equivalent (or lower) "bound" tariffs. This "tariffication" simplifies negotiations because it allows a better comparison of the protectionist effects of different national policies.

Tariff rates were reduced in all products, guaranteeing at least minimal access to even previously closed markets such as Japanese and Korean rice. Among developed countries, the rates on each product must be reduced by at least 15 percent, with an average reduction across all products of 35 percent after a phase-in period of six years. LDCs are permitted ten years to phase in reductions of at least 10 percent, with an average of 24 percent. Markets receiving $8 billion in U.S. agricultural exports were affected by the elimination of NTBs.

The principal protagonists in the dispute over agriculture—the United States and the EU—clashed with particular ferocity over subsidies. The United States, which itself subsidizes farmers in a variety of ways, nonetheless took a hard line because about 60 percent of U.S. agricultural exports face subsidized export competition. The EU, whose Common Agricultural Policy (CAP) has been described as "the acknowledged paragon of farm-trade lunacy," resisted strongly, not least because the diversity of interests among its twelve member nations made any agreement, even among themselves, exceedingly delicate.[16] Before the agreement, the United States spent about $1 in subsidy for every $100 in agricultural exports, and the EU spent about $25. The agreement requires at least a 21 percent reduction in volume of each subsidized agricultural export as well as a 36 percent reduction in budgetary outlays overall, to be phased in over six years. As a result, the EU would cut subsidies by $5–$7 billion, the United States about $500 million. LDCs are permitted ten years to phase in minimum reductions of 14 percent by volume and 24 percent in total cost....

In addition to tariff reductions, GATT 1994 and its associated agreements also clarified and tightened various trade rules. For example, distinctions are drawn more clearly between those subsidies that are prohibited and those designed to meet goals such as regional development, environmental protection, and improved industrial research, which are not. The use of "health measures" as protectionist devices was disciplined by requiring scientific evidence to support the need for an import restriction. Similarly, technical barriers to trade—the use of testing, certification, and other procedures as a protectionist measure—are now restricted. Finally, there are more precise rules for countervailing duties.

The World Trade Organization

Perhaps the most visible accomplishment of the Uruguay Round is the creation of a permanent trade institution, the World Trade Organization, which commenced operation on January 1, 1995, nearly fifty years after the proposed ITO was abandoned. The WTO is not a wholly new organization, of course. Its staff and building in Geneva are identical to that of the GATT secretariate it replaced and the GATT agreements remain at the center of the legal order it now supervises. Furthermore, while the WTO may be said to govern global trade, it does so quite loosely and with very limited resources. Its annual budget, about $80 million, is smaller than at least 15 other international economic organizations and barely 5% of the largest, the World Bank. Its staff, fewer than 500, is similarly dwarfed by the World Bank's 7000 and the IMF's 3000. They have no enforcement powers and are neither authorized to interpret GATT/WTO rules nor investigate violations of them.

Still, the WTO does represent an important milestone, only partly because its founding coincides with the adoption of GATT 1994 and other agreements that clarify rules (e.g. SPS) and extend them to other areas of trade (e.g. GATS). The WTO also gives new prominence to the Trade Policy Review Mechanism (TRPM) and, most importantly, strengthens the system of dispute settlement. The Trade Policy Review Board is responsible for conducting periodic surveillance of the trade policies and practices of all members. The largest nations are reviewed every two years; the remainder at wider intervals. Trade policy reviews were begun in response to an influential 1985 GATT report that concluded "Governments should be required regularly to explain and defend their overall trade policies." Article X of GATT had always required members to publically announce all changes in trade policy but very few did so. The TRPM was designed to strengthen observance of WTO commitments by monitoring compliance "and by establishing a forum within which members can question one another's policies and practices."[17]

While the TRPM may bring to light a nation's trade policies and practices, it is not a means to enforce WTO rules or even to investigate violations of them. Indeed, overt inconsistencies between a nation's policies and its WTO obligations can--and frequently do--continue indefinitely, until another nation lodges a protest. That complaint initiates the provisions of the dispute settlement system, the most significant and most controversial new contribution of the WTO. The process begins when one nation files a complaint with the Dispute Settlement Body (DSB) against the policy or practice of another nation. If consultations between the parties cannot resolve the matter, the DSB appoints a panel of three (sometimes five) experts to hear evidence on the legal question of whether the policy in question is consistent with the relevant provisions of GATT and the other agreements which constitute WTO rules. That panel report, which rules on the violation and recommends how the violator should rectify it, can be appealed to an appelate body, whose final recommendation will be adopted unless the entire WTO membership unanimously disagrees. If the guilty party refuses to make the recommended changes or to offer acceptable compensation, the DSB will authorize sanctions to be exacted by the complaining nation, ordinarily by suspending concessions (that is, by raising tariffs against products of the guilty nation).

This dispute-resolution mechanism has been the most controversial feature of the WTO, first during the ratification debate in the United States, and later by virtue of its early decisions. It has become a lightening rod for various criticisms of the WTO because it is charged with applying to particular cases the contentious principles contained elsewhere in WTO rules, including GATT 1947. Under the old GATT procedure, disputes were investigated by a special panel, but because its rulings were subject to a consensus among all GATT members, every nation had a veto over any adverse judgment. The WTO panels are also more influential because they have been given a more explicit standard of review that increases the predictability of action, and investigating authorities are now required to provide public notice and written explanations of their actions. These improvements are long overdue because some enforcement mechanism is necessary if trade law is to be effective. The United States argued most strongly for the new rules because of frustration over the ineffectiveness of the old GATT mechanism, which it used more often than any other nation.

However, a surprising variety of American groups ... opposed the WTO as a violation of national sovereignty. Environmental groups such as Friends of the Earth, Greenpeace, and the Sierra Club were joined by consumer advocates such as Ralph Nader but, surprisingly, also by conservatives such as Ross Perot, Pat Buchanan, Jesse Helms, and Howard Phillips of the Conservative Caucus. They feared that a WTO panel would rule that various U.S. government policies constitute unfair trade practices warranting retaliation by others. A GATT panel had ruled previously that the U.S. Marine Mammal Protection Act was an unfair trade restriction because it prohibited the importation of tuna caught by nets that also kill dolphins. EU automakers also challenged the U.S. law that established standards for auto emissions and fuel economy. Buchanan said, "WTO means putting America's trade under foreign bureaucrats who will meet in secret to demand changes in U.S. laws.... WTO tramples all over American sovereignty and states' rights."[18] Because the WTO could not force a change in American law, GATT director general Peter Sutherland called this position "errant nonsense," but the WTO could authorize an offended nation to impose sanctions or withdraw trade concessions as compensation for the injury. Thus, in July 1994, attorneys general from forty-two states wrote President Clinton saying the agreement could jeopardize state sovereignty.

The first few years of experience with the WTO dispute resolution mechanism suggest that two GATT provisions allow the greatest intrusion into domestic arenas usually thought to be within the sphere of national sovereignty. Both the "national treatment" principal and the "nullification or impairment" clause have been fundamental to GATT since 1947, but they have assumed greater importance under the WTO for several reasons. Most importantly, because dispute resolution panel decisions are now binding, states have a greater incentive to use these provisions to challenge the domestic policies of others. Of course, with tariffs much reduced, such domestic policies have much greater impact than when they were dwarfed by traditional barriers. Furthermore, the WTO applies these obligations much more broadly and with much greater precision than previously.

GATT's article III establishes the "national treatment" principle, that "internal taxes, laws, and regulations should not be applied to imported or domestic products so as to afford protection to domestic production. Imports shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements." The WTO has heard numerous complaints turning on whether a domestic and foreign good should be considered "like products". It has ruled that the EU ban on meat treated with growth hormones is a violation, rejecting the EU defense that such treatments render U.S. beef a cancer risk (and therefore not a "like product" entitled to the same status as European beef). Citing the Sanitary and Phytosanitary Measures Agreement (SPS) negotiated during the Uruguay Round, the WTO panel found that the scientific studies relied upon the EU to establish the health risk did not meet the required burden of proof and further denied the EU's request for a two year delay to commission acceptable scientific studies that would do so. Canada has also used the SPS to challenge the EU's exclusion of asbestos products, which have been banned in the U.S. for many years as a carcinogen. The "like products" standard has also been invoked to challenge the U.S. prohibition against the importation of shrimp from fishing fleets that use techniques thought to trap endangered sea turtles. In this case, it was ruled that an adequate regulatory program did not exist to certify that the average rate of taking of sea turtles by foreign fleets was greater than those of the U.S. The "like products" standard has also been used to challenge the conformity of domestic taxes to the national treatment principle. Japan was found in violation by taxing vodka at a higher rate than shochu, while similar cases are pending concerning Chile's taxation of pisco and Korean taxes on soju.

GATT's article XXIII allows any nation to challenge the domestic laws of another if they "consider that any benefit accruing to it directly or indirectly under this Agreement is being nullified or impaired" by them, regardless of whether the law had that intention. This provision has been the basis of some notable attempts to penetrate domestic practices. The U.S. has challenged Japan's Large-Scale Retail Store Law, which limits the establishment of large retail stores that might drive smaller competitors out of business and regulates the floor space, business hours and holidays of supermarkets and department stores. The U.S. contends that it is difficult and expensive to market American products to the thousands of small retail stores in Japan and that it would be much easier for them if Japanese law and regulatory practices allowed large chain stores that were open longer hours to operate more freely. As evidence that these domestic practices "nullified and impaired" the market access to which American producers were entitled by virtue of Japanese commitments under GATT, the U.S. observed that Kodak photo film accounted for over 40% of the market in Europe and elsewhere, but only 7% of Japanese sales. A WTO panel rejected the claim but the U.S. has continued to press the point in bilateral negotiations with Japan.

The U.S. has been the most active claimant in WTO cases. For example, the WTO Annual Report for 1998 records that seven of the eight panel reports adopted concerned claims initiated by the U.S. Five of the 15 new panels convened in the previous year originated from U.S. complaints, and 12 of the 36 other requests for consultations, a first step toward the convening of a panel, were brought by the U.S. Among them were U.S. contentions that aspects of the income tax law of five different nations as well as French government loans to develop a flight management system for the Airbus aircraft amount to export subsidies. The U.S. also disputed the EU's classification of Local Area Network (LAN) adapter equipment as "telecommunications equipment" rather than "automatic data processing machines" (which enters under a lower tariff) and protested Canadian patent protection that lasts only 17 years rather than 20 as required under the TRIPS agreement.

The U.S. has also been the defendant in a number of complaints. The U.S. laws that have been challenged include a 1996 Massachusetts Act that prohibits state officials from procuring goods or services from any persons who do business with Burma (Myanmar), in protest of its human rights record. Complaints have also been filed over the Helms-Burton Bill that discriminates against Cuban products, the Harbor Maintenance Tax said to discourage trade, and the U.S. Copyright

Act, which permits, under certain conditions, the playing of radio and television music in public places without the payment of a royalty. The most significant complaints, however, are those described in chapter five concerning American unilateral actions under sections 301-310 of the Trade Act of 1974 and the Anti-Dumping Act of 1916, which impose penalties for alleged trade violations without recourse to WTO dispute settlement.

Conclusion: Trade Dilemmas and International Institutions

The controversies surrounding contemporary international institutions are replete with trade dilemmas. The familiar liberal benefits claimed for the Uruguay Round are too huge to be dismissed even if U.S. trade representative Mickey Kantor's prediction of $1 trillion in gains over ten years is disputed by the much smaller estimates of the World Bank, the Organization for Cooperation and Development (OECD), the Institute for International Economics, and the Economic Policy Institute. These benefits must be balanced, however, against other considerations.

Liberalizing trade produces winners and losers. The World Bank identifies Africa as a net loser of the Uruguay Round because its costs for food imports will rise and the prices of commodities exported by African nations, such as tea, coffee, and cocoa, will fall. In the United States, the distributional dilemma of trade has been raised by industry groups ranging from corn growers to textile producers.

If the present conception of the WTO is controversial, it would have become more so under a social clause considered by the preparatory committee for the WTO. Various proposals under this clause would have exempted from GATT benefits any exports produced by slave labor, child labor, workers prohibited from organizing and bargaining collectively through labor unions, or those denied a minimum wage or health and safety protection. Such proposals are unlikely to be accepted, however, because they seek agreement where none is possible: Not all nations share the values implied by the willingness to sacrifice commerce for other ends.

Neither has time diminished the dilemmas concerning the effect of trade on the state, especially matters of national sovereignty. The case involving EU prohibitions against hormone-treated beef from the U.S. is perhaps the most revealing contemporary example. Surely the U.S. is correct in noting that free trade requires nations to refrain from using fraudulent health issues as a disguised means of protecting its inefficient industries. Further, the experience of several centuries makes it clear that the drive for free trade, which may begin with modest tariff reductions, leads inexorably to targeting aspects of national life that are more sensitive, controversial, and likely to provoke conflict. Finally, it is hard to deny the need for some institutional means to transform such political disputes into more easily resolved legal ones. Yet, surely the EU is also correct that the European citizens' right of self-determination includes the freedom to elect governments that pass laws to protect communities against health risks. That would seem to include the right to their own weighing of those risks, including the judgement that some foods may be dangerous even though formal scientific studies have yet to prove it conclusively. Finally, it is hard to deny that the WTO finding has undermined the sovereignty of states and with it the freedom of citizens.

Trade inevitably poses such dilemmas. It is easy to see that some individuals, groups and nations will differ with others in how to resolve them. The policy choices by nations concerning the institutions that embody these options reflect different theories and values, different power distributions, and different estimates of the effects of markets. Trust in trade-liberalizing institutions is likely to be greatest in those nations with the greatest power to dominate them. As always, support for liberalization is greatest in nations with the most productive industries (and thus the greatest stake in removing barriers to trade), and with the highest weighting of trade benefits among its value priorities. Opposition is more likely from weaker states (which are more protective of their fragile sovereignty), from economies with more threatened industries, and from societies with a greater commitment to values other than aggregate growth.

Controversies over the various safeguard measures employed by nations pursuant to GATT's Article 19 also revisit this enduring problem of squaring the benefits of trade expansion with the compromises of national sovereignty required to achieve them. Thus, the very mercantilist exceptions that made the liberalism of Bretton Woods acceptable to nations have come under attack, revealing the inherent inconsistencies of the system. Indeed, the international trading order struggles with the coexistence of systemic institutions more liberal than mercantilist and national policies inclined to be more mercantilist than liberal.

Endnotes

1. See Charles Kindleberger, *The World in Depression 1929–1939* (Berkeley: University of California Press, 1973); and Robert Gilpin, *U.S. Power and the Multinational Corporation: The Political Economy of Foreign Direct Investment* (New York: Basic Books, 1975).

2. American leadership was long overdue. Britain's ascendance peaked around 1880 and its relative decline had been unmistakable since World War I. The United States surpassed Britain in total income by the middle of the nineteenth century, in per capita income by the beginning of the twentieth, and in volume of global trade and investment shortly after World War I.

3. This standard component of liberal theory appeared as early as 1808 in the work of Robert Torrens, who also developed the theory of comparative advantage a decade before Ricardo. See Fritz Machlup, *A History of Thought on Economic Integration* (New York: Columbia University Press, 1977).

4. American isolationism before World War II was manifested in rejection of the League of Nations, insistence on the repayment of World War I loans, refusal to cooperate during the London Economic Conference of 1933, and very high tariff rates even prior to Smoot-Hawley (Conybeare contends that the United States adopted a free-rider posture more often than any other nation).

5. Quoted in John H. Jackson, *The World Trading System: Law and Policy of International Economic Relations* (Cambridge: MIT Press, 1989), p. 10.

6. The ITO proposed commodity agreements to ensure prices that were fair to consumers and provided a reasonable return to producers. It also provided for governmental cooperation in a variety of areas only tangentially related to trade.

7. For a brief overview, see Robert Baldwin, *Trade Policy in a Changing World Economy* (Chicago: University of Chicago Press, 1988), chapter 11.

8. There are many exceptions, which I will discuss shortly. Even the MFN clause cannot eliminate discrimination if a tariff schedule contains categories that apply only to the products of one country. For example, the 1902 German tariff law charged a lower duty on "brown cattle reared at least 300 metres above sea level and having at least one month's grazing at least 800 metres above sea level." The practical effect was to give preference to Swiss cattle. See Richard Pomfret, *Unequal Trade* (Oxford: Basil Blackwell, 1988), chapter 1.

9. For similar reasons, the United States had been able to achieve a decrease in tariffs of about one-third in bilateral treaties with thirty-one nations between 1934 and 1945 under the U.S. Reciprocal Trade Agreements Act, which contained a similar MFN provision.

10. Quantitative restrictions such as quotas are prohibited because, unlike tariffs, they require government administration that can easily disguise discrimination.

11. Developed nations less frequently invoke the escape clause today, preferring to offer "trade adjustment assistance" to industries and enhanced welfare benefits to workers.

12. Gardner, *Sterling-Dollar Diplomacy*, p. 376.

13. Because this book focuses upon trade issues, I can mention only in passing those monetary problems not linked directly to trade.

14.While the highly protectionist Multi-Fiber Agreement is being phased out, the United States will lower its textile tariffs by an average of only 12 percent, phased in over ten years, not the 50 percent cut demanded by the EU. Even so, U.S. Senate ratification was delayed by Senator Ernest "Fritz" Hollings of South Carolina, a powerful committee chairman who claimed that 40,000 jobs in his home state would be endangered by even these modest reductions.

15. Jeffrey J. Schott, ed., *Completing the Uruguay Round* (Washington, D.C.: Institute for International Economics, 1990).

16. "Free Trade's Fading Champion," *Economist*, April 11, 1992, p. 65.

17. Donald B. Keesing, *Improving Trade Policy Reviews in the World Trade Organization* (Washington DC: Institute for International Economics), 1998, p. 1.

18. Quoted in Robert Dodge, "Grappling with GATT," *Dallas Morning News*, August 8, 1994, p. 1D.