

Cato Institute Policy Analysis No. 78: Fiddling While the GATT Burns

September 25, 1986

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Executive Summary

I have never faltered, and I will never falter, in my belief that enduring peace and the welfare of nations are indissolubly connected with friendliness, fairness, equality and the maximum practicable degree of freedom in international trade.

--*Cordell Hull*, Economic Barriers to Peace

After much huffing and puffing, governments now seem to be moving toward another round of multilateral trade negotiations conducted under the auspices of the General Agreement on Tariffs and Trade (GATT).[1] This round will be the eighth since World War II, but only the third in the past twenty years. The last such round, the Tokyo Round, lasted six years, ending in 1979.

The next round could take longer, not merely because the issues have become more complex but also because, it would appear, there is no country whose representatives know precisely what they want from others and no country in which there is a broad consensus in favor of a significant liberalization of its own barriers to trade. A cynic might conclude that some people regard the prospect of lengthy negotiations as a "consummation devoutly to be wished" rather than as a distressing fact of life. The lengthier the negotiations the longer politically difficult decisions can be avoided. Indeed, permanent negotiation can itself be a strategy, albeit a profoundly conservative one.

Such a cynic would get some support for his views from inquiry into the genesis of the generally restrained enthusiasm for the new GATT round that is apparent in the world's capitals. Rather than searching for ways to restore the free-trade consensus, countries are busy pointing the finger at each other. Headlines in U.S. newspapers a year apart read "Western Europe Sees U.S. Protectionism Looming, and Warns It Would Retaliate" and "U.S. Sees Protectionist Sentiment on the Rise in Western Europe." [2] Both charges, it would appear, are correct. While the United States and Canada negotiate a free-trade area, the two countries impose new tariffs on each other's products. Policymakers around the world are closest to agreement on just one point, which is that the United States needs to be helped to help itself.

In the United States the real appreciation of the dollar in the first half of the 1980s, and the associated growth in the trade deficit, have resulted in protectionist pressures growing to a level probably not seen since the 1930s. During his 1984 campaign for president, former vice president Walter F. Mondale complained 'We've been running up the white flag, when we should be running up the American flag! . . . What do we want our kids to do? Sweep up around Japanese computers?' [3] Neoliberal presidential hopeful Rep. Richard A. Gephardt (D-Mo.) and conservative columnist Anthony Harrigan have both warned that the United States is becoming a "colony," with Harrigan dismissing the idea of free trade as "simple-minded economic calculus." [4] Throughout 1985 members of Congress reported that lobbyists and constituents were becoming more and more insistent that Congress "do something" about

the trade deficit and the perceived loss of jobs due to exports. Rep. John D. Dingell (D-Mich.) demanded that the Japanese "stop engaging in the most outrageous trade practices ever," while Sen. Alan J. Dixon (D-Ill.) said, "The Japanese have done extremely well, to a large extent at our expense." [5] The anti-Japanese rhetoric became so strong that Japanese-American members of Congress became concerned about its racial undertones. [6] This concern was presumably not eased when two unemployed auto workers in Detroit fatally beat a Chinese-American student because he looked Japanese to them--and a judge gave them suspended sentences. [7]

The principal and at present almost the only force of resistance to protectionism, it seems, is the administration. By virtue of his national mandate, a president is in a relatively good position to see both the general domestic interest in liberal trade and the international aspect. Ever since the Hawley-Smoot Tariff Act of 1930, Congress has by and large, if to a decreasing extent, been prepared to leave the initiative in trade policy to the administration, being well aware of the dangers of unrestricted logrolling on the matter. The administration, in turn, has justified its preponderant position by emphasizing the international dimension of trade policy. More precisely, it has stressed the need to negotiate trade policy with other countries. Congress has for the most part accepted the rationale and has been prepared to grant wide negotiating authority to successive administrations.

The need to get trade policy out of the hands of Congress and into those of the administration is the main political justification for another GATT round. It is not the intention here to question that rationale, which is a particular example of the "bicycle theory" of trade negotiations, the argument that, in the absence of international negotiations to liberalize trade, domestic pressures would increase protection in almost all countries. The "bicycle" of negotiations has to move forward, it is argued, if it is not to fall over. But to negotiate is not enough. Negotiations must aim at liberalization rather than the containment of protectionist pressures through market-sharing arrangements and other illiberal devices, as is now too often the case. What is negotiated and how are themselves important.

Accordingly, the question to be asked about the new GATT round is not whether it will take place, or even whether some agreement will be reached, but rather what should be talked about if the negotiation is to be more than an exercise in public relations. What are the problems in the international trading system to which the new GATT round might be a solution? And what sorts of agreements might actually represent a solution to those problems?

Agenda for Negotiations

Against the standard of a useful negotiation, the current agenda for trade negotiators is one on which agreement is doubtful. But worse, such is the present climate of discussion, productive agreement seems almost inconceivable. The systemic elements in the GATT are eroding, while little other than hectic and increasingly desperate improvisations are taking their place.

The starting point for a consideration of the present agenda is the outcome of the GATT ministerial meeting of 1982. The present work program was all that emerged from the meeting. However, with a few qualifications and subsequent additions, it is the only agenda there is.

Ministerial Meeting of 1982

The GATT ministerial meeting was a failure in the sense that, as the communiqués made clear at the time, [8] it was convened in recognition of the perils of protectionism but failed to come to grips with them. In particular, the proposal to agree on a commitment to a "standstill and rollback" of protectionism did not pass. Instead, the ministers agreed "to make determined efforts to ensure that trade policies and measures are consistent with GATT principles and rules." This failure was disappointing to many at the time. In any case, as should have been evident, the movement toward protection implicit in existing laws and attitudes could not have been arrested by such a declaration (as was proved by the fate of subsequent pledges in 1983 at the ministerial meeting of the Organization for Economic Cooperation and Development and at the Williamsburg economic summit).

Otherwise, the GATT ministerial meeting called for study groups, examinations of issues, and the drafting of "understandings" for future consideration. The issues to be covered were (1) a code on emergency protection, on which a decision was supposed to be reached by the 1983 GATT session, but was not; (2) the expansion of trade between developed and developing countries; (3) trade in agricultural products; (4) trade in tropical products; (5) quantitative

trade restrictions and other nontariff measures; (6) the implementation of the Tokyo Round agreements and arrangements; (7) structural adjustment and trade policy; (8) trade in textiles and clothing; (9) trade in a number of natural-resource products; (10) the effects on trade of erratic fluctuations in rates of exchange; (11) dualpricing practices; (12) rules of origin; and (13) trade in services.

To this lengthy shopping list should be added two concerns of the United States: trade in high-technology products and performance criteria for foreign investment, both of which are related to long-standing worries about the market-distorting policies of many governments. In addition, attention has focused on the safeguarding of intellectual property rights, of importance in the international transfer of technology, and on the GATT's dispute-settlement procedures. On what may be called a hidden agenda, there is also the question of relations between Japan and her trading partners, not only the United States and the countries of the European Community but also those affected by bilateral deals among the Big Three.

Subsequent Developments in Trade Policy

It is necessary also to recall some of the subsequent developments, most of which have made matters still more difficult:

There is the new interest of the United States in reaching agreement on a number of free-trade areas with such nations as Israel and Canada, none of which appear likely to be entirely consistent with Article XXIV (providing for departures from the principle of nondiscrimination to form free-trade areas and customs unions).

ø There is the continuing development of the sectoral approach to trade policy, shown in the elaboration of a comprehensive system of export-restraint arrangements on shipments of steel to the United States, following similar arrangements negotiated by the European Community. Steel is now almost as completely outside the normal GATT rules as agriculture and textiles and clothing.

There is the protectionist pressure in the United States associated with the appreciation of the dollar in the early 1980s and the large current-account deficit, which seems to have lessened only slightly with the more recent decline of the dollar and the modest reduction in the trade deficit.

There has been the renegotiation of the Multi-Fiber Arrangement (MFA) in 1986, in which the game of protectionist leapfrog played between the European Community and the United States since the 1960s saw the United States jumping ahead of the Community. The new MFA, the fourth, is to last for five years and is yet more protectionist than its predecessors.

ø There is also the recent enlargement of the European Community, to include Spain and Portugal, which not only will absorb the energies of the member countries but also is likely to increase the pressures for discrimination against countries outside the community.

Irrelevance of the Current Agenda

Set against these developments, or viewed even in its own terms, the current agenda for the new GATT round looks unpromising. For example, while analysis of the implementation of the Tokyo Round agreements on nontariff measures is no doubt needed, there is little reason to suppose that thinking has gone beyond the conflicts and confusions of the early 1970s, which were the precursors of the present difficulties. Again, the "safeguards" issue is no more amenable to solution--if anything, less--now than ten years ago. The stumbling block in the past has been the issue of "selectivity" on which agreement would almost certainly involve the formal abandonment of the most fundamental principle of the GATT, that of nondiscrimination. Failing resolution of the "safeguards" issue the stated difficulty over "structural adjustment" can hardly be resolved.

Turning to some of the other items on the agenda, it must be acknowledged that relations between developed and developing countries are a controversial matter (and have been since 1947), but the root of the problem lies in contradictory demands on which satisfactory agreement has become more remote than ever. The number of particular industries on the list is noteworthy, but in these cases one has to recognize an iron law of negotiations on a single

industry: the tendency to agree on a protectionist market-sharing arrangement, it being almost impossible for the governments of countries whose industry suffers from a comparative disadvantage to agree formally to a policy of throwing the industry to the wolves. Again, the problem of "erratic fluctuation in rates of exchange" hardly looks amenable to negotiated action in the GATT and is, indeed, more of an excuse for inaction on trade policy than a call for action on exchange rate policy itself.

In short, the current agenda reads like the list of symptoms that a patient might take to his doctor rather than as the diagnosis of an illness--and still less the prescription for a cure. There is no underlying conception of how the drift is to be stopped or international order is to be restored. There is the danger that problems will be resolved, if at all, by negotiating yet more market-sharing arrangements in particular sectors, thereby increasing the politicization of trade and progressively thwarting the operation of market forces. Just as likely, there will be no agreement at all, with the attempt at another grand play in the theater of commercial diplomacy merely demonstrating the bankruptcy of the company. In its irrelevance to the fundamental issues at stake, such a negotiation would amount to little more than fiddling while the GATT burns.[9]

Is There Still a Trading System?

If one regards the GATT as being inter alia an agreement on a number of basic principles or norms of behavior that, if followed, would allow the orderly evolution of an international market economy, it would appear to be moribund. The GATT has become little more than a forum for commercial diplomacy or a historical record of particular decisions to liberalize trade. It no longer embodies living norms. If that is not appreciated, then any consideration of what is to be done would be futile.

To assert, in looking at the GATT, that the emperor has no clothes is perhaps startling, largely because the GATT is rarely looked at closely. But note the following two points:

First, at the creation of the GATT, its cornerstone was the principle of nondiscrimination, requiring most-favored-nation (MFN) treatment to be accorded unconditionally to all member countries (except in a very limited number of clearly defined circumstances). Nowadays, though, a very high proportion of international trade is conducted on a discriminatory basis. Furthermore, whenever a new crisis arises, it tends to be settled by discriminatory protection outside the GATT framework.

Second, similarly, in the beginning it was intended that the tariff should be the sole instrument of protection, being consistent with the price mechanism. Nowadays, though, the tariff has largely fallen into disuse, particularly when a new source of competition appears on the scene.

These two fundamental norms were not chosen out of whim.[10] They reflected a careful consideration of the economic and political requirements of international economic order. The essential aim was to control the actions of governments so as to make possible the successful working of a competitive market economy. This meant that trade measures had to be stable over time, had to be transparent, and had to allow market forces to operate. The emphasis on the tariff as the sole legitimate instrument of protection followed naturally from these goals, as did the principle of nondiscrimination.

Nondiscrimination was never universally accepted, but attitudes and policies have evolved further in the opposite direction. A number of governments would claim today that the right to discriminate against those they regard as disruptive, or as not playing by the rules, is an essential element in their trade policies. Even the United States, by far the most important proponent of the principle of nondiscrimination in the past, seems to have abandoned its adherence to this principle. Equally, the tariff is an increasingly insignificant instrument of trade policy, having been replaced by the "voluntary" export-restraint agreement (VER), by other nontariff measures, and by subsidization. None of these provides a predictable framework for competition, and the first represents an explicit repudiation of the very idea of competition. The actual trading system is therefore largely a series of improvisations. While trade may still grow in such a world, the functioning of international prices, which is a fundamental aspect of global competition, has been steadily impaired.[11]

On the Slippery Path

Not only has there been little adherence to fundamental GATT norms but the deterioration has been progressive. It is evident, for example, that the attempted commitment to a standstill and rollback of protectionism at the GATT ministerial meeting of 1982 would have been inoperable. Words pronounced by heads of government at successive economic summit meetings cannot, in fact, be implemented. The way found to implement such commitments has been through a conditional acceleration of the Tokyo Round tariff cuts, a gesture of impotence if ever there was one.[12]

In considering why it is difficult to achieve a standstill and rollback of protectionism, one has to remember that both the GATT itself and the laws and practices of all countries embody provisions for increasing protection. Furthermore, existing precedents and attitudes, along with the policies of trading nations, more or less guarantee that those laws and practices will be used. How can one achieve a rollback given the current situation with regard to subsidies and countervailing duties, the commitments made to agricultural producers and producers of textiles and clothing, the *carte blanche* to developing countries to use quantitative restrictions for balance-of-payments purposes, the plethora of informal VERs, and, most fundamentally, the refusal to adjust to fundamental forces of comparative advantage?

Why have things evolved in this way? Five aspects of the history of the trading system established after World War II can be identified: (1) the increasing legitimacy of discrimination, (2) the growth of government intervention in the market process and the international response to it, (3) the refusal to accept the legitimacy of shifts in comparative advantage, (4) the role of mercantilist ideas in the GATT, and (5) the aim of having a universal institution. These are not independent elements but strands that intertwine; they are treated separately below only as a matter of convenience.

Spread of Discrimination

Most discriminatory restrictions in Western Europe were liberalized by the end of the 1950s, leaving only the most politically sensitive restrictions in each country. The trend in this period was clearly toward the GATT norm of nondiscrimination. But the trend was subsequently reversed.

ø The survival of quantitative restrictions on imports into Western Europe of "sensitive" labor-intensive products such as textiles and clothing created political difficulties for governments in countries, such as the United States and the United Kingdom, faced with rising exports from Japan and other East Asian nations. To cover the naked abandonment of GATT norms in the case of textiles and clothing, the concept of market disruption was invented, and formal agreements to except these products from normal GATT principles and rules--the arrangements that preceded the MFA--were reached.

ø The establishment of the European Community was in a sense a continuation of the trend of intra-European trade liberalization. At the same time, however, the Community embarked on a series of free-trade areas with selected developing countries that fell short of satisfying the conditions laid down in Article XXIV for departures from the MFN clause to form free-trade areas. It therefore represented an important breach of the principle of nondiscrimination.

ø It became increasingly clear that discrimination against successful developing countries and Japan was not likely to end. In this context the grant of preferences to developing countries and of increasing supposed help by waiving their GATT obligations was a cheap form of compensation. Furthermore, the developed countries reserved the right to discriminate against developing countries whenever they were disturbingly successful.

These various new forms of legitimized discrimination became entrenched between the late 1950s and mid-1960s. Thereafter the force of the principle of nondiscrimination could be seen to be progressively enfeebled. After the Kennedy Round negotiations, the rising use of discriminatory devices of protection began to offset the declining protection afforded by the traditional nondiscriminatory instrument, the MFN tariff. In the process, moreover, the instrument mandated by the GATT became progressively more irrelevant, one result being that a major focus of the Tokyo Round negotiations was the largely unsuccessful attempt to deal with nontariff measures.

Discrimination is always a potent source of international conflict. But the difficulty created by discrimination is more specific than that. Once discrimination has become a norm, further and progressive increases in protection are virtually inevitable, for the system tends to lose its one effective sanction, retaliation by the major established powers against

each other. Discrimination then acts as a sort of meat slicer on existing commitments.

What is more, the currently chosen instrument of discriminatory safeguard protection, the VER, allows producers in the restricted country to gain some compensation for the restriction. With many of the directly involved producers bought off in this way, there is a progressive movement toward officially sponsored market-sharing arrangements.

Once market-sharing arrangements are firmly implanted, they come to be used even among the established market economies, not least because protection tends to be ineffective if it is not applied to all competitive suppliers. Thus, governments--even of close allies--find themselves embroiled in the minutiae of decisions about production and trade and hence in conflicts over them, especially since no principled resolution of such conflicts is possible.

In short, once discrimination is accepted as entirely legitimate behavior, protection can no longer be stabilized.

Growth of Government Intervention

The second major element in the deterioration of the GATT system has been the difficulty of preserving a world economy based on market principles in light of moves away from the market economy in the domestic policies of some major countries.[13] The legal order of a free-enterprise economy, obliging firms to compete with one another, must provide recourse against subsidized competition. This is a particularly important point for the United States, where a high value is placed on the ideal of free competition and where there is a corresponding unwillingness, notwithstanding some exceptions, to subsidize domestic firms.

Until the 1970s the legal situation was clear. The law of the United States demanded automatic countervailing action against imports entering the U.S. market with the help of a subsidy either for its production or for its export--although in practice the law was not often invoked. As subsidization and other forms of aggressive industrial policy became legitimate elsewhere, especially in Western Europe but also in even greater measure in developing countries, the automatic countervailing duty became a subject of international dispute. The policy of the United States was subject to conflicting pressures, but the dominant internationalists, often themselves inclined favorably toward intervention, were unwilling to use the countervailing duty at all. The result was internal pressure to shift the administration of the countervailing-duty laws to parts of the U.S. government more responsive to domestic interests.

The subsidizing countries felt that the existence of the automatic countervail and, still more, the prospect of its more rigorous application meant that the United States was interfering in the exercise of their proper sovereign responsibilities. Accordingly, there was a threat of increased international conflict, to which the United States responded by accepting the idea of a relaxation of its law, to include an injury test, as a step toward a new GATT code on subsidies and countervailing measures. Furthermore, perhaps to reduce the level of foreign complaints about the legalism of policymaking in the United States, a little-noticed feature of the Trade Agreements Act of 1979 was a provision that quantitative export-restraint arrangements between governments were a legally acceptable remedy for subsidy complaints.

The compromise was not a success. The introduction of the concept of injury into the U.S. countervailing-duty law made the decisions of the United States appear to outsiders to be if anything still more arbitrary and even more objectionable than before. Moreover, the legitimacy of intervention abroad was not accepted among the people of the United States. Indeed, with increasing domestic economic difficulties, a perception of relative decline, and subsequently the rise in real rates of exchange in the 1980s, the strength of the people's objection to such practices probably increased. The result was a growing number of suits, an increasingly favorable hearing for them, and a number of changes in the law that make affirmative findings easier to reach.[14]

Faced with the domestic pressures on the one hand and the insistence on their rights by the exporting countries on the other, the Reagan administration took the path of least resistance. By comparison with the legal process and the possibility of countervailing duties, VERs were a relatively attractive solution for the governments of the exporting countries.

What then is the upshot of these developments? As a response to the copious interventions of foreign governments in the market process, the government of the United States, the largest free-enterprise economy in the world and the one

that promulgated the norms of nondiscrimination and competition policy, finds itself negotiating international cartel agreements with its principal suppliers. It would appear to be impossible to maintain a liberal international economic order in the face of the insistence of governments on the right to subsidize.

Shifts in Comparative Advantage

It is not only subsidized competition to which there is strong objection. Looking at the history of Japan and the developing countries in the GATT system, it is evident that there is an objection to comparative advantage per se; that is, to those forces of competition about which a firm cannot do anything. It is accepted, for example, that unsubsidized competition with firms in essentially similar countries is legitimate, but competition with those that enjoy cheaper labor or cheaper raw materials is not. The "pauper labor" argument (in the case of developing countries, the "pauper capital argument") has considerable political force.[15] Acceptance of this case, however, undermines the legitimacy of the basis for trade, so creating a permanent and unavoidable conflict.

The history of the textile arrangements, of trade policy for agriculture, of the resistance to imports of motor vehicles from Japan, and even of the way in which antidumping provisions are used shows the extent of the resistance to fundamental shifts in comparative advantage. In the light of hindsight, this can be seen as a fatal flaw in the system. A transparent system of stable protection cannot be combined with a determination to hold on to certain basic industries. The result has been an increasingly defensive trade policy adopted by what may be termed the old industrial powers. Such a commitment to particular economic structures is simply incompatible with the market-based norms of the GATT system.

Role of Mercantilism

In trying to appreciate the origin of the three problems already mentioned, one has to recall that the international trading system that emerged after World War II is based on a politically fruitful economic fallacy. The method of negotiating a reduction in trade barriers was based on the mercantilist idea that exports are the goal of trade policy and imports are the cost. In the GATT's peculiar terminology the liberalization of barriers to imports is described not as the aim of trade negotiations but rather as the "concession" required to bring them to a conclusion. This attitude was demonstrated again by Secretary of Commerce Malcolm Baldrige in his recent trip to Japan. Rather than urging the Japanese to reduce their trade barriers to improve their own living standards, he insisted that Japan "take on the responsibilities that go with [being a world economic] power"--these responsibilities being a more open economy.[16]

Within the GATT system the mercantilist view of trade is made effective through reciprocity, with the potentially damaging implications of reciprocity being contained by the commitment to the MFN principle. In this way, bargains reached among the major trading powers are to be made available to all contracting parties, and they are to be policed by those major powers on everyone's behalf.

The system rides two horses. There is tension between the mercantilist conception of the benefits of trade on the one hand and the commitment to nondiscrimination on the other, and that tension becomes more important as the number of those who are considered free riders increases. Furthermore, free riding can be defined in a number of different ways. A free rider may be a country that refuses to liberalize at all. It may be a country whose trade patterns do not evolve in ways expected at the time of liberalization, whether because of fundamental forces of comparative advantage, because of culture, or because of intervention by its government. It may be a country with a chronic tendency toward trade surpluses-- a cardinal sin from the mercantilist perspective. Or it may simply be a country whose pattern of comparative advantage is such that the adjustments created by its exports are deemed more costly than the benefits created by its imports. In short, except where trade liberalization occurs between countries that are remarkably similar, the very logic of mercantilism is likely to undermine the commitment to nondiscrimination.

This is just what has happened. Discrimination has consistently been employed to prevent the extension of trade liberalization on an MFN basis to those deemed to be free riders. Immediately after World War II, in what was supposed to be merely a transitional phase, discrimination was directed mainly at the United States. Subsequently, Japan and the newly industrializing countries were the principal victims. More generally, the weight of mercantilist ideas can be seen in both the subsidization of exports and the resistance to such subsidization, as well as in the unwillingness to adjust to shifts in comparative advantage. The combination of reciprocity and nondiscrimination that

is intended to produce a global trading system breaks down because it is internally inconsistent (from a political point of view), with the former undermining the latter.

Institutional Universalism

One of the reasons why mercantilism turned out to be damaging was that it was combined with the aim of extending the membership of the GATT as widely as possible. In the original concept the MFN clause was conditional, in the important sense that it was conditional on membership in the GATT. On the assumption that all contracting parties would accept the basic disciplines, the mercantilist calculus would then not be too much offended by the prevalence of free riding.

In the event, it proved impossible to combine the aim of universal membership with that of shared discipline. Under the general rubric of "equal treatment of unequals is unjust," the developing countries rejected the appropriateness of those disciplines for themselves. Yet it was the ever-growing number of developing countries that the developed countries, as well as the GATT Secretariat itself, wished to attract into the GATT, an aim still more eagerly pursued with the birth of the United Nations Conference on Trade and Development (UNCTAD). What is more, GATT mercantilism itself strongly supported the arguments of the developing countries. If import liberalization is a cost, or (more precisely) a "concession," it follows that a country is better off the less it concedes.[17] A onesided legal relationship is a natural consequence of the marriage of mercantilism to development assistance.

The entry of a large number of contracting parties into the GATT that do in fact contract to do virtually nothing--membership de jure but not de facto--would not have mattered perhaps if the countries concerned had continued to be seen as uncompetitive. This, however, has not been the case. Many developing countries have performed extraordinarily well in the export of products that compete with the production of developed countries. In that context the developed countries increasingly see themselves as bearing an unfair share of the burden of trade liberalization. It becomes more and more difficult to abide by the commitment to unconditional MFN treatment in the context of so one-sided a contractual relationship--one-sided, that is, from the mercantilist perspective inherent in the GATT.

Toward a More Productive Agenda

A potentially productive agenda needs to be based on a recognition that the norms of the GATT system are now moribund and that the forces that made them so are historically long-standing and deep-seated. The pieces of the system just do not fit together. The long list of specific issues before the GATT is largely symptomatic of the failure to think systematically about how the international trading system should operate as a whole.

To encourage the process of reexamination, one might start by asking what would happen if something were not done to arrest the drift. What will trade ministers be doing ten years from now? What sort of trading system will there be if present trends continue for another decade or so?

The answer would appear obvious: the best that can be hoped for is a more or less comprehensive network of continually renegotiated international cartel arrangements; the worst that can be expected would be a complete breakdown in international cooperation and a return to the chaos of the 1930s. Unfortunately, even the best is a recipe for economic disappointment and political-conflict.

These considerations lead to the idea of a negotiation that would include restoration of a generally applicable system of norms, rules, and procedures as a major element. Such a system could at least be glimpsed in postwar arrangements, but has since slipped from view.

A number of proposals for strengthening the international trading system in general, and for the new GATT round in particular, have been published.[18] Many of the specific ideas in these proposals are interesting. Rather than discuss them in detail, the approach taken below is to consider broad strategies for dealing with some of the systemic problems identified above.

Fundamental problems require radical solutions. They are unlikely to be dealt with on the basis of business as usual. Two radical proposals can be identified in the literature. One is a "GATT Plus" approach either on an unconditional or

a conditional MFN basis; in other words, a new agreement imposing tighter discipline among a more limited group of countries, but one to which any country could adhere.[19] The other is "disciplined unilateralism"; this implies improved procedures to identify the national interest in trade-policy decisions and better domestic trade laws, while allowing the level of protection to be determined domestically.[20] It is with an elaboration of these two alternatives that the present discussion proceeds.

Tighter International Discipline?

The term "GATT Plus" appears in a little-known report of the Atlantic Council of the United States published in 1975. The report elaborates a specific proposal for a comprehensive and tighter agreement than that embodied in the GATT itself.[21] The issue here is the basic approach rather than the precise details of that proposal. There are four guiding ideas. First, no country will agree either to a significantly greater degree of discipline in any area painful to itself or to a significant liberalization of its own barriers to trade unless other countries accept corresponding increases in discipline not only in that area but also in others of particular importance to the first country. At the same time, it must be rendered impossible for a country to substitute another barrier to trade for one that has been ruled out within a specific code. For both these reasons, codes that tighten GATT discipline must be negotiated and adhered to as a package, as was the case for the GATT itself. Second, countries will not continue to accept that those who do not themselves abide by any of the disciplines should have a voice in the administration of the rules. Third, the obligations accepted must be seen both ex ante and ex post as of equal weight. Fourth, the agreement must be open; that is, it must be one that any country willing to abide by the relevant disciplines can join.

Such a tightening of GATT disciplines in one coherent package would raise formidable difficulties in two different respects. The first relates to the coverage of such an agreement and the second relates to whether the benefits of such an agreement would be limited to the signatories or not.

Broadly speaking, the aim would be to create a transparent, liberal, and stable trade regime based on market-conforming instruments of policy. To achieve this, the package of agreements would have to cover (1) safeguard protection, (2) subsidies and countervailing duties, (3) dumping and antidumping measures, (4) protection for balance-of-payments reasons, (5) public procurement, (6) infant-industry protection, (7) other nontariff measures, (8) dispute-settlement procedures, and (9) administration of the agreement. In addition, it would be highly desirable if there were agreement on (10) agriculture, (11) trade in services, (12) protection of intellectual property rights, and (13) investment, including rights of establishment and national treatment. Furthermore, plans for the liberalization of barriers to trade would also have to be included.

The assumptions underlying this approach are both that a piecemeal reform of the GATT is unlikely to go very far and that no reform is possible if all members of the GATT are to be involved. In this way, the free-rider problem would be reduced, but whether it would be eliminated depends above all on whether conditional or unconditional MFN treatment would be afforded.

The question of conditional versus unconditional MFN treatment is in any case coming to the fore because of developments in the system itself. It cannot be avoided. What then are the pros and cons of conditional and unconditional MFN treatment respectively?

In favor of conditionality are the following considerations:

ø The GATT itself is a conditional MFN agreement in the sense that only contracting parties are entitled to the benefits of Article I (requiring nondiscrimination). Generally, the benefits, especially of tariff reductions, are accorded to nonmembers, but this is a favor rather than a right.

The conditional element in the GATT was based on the assumption that all members would undertake substantially equivalent obligations and so be entitled to equal treatment according to mercantilist logic. In practice, however, obligations are by no means universally accepted, the implicit bargain being thereby violated.

Accordingly, conditional MFN obligations would do no more than reestablish the GATT as it should be. They would not rule out the extension of the relevant treatment, but as a matter of favor rather than of right.

Furthermore, without conditional MFN treatment there would be no incentive for nonsignatories to adopt the package of new and tighter obligations, and the free-rider problem would merely be reinstated.

There are also quite strong arguments against conditional MFN treatment:

The rights of existing contracting parties to the GATT might be violated, even though those rights might be more apparent than real, being moribund in certain cases. For example, it would generally be agreed that there is a right not to be treated in a discriminatory or selective manner under the safeguard clause of the GATT. If, however, the benefit of nondiscriminatory treatment were to be conditional on signing the new agreement, then the existing right under the GATT would be impaired.

ø Building a conditional MFN clause into an agreement limited to a smaller group of countries than the GATT itself would inevitably tend to strengthen the legitimacy of the basically fallacious mercantilist view of trade. This, it can be argued, has been one of the adverse consequences of the GATT itself.

If it were decided on balance that the right approach would be to try to improve trade policies through tighter international agreements, a conditional MFN approach would appear to be politically inevitable. It seems increasingly unlikely that countries would accept tighter obligations without trying to curb free riding. But the problems created by adherence to the conditional MFN approach would have to be dealt with. Apart from the obvious fact that countries could provide the benefits of the package of agreements to nonsignatories as a favor, other solutions would be as follows:

Employ the conditional MFN clause only where the obligation in question is clearly more stringent than in the GATT and not where it is a question of implementing an obligation under the GATT.

Provide a lengthy period of adjustment to developing-country signatories of the package in the course of which they would be entitled to its benefits.

Offer the benefits as a right to all countries defined as developing countries in accordance not with self-selection, as at present, but with a definition agreed upon by the signatories of the package of agreements.

Finally, to the extent that administration of the package in all its aspects would be limited to its signatories, there would still be an incentive to sign and participate even if the element of conditionality were to be diluted in the various ways suggested.

Disciplined Unilateralism?

One element of any improvements in the international trading system would have to be improved domestic laws and procedures for considering pleas for protection. The purpose of such changes would be twofold: to make the process of granting protection more transparent, and at the same time to introduce some economic rationality into discussions of protection. Furthermore, insistence on more transparent forms of protection such as tariffs, auctioned quotas, or subsidies would have to be an element of any proposal for tighter international discipline. By making the economic costs of protection more visible, the process of public education would be improved and, it may even be hoped, the mercantilist fallacy that underlies so much trade policy would wither away.

Two ways of achieving the goal of improved domestic discussion have been proposed. One would be essentially legal, namely, a nondiscrimination treaty. The point of a nondiscrimination treaty is that it would make illegal various kinds of covert, discriminatory, administrative measures of protection, such as VERs. Furthermore, under a plausible interpretation of the concept of nondiscrimination, the only quantitative restrictions that would be permissible would be auctioned quotas, since there is no other way of allocating import licenses in accordance with consumer preferences. Thus, the possibility of public and legislative oversight of protection would be greatly increased.

The second way would focus on the economic content of procedures for granting protection. All requests for protection need to be publicly evaluated and the economic costs and benefits need to be assessed. It has been noted that estimates

of the costs of such measures as VERs on exports of motor vehicles from Japan to the United States have influenced the debate on protection. This second way, therefore, would involve a technocratic rather than a legal approach to improving the domestic context for trade policy formation.

Consideration of ways of improving domestic decisionmaking in trade policy matters makes it possible to go somewhat further. Looking at what is actually happening in the international trading system, it may be argued that the point has been reached--perhaps long been passed--at which international agreements can no longer bind domestic policy. Governments may commit themselves in international forums to certain degrees of liberalization or to certain disciplines, but domestic pressures will all too often ensure that the liberalization achieved, or the instrument bargained away, will be replaced by possibly worse and almost certainly more covert action. This is all the more probable because the structure of bargaining is mercantilist and the associated attitudes are likely to mean that almost any outcome is viewed as unfair in certain respects, especially when many countries fail to accede to international discipline or fail to liberalize their trade policies.

To the extent that this is the case, it may be argued that the most important reform would be to make the domestic costs and benefits much more obvious and, correspondingly, give domestic political forces more room to maneuver. After all, protection is not mainly a matter of international relations; rather, it is primarily a matter of the internal distribution of income--a truth obscured by the present framework of trade policy. The answer then might be to allow bound tariffs to rise-- what is sometimes referred to as "retariffication"--and concentrate on reaching international agreement less on the level of protection than on its form and on the procedures for changing it. The result over time might be to create a clearer domestic understanding of the implications of decisions on trade policy.

Next Steps

Governments appear to have arrived at the beginning of another major adventure in multilateral commercial diplomacy. There is a long list of unfinished and new business, but that list is in large measure indicative of cracks in the foundations of the system itself. Put most simply, the generally mercantilist attitudes that underlie and are reinforced by the GATT make it politically impossible to sustain equal treatment of all GATT members when their policies or trade behavior diverge radically. Differences in resource endowment, in government involvement in economies, and in the willingness to accept international obligations on trade policy all affect the willingness of trading partners to afford liberal and equal treatment. The result has been a strong impulse toward discrimination that is sometimes tacit and sometimes overt. Yet, with discrimination now well established, stabilization of the conditions of trade is virtually impossible.

If the next GATT round is to create a durable framework of liberal and stable policies in as wide an area as possible, these basic flaws have to be addressed. Two approaches have been considered above, which may be summarized as follows: (1) use mercantilism more fully, or (2) transcend it.

Under the first approach would come an attempt to construct a still tighter set of obligations and a greater degree of liberalism than so far in the GATT among a group of countries all of whom accept the relevant disciplines. In this context the question of whether the now virtually moribund commitment to nondiscriminatory treatment of all GATT contracting parties can be revived would have to be addressed directly.

The second approach would be to recognize that the main problem is the mercantilist vision according to which trade policy is a conflict between sovereign states rather than within them. The preferred solution would then be to improve procedures and laws governing the domestic formation of trade policy, the long-term aim being one of public education. The corollary of this approach would be somewhat less international discipline on the level of protection than at present.

In practical terms the new GATT round will have to start with an appreciation of the problem as a whole and not just with a long list of particular demands. Bargaining over specific issues within a sturdy system may make sense but not when the system itself is flawed. A logical first step, therefore, might be a comprehensive review of the working of the GATT system as a whole. The present time may be the last opportunity to achieve such a reconsideration for many years, perhaps in this century. Given the problem and the occasion, fiddling is not enough.

FOOTNOTES

A version of this paper appeared in *The World Economy* (March 1986).

[1] The first two parts of this article draw on the draft report of a study group under the chairmanship of Amnuay Viravan discussed at an Asian-Pacific trade conference in Tokyo on March 15-17, 1985, and organized by the Trade Policy Research Centre for the United Nations and the government of Japan. In thinking about the place of the principle of nondiscrimination in the international trading system, the author is indebted to the late Jan Tumilir for many discussions on the issues involved.

[2] Gary Putka, "Western Europe Sees U.S. Protectionism Looming, and Warns It Would Retaliate," *Wall Street Journal*, March 31, 1985. Stuart Auerbach, "U.S. Sees Protectionist Sentiment On the Rise in Western Europe," *Washington Post*, March 18, 1986.

[3] Martin Schram, "Big Fritz': Tough Talk And a Flag," *Washington Post*, October 7, 1982.

[4] Ralph Z. Hallow, "Gephardt Praises Trade Bill; Kemp Says 'Protectionist'," *Washington Times*, September 26, 1985. Anthony Harrigan, "Free Trade's Costs," *American Spectator*, February 1985.

[5] David Shribman and Art Pine, "Sentiment in Congress Growing More Hostile Toward Restrictive Japanese Trade Practices," *Wall Street Journal*, March 25, 1985.

[6] David Shribman, "Rising Protectionist Rhetoric in U.S. Recalls Anti-Japanese Feeling of '40s," *Wall Street Journal*, September 20, 1985.

[7] "It Isn't Fair," *Time*, November 14, 1983.

[8] See, for example, Fifteenth Meeting of the Consultative Group of Eighteen, GATT Press Release No. 1291 (Geneva: GATT Secretariat, June 26, 1981).

[9] The phrase refers to an apocryphal story of the Emperor Nero fiddling while the city of Rome burned. It may be suggested that given the realities of prevailing technology, the emperor could not do much about the blaze. It is to be hoped that in spite of contemporary political realities, the same is not true for those presently in charge of trade policy.

[10] For a not-too-technical discussion of the GATT system, see Kenneth W. Dam, *The GATT: Law and International Economic Organization* (Chicago and London: Chicago University Press, 1970), as well as Gerard Curzon, *Multilateral Commercial Diplomacy* (London: Michael Joseph, 1965).

[11] The extent to which the price mechanism has been impaired was stressed in a recent GATT annual report, *International Trade 1982-83* (Geneva: GATT Secretariat, 1983), chap. 1.

[12] This point has been emphasized in Brian Scott et al., *Has the Cavalry Arrived? A Report on Trade Liberalisation and Economic Recovery*, Special Report no. 6 (London: Trade Policy Research Centre, 1984), pp. 12-14.

[13] The problems posed by the growth of government intervention in the market process, in both developed and developing countries, are reviewed in Lord McFadzean of Kelvinside et al., *Global Strategy for Growth: A Report on North-South Issues*, Special Report no. 1 (London: Trade Policy Research Centre, 1981), especially chaps. 2 and 4.

[14] On the general subject of subsidies, see Gary Clyde Hufbauer and Joanna Shelton Erb, *Subsidies in International Trade* (Washington: Institute for International Economics, 1984). On recent developments in trade law in the United States, see Eliza Patterson, "Features of the Omnibus Trade Act in the United States," *The World Economy* (December 1984): 407-20.

[15] For an analysis of the modern version of the "pauper labor" argument for protection, see Deepak Lal, *Resurrection of the Pauper-Labour Argument*, Thames Essay no. 28 (London: Trade Policy Research Centre, 1981).

[16] Stuart Auerbach, "Baldrige Warns Japan on Trade; Commerce Chief Threatens Ban If Protectionist Policies Continue," *Washington Post*, July 29, 1986.

[17] The implications of the entry of developing countries into the GATT are explored at length in Robert E. Hudec, "Participation of Developing Countries in the GATT Legal System," a paper prepared for a research meeting on the participation of developing countries in the international trading system, convened by the Trade Policy Research Centre at Wiston House, near Steyning Sussex, England, on October 22-25, 1984.

[18] See, in particular, Fritz Leutwiler et al., *Trade Policies for a Better Future* (Geneva: GATT Secretariat, 1985); Gary Clyde Hufbauer and Jeffrey J. Schott, *Trading for Growth: The Next Round of Trade Negotiations*, Policy Analyses in International Economics no. 11 (Washington: Institute for International Economics, 1985); and C. Michael Aho and Jonathan D. Aronson, *Trade Talks: America Better Listen!* (New York: Council on Foreign Relations, 1985).

The first of these reports is the most purist, and for that reason its focus is closest to that of the present article. Particularly important is this report's emphasis on the need for improved domestic transparency of the costs of protection, which is the first recommendation (Leutwiler et al., pp. 35-37), and on the need to focus a new round on "the primary goal of strengthening the multilateral trading system and further opening world markets," which is the thirteenth recommendation (*ibid.*, p. 47).

The other two reports are more realistic and pragmatic. An interesting indication of the problem created by a long history of thinking in terms of GATT mercantilism is the use of the mercantilist perspective in these works, both of which are authored or coauthored by economists. C. Michael Aho and Jonathan Aronson remark, for example, that "in the United States, generosity has waned and the determination that every country should pay its fair share has increased" (Aho and Aronson, p. 26). Similarly, Clyde Gary Hufbauer and Jeffrey J. Schott argue that "countries with strong current-account positions should take the lead in implementing their concessions" (Hufbauer and Schott, p. 25) and that the rules of "fair trade" should be extended, *inter alia*, to labor standards (*ibid.*, p. 19). A system that is based on nonsense inevitably makes nonsense orthodox. These authors certainly know that what they are saying has no economic logic behind it, but do their readers?

[19] On the idea of a new and tighter trade agreement, see *GATT Plus: A Proposal for Trade Reform*, Report of the Special Advisory Committee of the Atlantic Council (Washington: Atlantic Council, 1975). On the (earlier) idea of a free-trade treaty among developed countries, along with rules of competition on nontariff interventions in the market, see Hugh Corbet and Harry G. Johnson, "Optional Negotiating Techniques on Industrial Tariffs," in Frank McFadzean et al., *Towards an Open World Economy*, Report of an Advisory Group (London: Macmillan, for the Trade Policy Research Centre, 1972). On the idea of developing a series of codes on the basis of conditional MFN treatment, see Hufbauer and Schott, pp. 19-22.

[20] On the idea of greater unilateralism in trade policy, see J. M. Finger, "Incorporating the Gains from Trade into Policy," *The World Economy* (December 1982): 367-77. For a general discussion of the domestic, especially the legal and constitutional, aspects of trade policy and the case for a nondiscrimination treaty, see Jan Tumlir, *Protectionism: Trade Policy in Democratic Societies*, AEI Study no. 436 (Washington: American Enterprise Institute, 1985).

[21] *GATT Plus: A Proposal for Trade Reform*.