2 Making Trade Relations Work

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

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

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

EXCHANGE RATES AND COMMERCIAL POLICY

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

TRADE DIPLOMACY: THE RULES OF THE GAME

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

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

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

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

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

Reciprocity: What Give-and-Take Means

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

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

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

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

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

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

The Next Step: Collective Action

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

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

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

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

Nondiscrimination: Treating Others the Same

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

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

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

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

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

National Treatment: Still More Equality

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

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

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

Fair Competition

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

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

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

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

Transparency and Common Standards

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

Compliance: Will Others Obey the Rules?

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

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

National Sovereignty: Overruling the Rules

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

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

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

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