

THE GATT SYSTEM IN THE 1990s*

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INTRODUCTION

The period since the end of the second World War has been remarkable for the sustained economic expansion which has occurred in the Organization of Economic Cooperation and Development (OECD) countries (except for the 1981-82 global recession, and to a lesser extent in 1973-74), and the role that world trade has played in this. In most countries, the ratio of trade (imports or exports) to gross national product (GNP) has doubled, and in some cases trebled, and, in the main, trade barriers (on manufactures at least) have come down and remained down, even when trade or macro shocks have affected either individual countries or the global economy.

Rightly or wrongly, a large part of the achievement of growth and prosperity on the one hand, and a liberal trading order on the other hand, is often credited to the General Agreement on Tariffs and Trade (the GATT), a system of mutually enforced disciplines and obligations initially developed by governments after the war and then progressively expanded. These trade rules were designed to progressively lower trade barriers and to prevent them from subsequently rising again. While it is overly simplistic to attribute all post-war trade liberalization to the GATT (regional arrangements such as the Economic Community (E.C.) or Canada-U.S., and unilateral actions such as those in Japan have also been important), the emphasis on multilateralism, non-discrimination and internationally agreed disciplines are often taken as the cornerstones of the GATT system which have largely come to define the post-war world trading order.

However, despite its successes, even under the optimistic scenario of a strong and positive outcome to the Uruguay Round, the GATT system appears to us now to be under some stress and in this article we suggest that these stresses may well intensify in the decade ahead.

We try to lay out what these stresses could be, what positive steps may be needed, and who should take action, to preserve a system which has played a crucial role in generating present global prosperity. In essence, our argument is that because trade has been expanding and barriers in the major industrial countries have, on the whole, been coming down in the post-war period, the trade rules governing the system have largely focused on achieving more liberal trade arrangements, rather than on heading off emerging trade conflicts or preventing trade wars. This is not to deny the GATT's potential contribution in

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these directions. Under the current circumstances, however, we see the GATT system as relatively weak in its ability to prevent trade conflicts among the major powers.

Moreover, the GATT system itself has become increasingly impure over the years when judged against the original principles for which it was intended. We are now at a point where the credibility of the system itself, as a co-operative arrangement endeavoring to prevent major trade conflicts, may be seriously eroding. In recent decades (and especially since the 1981-82 recession), the non-discrimination principles in the GATT have been progressively undermined by Voluntary Export Restraints (VERs), trade arrangements in textiles and steel, as well as in other ways. Recent moves by the three major powers towards regional trade arrangements (Europe 1992/EFTA, U.S.-Canada/Mexico, Japan-ASEAN) have further elevated concerns over the credibility of a single multilateral system of trade rules, such as the GATT.

The more this process towards regionalism accelerates, the weaker the joint commitment to the co-operative arrangement (such as the GATT) becomes. The credibility of such a joint agreement to be able to survive becomes increasingly in doubt. The paradox is that the more successful the GATT process is at achieving mutually agreed market openings, the more difficult it becomes to sustain the openings. With fewer barriers to remove, there is less need to demonstrate commitment to persuade partners to negotiate further, and there is more incentive to find ways around existing commitments. In the U.S., where Congressional commitment to the GATT process has always been seen abroad as somewhat half-hearted, the argument is increasingly heard that bilateral, aggressive trade actions provide the best course for U.S. trade policy.

Thus, while a positive outcome to the Uruguay Round will help, we nonetheless see a further and potentially major episode of new difficulties ahead for the GATT system in the 1990s. Simmering trade disputes between the U.S. and Japan could easily erupt into more major hostilities; each bilateral relationship between the three large powers (E.C./U.S., U.S./Japan, E.C./Japan) has its elements of strain; the end to the Cold War substantially complicates the global trade policy picture; and trade-induced adjustment and other pressures on all three major powers seem likely to intensify. The issue, therefore, is how the strong economic performance of the world economy, which the GATT system has facilitated over the post-war years, can best be maintained in light of these potential pressures.

The key developments which will affect the trading system in the decade ahead are as follows. First, there is the end to the Cold War. The issue for the trading system is not so much the direct impact on trade flows that will occur by more fully involving Eastern Europe and the U.S.S.R. in the network of inter-OECD trade (currently these seem likely to remain small), but more importantly, the linkage between trade policy and wider strategic issues. Strategic considerations have played an important role in shaping the post-war trading system and the events resulting in the end of the Cold War suggest that the trading system could, in fact, be more in flux than at any time since the late 1940s.

Second, relative to the U.S., Europe and Japan have both steadily risen in importance in global trade policy-making over the last two decades. The growth in European power reflects the political consolidation and enlargement of the

European Community, while the growth in Japanese power reflects Japan's strong economic growth. The result is that today, unlike the late 1940s, the world is more tripolar than unipolar, and consequently, it is inherently more tension-ridden. There is a significant risk that current U.S.-Japanese trade relations will worsen, that aggressive 'market opening' trade restrictions may be voted in by Congress, and that a period of major U.S.-Japanese trade conflict will follow. In the longer term, all three of the major bilateral relationships could become considerably more strained than they are currently.

Third, we see an increased likelihood for a further acceleration in the pace of change around the world, in both the level and growth rates of trade flows, as well as production and regional growth. These will likely generate yet more pressure for domestic adjustment and accommodation in the larger OECD countries, and ultimately may intensify trade conflicts. The dynamics of change in trade flows are now so rapid that major developments often go relatively unnoticed. One such example is Mexico's position as the fifth largest exporter to the U.S. The strong Mexican export growth to the U.S. in the past few years, especially in autos and parts, places Mexico as a strong competitor in U.S. markets to West Germany and Taiwan. In addition, the onset of major global excess capacity in automobile manufacturing will create increased trade tensions and pressures in the early 1990s. Yet another potential pressure point is the emergence of ASEAN plus the Asian NICs who, collectively, now almost equal Japan in exports to the U.S. These and other developments, which often go unnoticed but are now occurring more frequently, all suggest the need for a trade system that is capable of defusing the pressures which such rapid change can quickly create.

The concluding section of this article sets out a series of possible short to medium-term measures that could be jointly agreed to by all three major powers. These measures attempt to strengthen the ability of the system to deal with new developments and, more importantly, to keep the system open. The primary purpose of these measures is to establish mechanisms to help weaken trade conflicts and head off possible trade wars before they occur. Such measures could involve trilateral agreements going beyond existing GATT disciplines, but at the same time, these measures would be GATT-compatible and aimed to help strengthen existing GATT arrangements.

These measures encompass the entire range of helpfulness and strength, including: the relatively weak but helpful joint consultation-type, information-gathering, early warning systems; jointly agreed cooling off periods before any GATT-compatible (balance-of-payments and safeguards) or incompatible (such as Section 301 retaliation) measures are used by any of the three powers against each other; jointly agreed rules for any new trade arrangements which any of the three countries negotiate with smaller countries (such as a mutual agreement that benefits achieved by any one of the three with smaller countries will be available to others through MFN treatment, or agreement not to initiate or negotiate any new regional trade arrangements over a given period); trilaterally agreed dispute settlement techniques, strengthened beyond the current GATT rules, for disputes involving any of the three with one another.

The idea behind this approach would be to generate stronger and more decisive joint trade policy leadership from the large powers than currently seems

to be present, in part by putting in place stronger mechanisms than currently exist in the GATT (or are likely to result from the Uruguay Round). The hope is that this might help reduce the risk of future trade conflicts, and even trade wars, rather than simply waiting to act until pressures develop.

We also see the current Uruguay Round of GATT negotiations (due to conclude in December 1990) as not fundamentally designed to deal with the pressures in the system we see likely developing in the 1990s. The Round is, in part, an outgrowth of concerns held by a number of countries following the 1981-82 global recession. Some concerns include that a wave of new protectionism could threaten world trade, that a number of changes were needed to strengthen the system, and, in part, a reflection of demands to deal with sectoral issues such as agriculture and new issues (services). The Round was not intended to deal with the new problems such as those brought about by the end of the Cold War; life in a tripolar world; and ever more rapid global change. While a positive conclusion to the Round would be helpful in moving the system forward in some of the same directions we later suggest, we basically argue that, to some extent, events have now overtaken the issues that the Uruguay Round was launched to address.

Furthermore, the time necessary to first launch and then complete a GATT negotiation, as shown by the three rounds since the 1960s¹, suggests that the traditional GATT process may be insufficient to quickly yield decisive outcomes to alleviate the worst of the potential problems for the system that we suggest may occur in the future. As a result, we suggest that one way forward may be for the three major powers in the system -the U.S., the E.C. and Japan - to engage in a joint and more active trilateral approach to global trade policy management than is currently the case, and make it explicitly complementary to the longer term GATT process.

HOW HAS THE GATT SYSTEM PERFORMED TO DATE?

The current GATT-based international trading system relies on a series of rules and arrangements negotiated multilaterally between (now 98) participating countries. These place limits on the way countries can use tariffs and other trade-restricting measures to protect their markets and/or influence their trade. These arrangements, now contained in the General Agreement itself, along with subsequent additions and changes, were first negotiated in 1947 and then in the eight GATT negotiating rounds that have followed.² They set out broad principles, enforcement procedures, and other rules which largely define the global trading system of today.

1. The Dillon Round (1960-61), Kennedy Round (1964-67), and Tokyo Round (1973-79).

2. The GATT, as established in 1947, was actually meant to be an interim agreement between the original 23 signatories to facilitate tariff reductions until a wider ranging and more permanent International Trade Organization (ITO) became effective. For more detailed discussion of the ITO and the history of various GATT rounds, see J. CURZON, *MULTILATERAL COMMERCIAL DIPLOMACY: THE GENERAL AGREEMENT ON TARIFFS AND TRADE AND ITS IMPACT ON NATIONAL COMMERCIAL POLICIES AND TECHNIQUES* (1965); K. DAM, *THE GATT: LAW AND INTERNATIONAL ECONOMIC ORGANIZATION* (1970); W. DIEBOLD, *The End of the ITO*, in *ESSAYS IN INTERNATIONAL FINANCE* 16 (1952); J. JACKSON, *WORLD TRADE AND THE LAW OF GATT* (1969); E. PREEG, *TRADERS AND DIPLOMATS: AN ANALYSIS OF THE KENNEDY ROUND OF NEGOTIATIONS UNDER THE GATT* (1970).

The period since the General Agreement was first concluded has been remarkable by historical standards both for the growth which countries have experienced, and the role that trade has played in this. World trade has grown at about 6.5 percent per year in real terms, much faster than the 4.5 percent growth in real global output.³ Most of the major OECD countries have more than doubled their trade shares (imports or exports/GNP). In the last two or three years, world trade has achieved 5 to 8 percent annual growth rates.⁴

Beyond this impressive growth and trade performance, the much feared major recession and accompanying contraction of trade did not arrive in the immediate post-war years.⁵ Nor has there been the equally feared outbreak of retaliatory trade wars, mirroring the events of the 1930s. Not until the major recession of 1981-82 (the deepest since the 1930s) did global trade growth become negative.⁶ However, rather than touching off major trade wars or across-the-board tariff increases, it resulted instead in product-specific protectionism in the form of voluntary export restraints and orderly marketing arrangements, especially in the key sectors of steel and autos.⁷

Over the post-war years, the trading system thus seems to have been resilient enough to withstand various tremors and strains without setting off the forms of trade war which are often taken as characteristic of the 1930s. The collapse of the Bretton Woods system in 1971 and the accompanying 10 percent temporary U.S. import surcharge,⁸ whose GATT-compatibility was questioned at the time, clearly created difficulties, but no counter measures from Europe occurred (nor from Japan, even though, in economic terms, it was much less significant at the time). The 1973 oil shock and the accompanying 1974 recession also left the trading system largely unscathed, but not without much concern at the time as to what the outcome might be. It was widely feared that the 1981-82 recession, the deepest since the 1930s, might set off a new round of global protectionism with retaliatory tit-for-tat trade barrier increases. What resulted, however, in the industrial countries was adjustment-resisting measures in the form of voluntary export restraints. In the mid to late 1980s, with a ballooning U.S. trade deficit, a major Japanese trade surplus, and large bilateral imbalances, the fear was once again that there would be an increasing resort to major new protection.

By any stretch of the imagination this performance has been strong. It has, however, and somewhat paradoxically, occurred within a system of international rules and disciplines which has become ever more eroded over the years relative to its basic principles. While yielding liberalization in the form of tariff cuts, the GATT system has, nonetheless, spawned GATT-incompatible trade restrictions in textiles, steel, autos and other product areas; and a large and growing number

3. See U.S. Government, *Economic Report of the President* 138 (February 1988).

4. See GATT (1988) p.1, and GATT (1989a) p.5.

5. The first decline in the volume of world trade occurred in 1958 by a little less than 1 percent. GATT (1983a) p.3.

6. See GATT (1983) p.1.

7. See GATT (1989b). See also *infra* note 10.

8. On August 15, 1971, the U.S. imposed a 10 percent import surcharge and announced the dollar would no longer be convertible into gold, effectively ending the Bretton Woods system. The surcharge was removed in December after a negotiated depreciation of the U.S. dollar and appreciation of other key currencies. For further discussion, see GATT (1972b).

of voluntary export restraints (VERs).⁹ The GATT has so far failed to bring agriculture within system rules, and has, thus far, been ineffective in preventing the spread of protection contingent upon various actions of exporters (countervailing and anti-dumping duties).¹⁰

Even without this trend towards erosion, the General Agreement represents relatively weak discipline over government trade policy actions, in part because the GATT itself was only a temporary arrangement.¹¹ More importantly, perhaps, there are a number of escape clauses which allow governments to resort to protection in a GATT-consistent manner. These include measures taken for balance-of-payments reasons (Articles 12 and 18-B), to provide relief from temporary import surges (Article 19), anti-dumping duties (Article 6), and others. Enforcement of GATT disciplines is also widely seen as slow, cumbersome and of questionable effectiveness.¹²

THE GATT SYSTEM AT THE START OF THE 1990s

As the GATT system enters the 1990s, we see it as approaching a series of watersheds on a number of different fronts. There is the latest GATT Uruguay Round due to conclude in December 1990 which will determine whether there is enough collective political will for countries to jointly commit themselves to a system of strengthened multilateral trade disciplines.¹³ There is evidence of a further recent acceleration in regional arrangements (E.C.-EFTA, E.C.-U.S.S.R., U.S.-Mexico¹⁴), which seems likely to gather added momentum if the global system is perceived to be weakening. There is the attempt in the Uruguay Round to extend GATT disciplines into the new areas of services, intellectual property and investment measures. This effectively moves GATT beyond border measures in a major way to address domestic policies and their impact on trade. The success or failure of this effort will reflect how far the GATT framework can realistically evolve as a wider global integrating device.

9. According to GATT (1989b) p.91, as of February 1989, the following sectors are most affected by restraint agreements: textiles and clothing (77, of which 29 bilateral agreements have been notified under the MFA), agriculture and food products (64), steel and steel products (52), electronic products (32), automobiles and transport equipment (21), footwear (17), and machine tools (14). The U.S. and the E.C. account for 80 percent of the measures. Data in UNCTAD (1988) p.9, indicates that in the period 1981-87, voluntary export restraints were the most rapidly growing form of trade restriction.

10. GATT (1989b) p.4-5, reports that the use of anti-dumping and countervailing measures over the period September 1988-February 1989, confirmed the trend towards a broadened use of these measures. Anti-dumping actions have recently been extended to cover action against imported components of goods which are the subject of anti-dumping actions in their assembled form. Laird and Nogues (1988) report that during the period 1975-79, the U.S. processed 21 CVD cases annually, while during the period 1980-86, the annual number more than tripled to 66.

11. For further discussion, see Jackson (1989a) and Tumlin, *International Trade Regimes and Private Property Rights*, 5.2 CONTEMP. POL'Y ISSUES 1 (1987).

12. See Bliss, *GATT Dispute Settlement Reform in the Uruguay Round: Problems and Prospects*, 23 STAN. J. INT'L. L. 31 (1987) and Horlick et al. (1989) for discussion of problems with the existing dispute settlement mechanism.

13. Samuels (1990) p.8, asserts that "those countries unwilling or unable to accept the new obligations should be allowed to withdraw, and should be governed by other agreements yet to be negotiated. . . the new system may encompass fewer countries."

14. See *Soviets, EC Forge Sweeping Trade Accord*, Toronto Globe and Mail, Nov. 28, 1989; *U.S. Government Congressional Record*, October 3, 1989; 6 INTL. TRADE RPTR. 1253 (1989); *EC and EFTA to Discuss Economic Zone Next Year*, Financial Times, November 23, 1989.

There are also unresolved non-traditional trade problems, such as the U.S. disputes with Japan covering bilateral trade imbalances, the trade effects of Japan's distribution system, and other matters which the present trading system, as constituted, seems ill equipped to address.¹⁵ Other bilateral disputes between the three major powers are also increasingly evident¹⁶, and seem likely to grow. There are areas wholly excluded from the present system of trade rules, where impediments exist which are potentially of major importance in restricting the gains from trade. Restrictions on labour mobility are probably at the top of the list¹⁷, but restrictions on capital flows and restrictive business practices (competition policy) are also on the list.

It may be helpful to think in terms of three different scenarios that the global trading system may follow in the early 1990s.

The Fragmentation Scenario

This is where the outcome of the Uruguay Round is negative, there is further erosion of multilateral disciplines in the major trading regions (perhaps accelerated by new protectionist pressures accompanying a recession), gravitation towards regional trade arrangements involving large-country blocs (E.C., U.S., Japan) continues, non-compliance and weak enforcement of GATT disciplines becomes ever more pervasive, with eventually a significantly weakened common commitment to the multilateral system. The danger of trade wars occurring between the three larger trade blocs is increased in such a scenario.

The Strengthened System Scenario

This is where the outcome of the Uruguay Round is more decisive, middle-sized and smaller countries see their interests as residing in a system of stronger multilateral disciplines rather than regional arrangements, bold initiatives to extend multilateral disciplines to factor flows and non-manufactured goods flows take hold, non-traditional problem areas recede, respect for and national interest in the multilateral system rises, and, in effect, the GATT enters a new golden age. This scenario leads to a strengthened system, but may be the least likely to occur.

15. In May 1989, the U.S. named Japan under its Super 301 provision of the 1988 Omnibus Trade Act for unfair trade practices. Subsequent negotiations under the Structural Impediments Initiative (SII) are intended to open the Japanese market in areas such as supercomputers, satellites and forest products among others. See 6 INTL. TRADE RPTR. 684 (1989). See also the ECONOMIST, Nov. 18, 1989, at 15-16.

16. If discussions between the U.S. and Japan under the SII do not result in sufficient market opening, under the provisions of Super 301, the U.S. could impose sanctions against Japan as early as June 15, 1990. The U.S. is also engaged in a number of disputes with the European Community over initiatives to full European integration in 1992. The E.C. draft government procurement directive caused the U.S. Chairman of the House Subcommittee on International Economic Policy and Trade to ask the Administration to list the E.C.'s policy as discriminatory under U.S. trade law and subject to sanctions. The U.S. has also voiced disagreement with the E.C. directive on bank licensing and the directive on television broadcasting. The European Community and Japan have recently been engaged in discussions over E.C. VERs of Japanese cars and an agreement on Japanese semiconductor computer chips.

17. See Hamilton and Whalley, *Efficiency and Distributional Implications of Global Restrictions on Labour Mobility: Calculations and Policy Implications*, 14 J. DEV. ECON. 61 (1984) (speculative estimate that complete worldwide free labour mobility could double or even triple the value of worldwide product).

The Two-Tier Discipline Scenario

The third scenario is where only limited progress is made in the Uruguay Round, but enough to avoid the label of failure. Regional trade arrangements are expanded, especially in Europe; but with a joint reaffirmation of commitment to a multilateral system emerging from the three major regions or countries. Each set of regional arrangements proceeds independently taking a different form, but GATT disciplines remain and are enforced, especially by the larger countries against each other. Effectively a two-tier system of GATT disciplines coexisting alongside regional arrangements begins to take firmer shape than currently; a form of pax Europe-U.S.-Japan on the trade front.

Which of these scenarios occurs in the early 1990s depends, in part, on the outcome of the Uruguay Round. The outcome of the Uruguay Round, in turn, will be heavily dependent on the evaluation of the system as it has been performing in recent years by the key players in the negotiation (E.C., U.S. and Japan). Has the GATT system maintained open trade, and allowed for more openness? Has it, instead, been ineffective in meeting its goals? Is it still needed to prevent a retaliatory trade war from breaking out? Does it adequately serve the interests of all involved: large, small, developed and developing countries?

Beyond these various watersheds and their implications for various scenarios which the trading system might follow, lie a number of deeper ambiguities present in the system concerning the purposes for which the system rules are meant to serve. The resolution of these, if any occur, will also shape the future course of the system. Despite the drafting of the GATT and eight negotiating rounds (including the current round) it remains unclear whether the trade rules being negotiated are meant to achieve ever larger degrees of economic integration between countries (maximizing the gains from trade), to prevent regression towards autarchy through new protectionism (preventing a return to the 1930s), or simply to control trade protection on goods at national borders. It is also unclear whether the system of global trade rules is meant to subsume and eventually override any regional trade arrangements that groups of countries agree to, or whether global rules and regional arrangements are to be seen as a form of complementary two-tier trading system, each in its own way yielding ever more liberal trade. Furthermore, the tie-ins to other components of economic interdependence such as exchange rates, capital flows, debt issues, and foreign aid remain as complex and confused today as they were in the 1940s.

In our view, these ambiguities over the purposes and functions of the system remained unresolved and without need of clear resolution in the post-war years because of the dominance of one country (the U.S.) in the system. Country strategic interests (maintaining a U.S. defense presence) were linked to their possible trade policy actions, explaining relative passivity by Europe and Japan on trade issues and reflecting their desire to maintain strategic alliances with the U.S. against communist countries. Deviations from system principles by the dominant power leading to erosion of system principles were tolerated by others, in part, because of strategic linkage. Hence, under such circumstances, trade wars do not break out because of unipolarity, and adherence to the system is jointly pledged by all, partly on strategic grounds. Hence, both the success of economic performance under the system and its erosion could be mutually

accommodated in the unipolar world of the more immediate post-war years.

Under this view of the world, the trading system was able to withstand the stresses of events in the 1970s and 80s such as the 1971 breakdown of Bretton Woods (and the accompanying U.S. import surcharge), the 1981-82 recession, and large U.S.-Japan trade imbalances of the late 1980s, while embodying only relatively weak disciplines, in part because the strategic bond holding the system together was still strong. In addition, changes impinging upon the system were not overwhelming.

The threat we now see in the 1990s is that a weakened system, with weaker (and even fluid) strategic interests to underpin it, may not be able to withstand major stress such as that which might be brought about by a global recession. Trade wars could result in irreparable damage to a system of prosperity generating arrangements which have been 40 years in the making. Our paper, therefore, concludes with a call for the initiation of a major power process aimed at strengthening the system and providing expeditious, effective, even if only temporary, help to strengthen the system and reinforce co-operation. Our premise is that in the short run, ongoing GATT processes cannot be relied upon to deal with the situation and to produce sufficient strengthening in the system quickly enough to fend off the threat of major system difficulties that may occur throughout the 1990s.

STRESSES ON THE GATT SYSTEM IN THE 1990s

While the global trading system has performed well over the post-war years, as we enter the 1990s, we see new stresses emerging which will test the strength of the system.¹⁸ The Cold War seems to have largely disappeared, and with it gone, the strategic underpinnings of the system have changed. Whether ideological conflict is replaced by heightened North-South distributional conflict, global Asian-Euro-North American regional conflict, or even no conflict, the trading system cannot help but be affected.

In more immediate economic terms, the unipolar environment of the 1940s and 1950s seems to have been replaced by a tripolar world¹⁹, with first the formation and then the enlargement of the European Community, along with strong and persistent growth in Japan and the Pacific. With this change, the risk of heightened trade conflict seems to have increased.

In addition, the pace of global economic change, which accelerated in the 1980s, seems poised to become even more rapid as shown by a number of new but barely recognized developments: emerging export growth from Mexico to the U.S., Turkey to the E.C., the Asian NICs plus the ASEAN 4 to the U.S.; growing excess capacity problems in autos; and growing investment flows to ASEAN countries, Mexico and other countries.

18. For further discussion of the evolving global balance of power, see P. KENNEDY, *THE RISE AND FALL OF THE GREAT POWERS: ECONOMIC CHANGE AND MILITARY CONFLICT FROM 1500-2000*, 438-535 (1987) [hereinafter P. KENNEDY]; Kaiser, *A View from Europe: The U.S. Role in the Next Decade*, 65 INT'L AFF. 209 (1989).

19. See generally Nye, *Understanding U.S. Strength*, 72 FOREIGN POL'Y 105 (1988) (asserting that American strength is understated); ECONOMIST, Feb. 24, 1990, at 11-12 (supporting the view that while the U.S. is not as dominant as before, it is still "the superpower").

The End of the Cold War

Perhaps the most obvious set of stresses that seem likely to emerge in the GATT system in the mid to late 1990s are those created by the end of the Cold War.²⁰ There are, of course, more immediate issues for the system which the assimilation of the economies of Eastern Europe and the Soviet Union presents.²¹ For now, however, the direct trade flows involved, even with the E.C., are relatively small. There are, however, other issues of assimilation: Czechoslovakia and Poland (both GATT members) have called for a new form of trade organization to replace Comecon; there is the issue of Soviet accession to the GATT;²² and there are many other matters, not the least being eventual membership in the E.C. by East Germany, Poland, Czechoslovakia and Hungary.²³ The direct consequences appear tangential to the immediate economic interests of the larger powers since the economic activity seems small and disorganized. There is no immediate likelihood of rapid trade penetration by these countries, and present trade flows are small.

The wider and deeper source of stress for the system arises from the change this represents for the participation of the key players (the U.S., Europe, Japan and others). When the multilateral economic institutions were established in the immediate post-war period (the GATT, the World Bank, the IMF),²⁴ their designers were motivated by natural concerns of fuelling post-war reconstruction, providing a stable international financial environment, preventing any return to retaliatory trade wars as occurred in the 1930s, and (eventually) achieving new liberalization of trade by lowering trade barriers. While the objectives that the participants had collectively set for these institutions remained with the onset of the Cold War tensions, the motives underlying the behaviour of the countries acting within this system began to shift.

While military preparedness was seen by the United States as the central component of their policy for dealing with the Cold War strategic threat,²⁵ a

20. The Cold War ended "symbolically" with the opening of the Berlin Wall dividing East and West Berlin on November 9, 1989. This was the result of numerous protests in East Berlin calling for substantial political and economic reforms and followed on the reforms initiated in the U.S.S.R. under perestroika. Significant reforms have also been implemented in Poland and Czechoslovakia.

21. See Nello, *Some Recent Developments in EC-East European Economic Relations*, 24 J. OF WORLD TRADE L. 5 (1990); *Eastern Europe's Economies: What is to be Done?*, ECONOMIST, Jan. 13, 1990 at 21-26; *Special Report Eastern Europe in Ferment*, Financial Times, Jan. 24, 1990, at 7-10.

22. The Soviet Union formally applied for observer status in the GATT in March 1990, but will not likely become a full member for some time. For discussion of some of the problems that would have to be overcome, see J. JACKSON, *RESTRUCTURING THE GATT SYSTEM* (1990); M. KOSTECKI, *EAST-WEST TRADE AND THE GATT SYSTEM* (1978); Diebold, *The End of the ITO*, in 16 ESSAYS IN INTERNATIONAL FINANCE (1952); Dirksen, *What if the Soviet Union Applies to join the GATT?*, 10 THE WORLD ECON. 228 (1987); Kennedy, *The Accession of the Soviet Union to GATT*, 21 J. OF WORLD TRADE L. 23 (1987); Patterson, *Improving GATT Rules for Nonmarket Economies*, 20 J. OF WORLD TRADE L. 185 (1986); Financial Times, Dec. 5, 1989, at 5.

23. See *Gatecrasher's Europe?*, ECONOMIST, Nov. 25, 1989, at 11. See also *When the Party's Over*, ECONOMIST, Nov. 18, 1989, at 51-58.

24. For in-depth discussion of the evolution of these institutions, see R. GARDNER, *STERLING DOLLAR DIPLOMACY* (1956).

25. For discussion of the events leading to the Cold War and the U.S. policy of containment, see P. KENNEDY; D.M. SMITH, *THE AMERICAN DIPLOMATIC EXPERIENCE* (1972); Kindleberger, *Domination and Leadership in the International Economy*, 25 INT'L STUD. Q. 242 (1981).

strong system of multilateral institutions with membership dominated by like-minded partners was also seen as a helpful supporting structure. Thus, as Hudec (1987) documents, the willingness of the U.S. and Europe to allow newly developing countries in the 1960s to accede to the GATT with few conditions (unlike today), can be partly accounted for by the belief at the time that in some small way, this might help prevent them coming under communist influence.

In other regions (Europe and Japan), the response to U.S. requests on trade policy matters within the system was conditioned, in part, by their desire to preserve the U.S. military commitment to their own defence. Europe and Japan have thus consistently reacted favourably to U.S. requests for GATT rounds with U.S.-initiated agendas throughout the post-war years. Japan has also been largely passive in responding to trade actions against Japanese import surges in Europe and North America and in agreeing to VERs.²⁶ While Europe has become increasingly concerned with its own regional integration, its desire for as little trade confrontation outside Europe as possible, consistent with pursuing its commercial policy interest has resulted in a noticeably more introspective approach to trade policy than has been true of the U.S.

What we see as possible in the 1990s, is a changed environment insofar as how strategic interests condition the behaviour of countries on trade policy matters. A joint strategic interest where only one party provides military defense means that strategic interests can override trade interests and help to defuse trade conflicts. Such conflicts remain repressed; one party backs down quickly to preserve the strategic relationship, and major tensions in the system are not readily apparent. With changed or realigned strategic interests, more trade conflict may occur.²⁷ Without restraint, they may intensify to heights we have not seen for many years, crippling the trading system. The need is for a stronger system better able to regulate world trade, which harnesses the joint economic interest of the major three powers in ways which can defuse trade conflicts.

A Tripolar World

A second set of stresses we see for the trading system of the mid-1990s are those created by the evolution from the bipolar environment of the late 1940s to the tripolar environment of today.²⁸ In the late 1940s when the multilateral

26. This same pattern of accommodation to demands for trade restrictions on exports and/or trade liberalization is also clearly evident in the U.S.-Korea relationship. Interestingly, Hong Kong, which has much less strategic interest in its relationship with the United States, consistently takes the hardest line in response to pressure for voluntary trade restrictions.

27. In a speech to trade association executives January 13, 1989, the outgoing U.S. Commerce Secretary noted that "the military tensions of the 1980s are on the down-curve but what's going to happen in the 1990s is economic warfare, and economic warfare is trade." In a speech January 1990, the Chairman of Chrysler Motors Division called Japan an "economic aggressor". Global and Mail, Jan. 10, 1990, at B4. See Nicolaides, *Trade Warfare: The Quest for Fair Trade*, 44 THE WORLD TODAY 119 (1988); *U.S.-Japan Rupture Raises Risk of Economic Cold War*, Global and Mail, Jan. 19, 1990, at B1.

28. The U.S. share of industrial country exports rose from 25.6 percent in 1938 to 35.2 percent in 1952, while the combined share of Germany and Japan fell from 24.0 percent to 11.4 percent. As the post-war reconstruction got underway, U.S. world export share of manufacturers decreased from 29.4 percent in 1953 to 18.7 percent in 1959, while W. Europe's share rose from 49 percent to 53.7 percent, and Japan's from 2.8 to 4.2 percent. R.E. BALDWIN, *TRADE POLICY IN A CHANGING WORLD ECONOMY* (1988). In 1987, West Germany was the leading exporter of manufactures at 15.2 percent;

institutions were created, the U.S. was unambiguously the dominant economic power, a situation which prevailed through the 1950s. This was slowly challenged, at first by the creation of the European Economic Community with the Treaty of Rome in 1958, and subsequently with the emergence of Japan.

With continued high growth rates in Japan through the 1960s and 70s, and still high if somewhat reduced rates in the 1980s, Japan has grown to the point where, in global economic terms, it represents a major alternative source of economic power to the United States. Because its population is less than one-half of the United States, in GDP terms it is, of course, still smaller. But Japan has come to represent the largest single-country exporter to the United States. Japan accounts for growing inward foreign investment to the United States,²⁹ and contains a market which, in terms of underlying asset values, has a larger capitalized value of equities than the U.S. market. Furthermore, it has land values substantially in excess of those in the United States. Japan has also been the source of major trade surges into the United States in the post-war years, first in textiles and apparel, then in steel, autos, consumer electronics, computer chips and in other products. More recently, the Asian NICs (Korea, Taiwan, Hong Kong and Singapore) have also begun to represent sources of many of these same trade problems for both the U.S. and Europe.³⁰

Through trade, therefore, Japan has become a major source of adjustment pressure in both the European Community and the United States. It has generally followed a fairly passive approach when trade restrictions have been imposed upon it, seeking ways to accommodate trade restrictions rather than to challenge them in a confrontational manner. However, in the tripolar world of the 1990s and with growing Japanese importance in the world, it is no longer the case that this approach by the Japanese can be relied upon to continue. This is clear in recent policy debates in Japan; Japan is now the Japan that can say "no".³¹

Japan next at 13.0 percent; and the United States at 10.5 percent. *FEDERAL AGREEMENT ON TARIFFS AND TRADE (GATT), INTERNATIONAL TRADE '87-'88 Table AD 1 (1988).*

An important factor in the rise of American dominance after the war was the threat of Soviet expansion into W. Europe and elsewhere, and the U.S. effort of containment. Baldwin notes "American officials believed they had little choice from a national viewpoint but to assume an active political, economic and military leadership role to counter this Soviet [sic] expansionist policy" *BALDWIN, supra* note 28, at 209.

See Kindleberger, *supra* note 25, which asserts that U.S. leadership began to decline as early as 1960. For further discussion of the American decline in power, see D.P. CALLEO, *BEYOND AMERICAN HEGEMONY: THE FUTURE OF THE WESTERN ALLIANCE* (1987); P. KENNEDY; R.O. KEOHANE, *AFTER HEGEMONY: COOPERATION AND DISCORD IN THE WORLD POLITICAL ECONOMY* (1984); Whitman, *Leadership Without Hegemony: Our Role in the World Economy*, 20 *FOREIGN POL'Y* 138 (1975).

29. Japan's investment in the United States reached \$53.4 billion in 1988, and is estimated to exceed \$65 billion in 1989. *Globe and Mail*, Jan. 11, 1990, at B8.

30. Korea is fast becoming a serious competitor in the semi-conductor memory chip sector, raising concerns in the U.S. See *S.Koreans Raise New Fears in Silicon Valley*, *Financial Times*, Feb. 9, 1990, at 9.

31. *THE JAPAN THAT CAN SAY NO* was co-written by Morita and Ishihara and was published only in Japanese. In the book, they assert Japan should stop being afraid of success and "learn to strut it." In their view, other countries should emulate Japan and not criticize it. See *Globe and Mail*, Jan. 10, 1990, at B4. Japan also recently won its first ever appeal to a GATT panel over the European Community's "screwdriver" law. This victory could lead to Japan "settling other trade disputes by the letter of GATT rules." See *Financial Times*, March 10, 1990, at 2; March 13, 1990, at 7.

For the European Community, their major concern in the early post-war years was to achieve post-war reconstruction. They were aided by a series of programs, including the Marshall Plan and trade and financial arrangements under the International Monetary Fund and emerging arrangements in the GATT. Early GATT trade negotiations were dominated by the United States, because individual European countries were relatively small and had no way of asserting significant influence on the outcome. This changed dramatically in 1958 with the creation of the European Economic Community, and with it the Round process in the GATT was both accelerated and changed. The Dillon and Kennedy Rounds were both, in part, an American response to the formation of the European Community, since it was widely believed in the United States that the emergence of a single European bloc made it imperative to have firm trade arrangements which would guarantee market access for U.S. manufactured exports.³²

Through the years, this process of consolidation and integration in Europe has, even if in fits and starts, steadily progressed further. There has been substantial enlargement of the Community, first in 1973 with the U.K., Ireland and Denmark, and then in the early 1980s with Spain, Portugal and Greece. This has culminated in the Europe 1992 process whose objective is to achieve a single integrated market.³³ It now threatens to go further with a negotiation between EFTA and the E.C. in 1990 designed to achieve a "European Economic Space".³⁴ The reaction of the United States to each step in this process has been concern that this may turn out to be a trade-exclusionary device,³⁵ tempered by recognition of their strategic interest in a strengthened Europe. At various times, compensation has been sought for steps in this enlargement and consolidation.

Into the 1990s, this process in Europe may well progress even farther. Norway and Austria may eventually join the E.C.³⁶ The E.C. already has trade arrangements in place with major Eastern European countries, some of which have been negotiated since the political changes of late 1989.³⁷ As a result, a

32. For discussion of GATT rounds, see K.W. DAM, *THE GATT: LAW AND INTERNATIONAL ECONOMIC ORGANIZATION* (1970); J.W. EVANS, *THE KENNEDY ROUND IN AMERICAN TRADE POLICY* (1971); E. PREEG, *TRADERS AND DIPLOMATS* (1970); G.R. WINHAM, *INTERNATIONAL TRADE AND THE TOKYO ROUND NEGOTIATION* (1986).

33. For discussion of what is involved in the move to complete European integration in 1992, see COMMISSION OF THE EUROPEAN COMMUNITIES, *THE EC'S 1992 STRATEGY: MARKET INTEGRATION AND ECONOMIC GROWTH* (1989); DELEGATION OF THE COMMISSION OF THE EUROPEAN COMMUNITIES, *EUROPE 1992: EUROPE WORLD PARTNER* (1988); U.S. DEPT. OF STATE, *WESTERN EUROPEAN REGIONAL BRIEF: THE EUROPEAN COMMUNITY'S PROGRAM FOR A SINGLE MARKET IN 1992* (Nov. 1988); B. Balassa, *Europe 1992 and its Possible Implications for Non-Member Countries* (Oct. 31, 1988) (paper presented at a conference sponsored by the Institute for International Economics, Washington, D.C.); R.C. Hine, *Protection in the European Economy Before and After 1992* (May 22, 1989) (paper presented at a conference at Lehigh University); J. Whalley, *Developing Countries and the New Bilateralism* (1989) (paper prepared for a project on trade issues in development, North-South Institute, Ottawa, Canada).

34. Negotiations are now underway to conclude an agreement between the E.C. and EFTA in June 1990 on a European Economic Space. It is expected EFTA will agree to the E.C.'s laws on the "four freedoms" of movement in goods, services, capital and people.

35. 6 INT'L TRADE REP. (BNA) 120 (Jan. 25, 1990).

36. In July 1989, Austria formally applied for membership in the E.C. Depending on the outcome of Austria's request, Norway and Sweden have indicated they may also file for membership. Turkey's two-year old request is still being processed. 6 INT'L. TRADE REP. (BNA) 962-963 (July 19, 1989).

37. In December 1989, the European Community granted Poland and Hungary special quota exemptions, giving them preferential treatment over a wide range of competitors in sectors such as

more assertive Europe may be more likely to emerge in the 1990s. Trade expansion and enlargement would likely provoke a U.S. response more influenced by economic (over strategic) interests than previously. European responses to U.S. positions may be less softened by strategic considerations. Thus, a more conflict-ridden trade relationship may emerge in the 1990s.

The evolution from a unipolar to a tripolar world in the 1990s could generate potentially major problems for the trading system. Each of the large powers in the system may be more assertive of its interest than has been true earlier; more defensive on the trade front where domestic adjustment pressures are concerned, and more aggressive on the export side when their access seems threatened. This clearly has the potential to fuel, if not produce, major trade conflict.

More Rapid Global Economic Change

A further source of stress we see for the trading system in the 1990s is even more rapid economic change than has been true in previous decades. We see the trading system as evolving from the 1940s to the 1990s in ways in which the cycle of change seems to become progressively shorter but more intense.

Thus, in the 1950s the dominant event was the creation of the European Community. In the 1960s, it was the emergence of Japan. In the 1970s, it was the end of the gold standard and the U.S. surcharge followed by the oil crisis, the beginning of trade pressures and voluntary restraints, and accompanied by the recession of 1974. In the 1980s, it was global recession in the early 1980s, ongoing debt crises, volatile exchange rates, and global macro imbalances.

Looking at the 1990s, we see an accumulation of events which are evidence of significant and, at times, bewildering change which is equally hard, at times, to keep up with. Korea, for instance, grew in 1987-88 at 12 percent, but this year is in a major economic crisis. Export growth rate there has declined,³⁸ GDP growth slumped precipitously, and the cabinet has declared a crisis. Mexico has had growth rates of manufactured exports from the maquiladoras, largely in autos and parts, which has been running at 30 to 40 percent per year in the last few years. Mexico is now the fifth largest exporter to the United States, ahead of Korea and not far behind Taiwan. The countries of Eastern Europe have announced their desire to terminate all Comecon trade arrangements, trade in hard currency, and maintain an exchange rate regime comparable to that found in many of the Western European countries.³⁹ Turkey is emerging as a major exporter to the European markets,⁴⁰ growing extremely rapidly and representing

cars, shoes and toys. Also, in December 1989, the E.C. negotiated a 10-year trade and co-operation pact with U.S.S.R. It is expected the European Community will complete full-scale trade and co-operation agreements with all East European countries, except Romania, by May 1990. *Financial Times*, March 7, 1990, at 2.

38. The Korean Development Institute has predicted a 6.5 percent decline in export volume in 1989. See Park (1989). For further discussion of the slowdown in the Korean economy, see *Financial Times*, February 28, 1990, p.4.

39. In meetings in January 1990, reforms were proposed to annul Comecon's previous trade agreements and move towards settling their trade accounts with each other in convertible currencies. A special commission was established to report on ways to make the grouping more sensitive to market forces. See *Globe and Mail*, January 10, 1990, p.A2.

40. Turkey's 1987 exports to the European Community grew 49 percent over 1986. See also "A Country Now Boarding a Magic Carpet", *Financial Times*, March 6, 1990, p.2, which reports estimates that Turkey could experience as much as a 7 percent growth rate this year.

major adjustment problems, particularly in the textile and clothing area. In the case of the auto industry, there is clear evidence of major excess capacity problems. The Chairman of Ford has recently suggested that global excess capacity may now be running as high as 20 percent, given the dramatic Japanese investment in auto plants in North America and elsewhere.⁴¹ A major capacity overhang may, therefore, be a serious problem in this industry for many years to come, reminiscent of the situation in steel in the late 1960s and early 1970s.

All of these are but single instances of change, but we see change coming with increasing frequency in the 1990s. Latin America, which was written off over the decade of the 1980s as a negative growth region headed to economic oblivion, has staged a remarkable turnaround in the late 1980s⁴² (with one or two notable exceptions), and seems poised to regain its position as a major exporter to the United States. Trade between Japan and ASEAN is growing rapidly.⁴³ The Japanese trade surplus has begun to come down,⁴⁴ although not in terms of the bilateral surplus with the U.S., but nonetheless there is change.

How the GATT system accommodates all this change is, therefore, a key issue. Facilitating adjustment and dealing with conflict in a rapidly changing world we see as the central challenges for the trading system in the 1990s, and challenges which the system, as it is currently constituted, is unable to squarely meet.

MAINTAINING THE PERFORMANCE OF THE SYSTEM IN THE 1990s

Thus, our concern for the GATT system in the 1990s is the emergence of pressures which intensify trade conflict and make them more difficult to defuse. While helpful, a strong outcome to the present GATT Uruguay Round will at best provide marginal assistance should major difficulties develop. While the GATT system has the appearance of having performed well in the 1970s and 80s, it remains fundamentally untested in terms of its ability to keep trade free and open in the face of the more major stresses which might lie ahead. What we see is a need to maintain the performance of the system in the face of the movement from a unipolar to a tripolar world, a weakening of geopolitical and strategic interests underlying the trading system, and an acceleration in the pace and scope of global change.

The Need

In our judgment, the changes that we identify above suggest the need for a more activist approach towards maintaining the performance of the trading system in the 1990s. These changes either create or intensify trade tensions of various kinds, particularly those involving the three major powers in the system: the

41. See *Financial Post*, February 5, 1990, p.37.

42. Relative to 1987, Latin America more than doubled the growth of their merchandise exports in 1988. See GATT (1989a) p.14. Substantial increases in export values were recorded in Argentina and Chile in 1988. See GATT (1989a) p.20.

43. In 1988, trade between Japan and ASEAN increased by 25 percent in volume over the 1987 level. See World Bank (1989) p.32.

44. For 1989, Japan reported a trade surplus of U.S. \$64.4 billion, down from U.S. \$77.5 billion in 1988, while the surplus with the U.S. fell to U.S. \$45 billion in 1989, from U.S. \$47.6 billion. *Financial Post*, January 22, 1990, p.8.

E.C., the U.S. and Japan. Our approach is to suggest a series of steps to be taken within the current system of trade management to defuse potential trade conflicts and help prevent any that occur from escalating into trade wars between the three large global economies, particularly if recessions and other shocks were to hit the system in the mid to late 1990s.

The Potential Contribution of the Uruguay Round

The need we identify above could be partly met by a strong and decisive outcome from the Uruguay Round of trade negotiations in the GATT. However, this would only be a partial solution, much more is needed; and, at the point of writing, such a decisive outcome to the Round is far from being assured.⁴⁵

The Uruguay Round was launched largely in response to a series of concerns held by a number of countries in the early 1980s. One concern was how to keep the trading system open following the 1981-82 recession when, for a while, it was feared that countries might turn more protectionist.⁴⁶ A round was also seen as a way of dealing with issues left over from the Tokyo Round (agriculture, safeguards), as well as a way of bringing a range of new issues (services, intellectual property, investment) under international discipline. The small and mid-size economies took the lead with a demand to strengthen the system, enforce non-discrimination in the system, and return the GATT to consistency with its original principles.⁴⁷ Thus, at its launch in 1986, the Round was designed to strengthen global trade rules, but to do this in light of the problems of the early 1980s, not those of the 1990s.

The Round is due to conclude at the end of 1990,⁴⁸ but may well continue either in whole or in part for a short while beyond this (as happened with the Mid-Term Review of the Round in 1988). It may well also be the case that any agreements stemming from the Round are not implemented until the mid to late 1990s.

While helpful for dealing with some of the pressures on the system we identify above, even with a positive and decisive conclusion we see the Uruguay Round process as too slow and poorly focused for the emerging problems of the 1990s facing the system. A possible intensification of trade pressures between the large powers is the underlying concern. We see more active leadership from the large players in the system as needed,⁴⁹ and this need for leadership to deal with the changes that confront the system as not being met by the Round that is

45. In an effort to help further the slow progress of the Uruguay negotiations towards a successful outcome, there has been appointed a new Eminent Persons Group consisting of 10 members from major trading countries. According to the group, "Failure [of the GATT talks] could plunge the world into trade stagnation, recession and strained links between trading blocs", *Financial Times*, March 26, 1990, p.5. See also "EC 'distracted' from Uruguay Round", *Financial Times*, March 24, 1990, p.3.

46. See GATT (1983b), Ministerial Declaration, November 19, 1982, p.9, which states "[i]n the current crisis of the world economy, to which the lack of convergence in national economic policies has contributed, protectionist pressures on governments have multiplied, disregard of GATT disciplines has increased and certain shortcomings in the functioning of the GATT system have been accentuated."

47. For further discussion of the launch of the Uruguay Round and the role of the small and mid-sized countries, see Whalley (ed.) (1989b) Appendix B.

48. The final meeting is to be held in Brussels between November 26 and December 8, 1990. See GATT (1989c).

49. As Kindleberger (1981) p.253 puts it "without a stabilizer, the system is unstable".

currently underway. We also do not see another multilateral round of trade negotiations as the answer. Realistically, such a round could not be mounted until the mid-1990s at the earliest, and perhaps concluded by the end of the decade. Even if successful, this would be too slow in producing results, given the immediate challenges facing the system.

The Proposal

Our approach, therefore, is to encourage more active joint leadership on trade issues from the three large powers in the system (the E.C., the U.S. and Japan). These trading regions clearly have a strong joint and mutual interest in a well-functioning trading system which minimizes trade conflict and the probability of trade wars. Active management on their part, along the lines of the two-tier system scenario, which may anyway be emerging in the system, will go some way towards achieving these goals.

What we propose is an arrangement which would involve stronger joint major-power leadership in the system, but which we would also see as GATT-consistent and hence capable of strengthening the GATT system. Pending the launch and outcome of a further round of multilateral GATT trade negotiations beyond the Uruguay Round, we would suggest the three major powers in the system develop a trilateral framework which could put in place mechanisms to help in defusing future trade conflicts and heading off potential trade wars.⁵⁰ This could involve a gradation of measures varying in strength depending upon how far the three powers might be willing to go in their joint commitments.

We would begin with a firm statement of commitment by Japan, the United States and the European Community to the need to strengthen their trilateral trade arrangements to minimize the risk of major trade conflict, but to do so in a GATT-compatible manner. The endorsement of this approach by other GATT Contracting Parties would then allow efforts to be made to take this commitment further through a series of joint commitments and arrangements.

One might be an enlargement of the new GATT trade monitoring process agreed to in the Uruguay Round; the Trade Policy Review Mechanism. Under this, the three major powers could jointly support a larger effort which would monitor their mutual trade flows, barriers against each other, as well as emerging conflicts and market situations; acting, in effect, as an early warning system on trade disputes and committing more resources to the GATT Secretariat for what is a more assertive and investigative process than currently. Early identification of emerging problems we see as central in helping defuse the conflicts which might result.

Another might be a joint commitment by all three powers to either jointly forgo the use of GATT Article 12 and 19 measures, particularly where they involve major trade flows between one another, or if that goes too far, to a 'cooling off' period. This cooling off period could be for a year, pending

50. Hufbauer (1989) instead suggests the establishment of a Free Trade and Investment Area between the OECD countries. For other suggestions for the reform of the system, see Choate and Linger (1988), Preeg (1989), Bergsten (forthcoming) and Jones (1989). See also Samuels (1990). For earlier discussion of system reform, see Camps (1981) and Atlantic Council of the United States (1976).

notification of intent, and this may give sufficient time for the macro imbalances which might underlie such problems to improve, and other ways of approaching outstanding trade problems to be explored. A danger in the present situation is that circumstances may develop, such as a further worsening of the U.S. trade deficit, which could result in one or more of the three larger trading regions using trade-restricting measures compatible with the existing Escape Clause provisions of the GATT; namely, actions under Article 12 (Balance of Payments) or Article 19 (Safeguards). The use of a temporary import surcharge with an across-the-board tariff of, say 25 percent by the United States⁵¹ two years from now, following a further deterioration in the U.S. trade deficit, could result in a period of major difficulty for the trading system, with the possibility of countermeasures by Japan and Europe and resulting global turmoil.

We also see opportunities for the three major powers to reach agreements which may fend off trade pressures on other fronts. For instance, in the late 1980s instances arose where one of the three regions applied bilateral pressure to a smaller trading region to make a concession on a non-MFN basis. Where these concessions were made in a discriminatory manner, the other large regions would then also request the same concession, generating further trade pressures. An example is the bilateral threats which the United States made against Korea in the late 1980s, involving GSP graduation unless there was a change in patent arrangements in Korea away from process to product patents. The concessions which Korea made were limited in application to the United States. This subsequently induced the European Community to also threaten GSP graduation for Korea unless these benefits were also fully extended to the Community. When Korea did not do this, the Community subsequently graduated Korea.⁵²

In this environment, one possible avenue for agreement might be that where any of the three powers engage in bilateral negotiation with smaller trading partners, concessions requested of these trading partners would always be fully MFN, with the benefits fully extended to all other trading partners. This would help relieve pressures of the kind indicated above.

The three large powers could go even further and consider the possibility of implementing arrangements that would freeze problem situations where they are now. They could, for instance, commit themselves to no new bilateral negotiation of a comprehensive form, for an agreed period of time, pending developments in the GATT and on other fronts. This would help relieve further pressures in the system: the suspicion in the United States of exclusion from Europe 1992, the concerns in Japan and the E.C. of exclusions from U.S.-Canada and U.S.-Mexico arrangements, and the confusion in the United States and Europe over Japanese intentions towards ASEAN.

These are all examples of concrete measures and agreements which we would see as possible for the three large powers to agree on beyond their existing GATT obligations. The aim would be to provide more active leadership and management in the trading system than currently exists, and encourage the large powers to

51. In response to the mounting bilateral imbalances faced by the U.S. in the early 1980s, a number of surcharge bills were introduced in the U.S. Congress in 1985. For further discussion, see Rousslang and Suomela (1985).

52. For further examples of bilateral pressures, see Whalley (1989a).

act co-operatively so as to strengthen the system. We would also see such a three-power framework as coexisting alongside discussions on international financial issues: exchange rates, debt issues and interest rates. Major-power leadership in these financial areas has long been accepted, as reflected in the Plaza Agreement of 1985, the Louvre Agreement of 1987, and in other fora discussing exchange rate and other financial issues.⁵³ Given the heightened volatility in exchange rates in the 1980s, factoring in real side trade aspects of the wider relationship between the three major powers, seems a natural way to proceed.

We are aware that the proposals we make may not be received with uniform enthusiasm because it will be seen as contrary to the commitment to multilateralism in the GATT system. Such an arrangement might *de facto* establish collusion between the large trading powers⁵⁴; and at the same time, lead to *de facto* fragmentation of the trading system into large three trading areas with satellite, or client, trading partners attached to each of the large powers.

We accept that these are concerns, but at the same time, the stresses we see emerging in the system in the 1990s suggests to us there is no other obvious way of proceeding. A single multilateral framework in which all countries are thought to be of equal importance to the system, and in which all countries negotiate simultaneously, does not, in our opinion, meet the need of the early 1990s to fend off the possibility of major trade conflicts between the large powers which could adversely harm the trade interests of all countries in the system. Indeed, rather than fragmenting the system, we see our proposal as strengthening the system through a series of GATT-consistent arrangements which would involve the large powers making commitments, one with another, beyond their existing GATT obligations. GATT compatibility is, therefore, central to what we propose.⁵⁵

In summary then, we argue for the need for more active leadership and management in the trading system by the three large powers to deal with what we see as potential dangers for the global trading system in the 1990s, which could, in the worst case scenario, lead to outbreaks of significant trade wars.

SUMMARY AND CONCLUDING COMMENTS

In this paper, we have attempted to set out some of the emerging sources of strain for the GATT system in the 1990s. We suggest that the trading system of the post-war years presents something of a paradox; a system which seemingly has performed extremely well in terms of trade creation, trade growth and prevention of major trade wars. But at the same time, it is a system widely acknowledged to be weak in terms of its underlying disciplines, and a system

53. For further discussion, see Bergsten (forthcoming) and Funabashi (1988).

54. Bryant and Hodgkinson (1989) p.7, note "[i]n practice a judgment has to be made about which is the greater danger: that in the absence of cooperation between governments, international interaction will work to the detriment of public policy . . . or, alternatively, that collusion between governments will work against the public interest." In their view, "cooperation between governments, particularly democratic governments, can be plausibly expected to further the collective interests of their people."

55. We would also see the involvement of other parties as a possibility. Such involvement would tend to weaken and slow down the three-country active management process which we advocate, but it may be that an observer jointly nominated by the other GATT Contracting Parties, might help, especially in facilitating information flow.

which has become severely eroded as far as its underlying principles are concerned.

We suggest that these reflect two important features of the system that have been present since its early years: the dominance of one single country - the U.S., and the linkage between trade policy and wider strategic interests. It is recent changes in these two areas which we see as motivating a re-evaluation at this time of where the system should now head in the 1990s.

The end of the Cold War has eroded the strategic bond which, in our opinion, has partly held the system together in the post-war years. In addition, the emergence of a tripolar world, based on Europe, the United States and Japan, introduces potential new sources of conflict into the system. When we combine these developments with increased rapidity of change and possible future macro shocks to the system down the line, we see a need for an elevated level of leadership, management and activism with respect to trading system issues in the 1990s by the three large powers. The idea would be to put in place a firmer set of institutional arrangements which could fend off trade conflicts as they emerge and help prevent any future trade wars.

The proposal we set out is that the three large trading areas in the system - the E.C., the U.S. and Japan - jointly commit themselves to a series of agreements which demonstrate their commitment to more active management of the system, but do so in ways which are consistent with their GATT obligations. We set out a series of possible measures, beginning with an early warning/joint monitoring of trade flows, barriers and industry situations; to possible contractual agreements involving a 'cooling off' period in the event of any use of GATT-compatible trade restricting measures under Articles 12 and 19 against each other; agreements to ensure that any form of trade agreements with smaller countries as a result of bilateral negotiations be fully MFN-compatible; to potential agreements involving no new bilateral agreements by each of the three powers for a specified period of time. We also suggest that a large-power, trade-based mechanism of this kind might also be able to interface with G-7 exchange rate and macro discussions.

In our view, the Uruguay Round of GATT negotiations, while helpful, is unlikely to provide a strong enough response to the need we define. In part, this is because the Round is a response to the problems generated by the 1981-82 recession as well as to issues left over from the Tokyo Round, and is not a response to the problems of the early 1990s. In addition, GATT negotiating rounds take a substantial period of time to both initiate and conclude. The present round is due to finish in 1990, implementation will, in all probability, take place through the mid-1990s. To use another round of GATT negotiations to deal with the emerging sources of stress in the system that we raise here, we see as too little and too late.

There are clearly dangers in our proposal; it could lead to a collusive arrangement in which the three largest powers in the system gang up on other trading parties. One can even argue that it might eventually lead to a fragmentation of the present multilateral trading system. We are aware of such dangers, and argue in the text that the need we see for the trading system in the 1990s is for more active management and leadership to prevent trade conflicts which, in the worse case scenario, could eventually seriously affect all countries. In our mind, benefits in this direction outweigh concerns on these other scores. We see

the measures of the type that we propose as being fully GATT-compatible and will lead to a strengthening of both the system and its credibility by putting in place firmer measures which will help prevent the outbreak of trade wars. The arrangements would be made temporary, pending the conclusion of yet a further trade round to follow on after the present Uruguay Round, even if it is ten or fifteen years before it concludes.

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