ROGRESS IN POSTWAR INTERNATIONAL RELATIONS

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EMBEDDED LIBERALISM REVISITED: INSTITUTIONS AND PROGRESS IN INTERNATIONAL ECONOMIC RELATIONS

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A recurrent theme in the popular press and some academic accounts holds that the postwar economic regimes have already collapsed, or are in the process of doing so, with dire consequences ahead for international economic relations. Monetary disorder, neo-nationalist protectionism in trade, and a more generalized lack of leadership and external discipline, it is said, are coming to prevail. There is a measure of truth in these claims: Instances of each of these disturbing features can be found in current international economic relations. At the same time, however, there are good grounds to question the extent to which the conventional wisdom has fully grasped actual patterns of continuity and change. Above all, these scenarios of imminent calamity have been with us for nearly two decades now, from the alleged "collapse" of Bretton Woods and the anticipated "trade wars" of the early 1970s.[1] "Not since the 1930s . . ." has been a staple of economic commentary ever since. But two decades is not an unsubstantial period of time. For example, it is equivalent to the *entire* interwar period, which we routinely treat as an era of the twentieth century. Moreover, even when the conventional wisdom is descriptively accurate, the inferences drawn from

the descriptions are often exaggerated or yield anomalous conclusions.

If imminence fails to materialize over such an extended duration and if anomalies abound, then it may be worth exploring whether there is something amiss, not in the world of actual state behavior, but in the model of state behavior that analysts are bringing to bear on it. That, at any rate, is the proposition I explore here.

In the first section, I lay out what I take to have been the basic institutional framework by which the capitalist countries sought to come to grips with the twin desires of domestic and international economic stability at the outset of the postwar period—which I capture by the term *embedded liberalism,* in contradistinction to orthodox liberalism. Next, I sketch in the salient features of the postwar monetary and trade regimes through which the embedded liberalism compromise was enacted. I then examine actual patterns of state behavior in monetary and trade relations up to the present and show that what appears as anomalous behavior when viewed through the lenses of the conventional wisdom is quite consistent with the expectations of the embedded liberalism model. Finally, I conclude by suggesting that the bogus fears of the "new protectionism" mask very real progress in international economic relations during the postwar era—"instrumental progress" in the terminology of this volume—insofar as states appear to have institutionalized certain norms and precepts that make a recurrence of the 1930s a low-probability event.

THE EMBEDDED LIBERALISM COMPROMISE

As U.S. policymakers originally envisioned the postwar international economic order, their chief objective was that it be nondiscriminatory, which is to say that it reflect the principle of the open door. No mutually exclusive economic blocs were to be permitted, no beggar-thy-neighbor policies followed. Moreover, the United States favored the reduction of barriers to the flow of international economic transactions, especially those that lacked transparency and were difficult to apply in a nondiscriminatory manner. The international division of labor that would emerge as a result of these measures would enhance not only American but also global welfare, U.S. policymakers believed, while minimizing economic sources of inter-

national conflict. The mutually destructive consequences of the external economic policies states pursued in the 1930s were invoked as evidence to justify these beliefs.

At the same time, the postwar designs of U.S. policymakers also reflected another reality of the interwar years: the growing demand for and acceptability of state intervention in domestic economies, attempting to stabilize employment and prices in the face of the cyclical fluctuations that had always inhered in capitalist development. Indeed, the New Deal became an international showcase of sorts, an inspiration to both the theory and practice of reformist economic policy formation abroad. Neither the New York banking community nor the Republican party was much enamored by what they regarded as New Deal gimmickry, in domestic and international economic policy alike, but their views, although significant, did not prevail.

As a result, steps by the United States toward liberalization were coupled from the outset with measures to safeguard domestic stability. The Reciprocal Trade Agreements Act of 1934 typically is cited as heralding the American quest for liberalism to come. Yet, as Stephan Haggard has pointed out, President Roosevelt put off its submission to the Congress until domestic legislation was in place shielding business and agriculture from external threats and extending new guarantees to labor. And even then it contained escape clause provisions, permitting temporary protection of industries injured by liberalizing concessions.[2] What was politically expedient in the United States in 1934 had reached the status of historical first principle abroad by 1944: no liberalization without safeguards.

And so emerged the compromise of embedded liberalism, the grand domestic and international political bargain on which the postwar economic regimes came to rest: unlike the economic nationalism of the 1930s, the international economic order would be multilateral in character; but unlike the liberalism of the gold standard and free trade, its multilateralism would be predicated upon domestic interventionism.[3] Domestically, this was a compromise between the major social groupings (agriculture, labor, and capital), as well as between export-oriented and import-competing industries. Internationally, it was a compromise between the United States, where domestic stabilization measures remained the least comprehensive and systematic, and the most constrained by opposition, and the

European states, where rejection of liberal orthodoxy was universal but the objects of economic protection varied widely among the left, right, and center of the political spectrum.[4]

In sum, the broad expectation was held in governing circles at the dawn of the postwar era that the international economic order would become multilateral in form. Movement toward greater openness in the international economy, however, would be coupled with safeguards that acknowledged and even facilitated the interventionist character of the modern capitalist state. But the measures adopted to effect such domestic cushioning also were expected to be commensurate with the extent of the external disruptions and compatible with the long-term expansion of international economic transactions.

THE BRETTON WOODS REGIMES[5]

On the monetary side, by the time of the Anglo-American "Joint Statement of Principles," issued not long before the Bretton Woods Conference, a consensus had emerged between these two nations that provided for free and stable exchanges, on the one hand, and, on the other, the erection of a "double screen," in Richard Cooper's suggestive words,[6] to cushion the domestic economy against the strictures of the balance of payments.[7] Free exchanges would be assured by the abolition of all forms of exchange controls and restrictions on current transactions. Stable exchanges would be secured by setting and maintaining official par values, expressed in terms of gold. The "double screen" would consist of short-term assistance to finance payments deficits on current account, provided by an International Monetary Fund, and, so as to correct a "fundamental disequilibrium," the ability to exchange rates with Fund concurrence. Governments would be permitted to maintain control over capital movements.

In devising the instruments of the monetary regime, the most intense negotiations were occasioned by the functioning of the "double screen." On the question of the Fund, the British, in the person of John Maynard Keynes, had argued for an international overdraft facility, a Clearing Union. This would have created some $25 to $30 billion in new liquidity, with the overall balance of credits and debits in the Fund being expressed in an international unit of account that was to be monetized. The arrangement would have been self-clearing unless a country were out of balance with the system as a whole, in

which case complementary corrective measures were called for on the part of surplus and deficit countries alike. The ceiling could be raised by simple intergovernmental agreement, as additional liquidity was required to finance international trade. The U.S. plan, proposed by Harry Dexter White, the American counterpart of Keynes in these negotiations, originally called for a mere $5 billion Fund, though the United States ultimately agreed to $8.8 billion. However, these funds had to be paid in by subscription, as opposed to being created by agreement. Both access to the Fund and total liability were strictly limited by quotas, as were voting rights, all of which in turn reflected paid-in subscriptions—the initial U.S. contribution was $3.175 billion. Additional liquidity would come from increased gold production and the more costly process of increasing quotas (subscriptions). Moreover, a country that sought to draw on the Fund had to make "representations" that it needed assistance for making payments on current account, and for no other reason. Thus, with the United States, the only major creditor country in sight, seeking to limit its liabilities, the first part of the "double screen" was both more modest and more rigid than the United Kingdom and other potential debtor countries would have liked. But there was no question about its being provided.

On the second part, exchange rate changes, the United Kingdom was more successful in assuring automaticity and limiting intrusions into the domain of domestic policy. The Fund was required to concur in any change necessary to correct a "fundamental disequilibrium," and if the change was less than 10 percent, the Fund was given no power even to raise objections. Most important, the Fund could not oppose *any* exchange rate change on the grounds that the domestic social policies of the country requesting the change had led to the disequilibrium that made the change necessary.

Interestingly, the central issue of international liquidity generated relatively little discussion. In all probability, this was for two reasons. First, under the British overdraft scheme international liquidity would have been a nonissue, or at least only a minor issue, since accounts had to balance out while the ceiling could be raised as needed, and the British were too preoccupied with salvaging their scheme to pay close attention to alternative solutions to the liquidity problem. Second, the United States was not keen to have the issue discussed, counting all along on the U.S. dollar emerging as the chief interna-

tional medium of national currency reserves. And of course it did. All currencies were valued against the dollar and the dollar against gold; all countries in practice would use dollars to clear their international accounts and the dollar would be convertible into gold on demand. As a result, however, with gold production subsequently being inadequate and quota increases constrained by U.S. voting power, U.S. payments deficits became the major source of international liquidity.

Once negotiations on postwar commercial arrangements got under way seriously, in the context of an International Conference on Trade and Employment, the principles of multilateralism and tariff reduction were affirmed, but so were safeguards, exemptions, exceptions, and restrictions—all designed to protect the balance of payments and a variety of domestic social policies.[8] The proposed Charter for an all-encompassing International Trade Organization became internally so inconsistent that it is difficult to say just what sort of regime it would have given rise to. In any case, the U.S. Senate refused to ratify the Charter, it being too intrusive for some and not activist enough for others, as a result of which a far smaller domain of commercial relations became subject to the international regime than would have been the case otherwise. Among the most important areas excluded thereby were the regulation of commodity markets, restrictive business practices, and international investments. The more traditional concerns of commercial policy—tariffs, quotas, and the like—were addressed by the General Agreement on Tariffs and Trade (GATT), which the United States quickly helped to form and joined by executive order.

The GATT made obligatory the most-favored-nation rule, but a blanket exception had to be allowed for all existing preferential agreements (a U.S. concession to Britain), and countries were permitted to form customs unions and free trade areas (U.S. encouragement to Western Europe). Moreover, quantitative import restrictions were prohibited, but were deemed suitable measures for safeguarding the balance of payments—*explicitly* including payments difficulties that resulted from domestic full-employment policies. They could also be invoked in agricultural trade if they were used in conjunction with a domestic price support program. The substantial reduction of tariffs and other barriers to trade was called for, but it was *not* made obligatory, and it was coupled with appropriate emergency actions, which

were allowed if a domestic producer was threatened with injury from import competition that was due to past tariff concessions. The Agreement also offered a blanket escape from any of its obligations, provided that two thirds of the contracting parties approved—the United States promptly availed itself of the opportunity to exclude its entire agricultural trade from international scrutiny. Lastly, procedures were provided to settle disputes arising under the Agreement and for the multilateral surveillance of the invocation of most (though not all) of its escape clauses. The principle of reciprocity was enshrined as a code of conduct, to guide both tariff reductions and the determination of compensation for injuries suffered.

In the minds of White and Keynes, the institutional edifice necessary for a viable international economic order to emerge would require yet a third pillar: the intergovernmental provision of investment capital. Neither thought that private sources of investment funds alone could do the job, and they pointed to the erratic patterns of capital flows in the interwar period as proof positive. Hence, both turned to intergovernmental schemes. Indeed, White's first draft plan for an "Inter-Allied Bank" was more ambitious than his corresponding proposal for a monetary fund. The Bank would have a capital stock of $10 billion and was designed to engage in countercyclical investment as well as the stabilization of commodity prices. Keynes's proposal was more tentative, because for him much hinged on whether or not his Clearing Union was adopted, but he leaned toward an international mechanism to coordinate national investment plans. Needless to say, neither the United States nor the United Kingdom was interested in so constraining their national discretion or the future of their national capital markets, a sentiment that was echoed if not amplified by their respective financial centers. The International Bank for Reconstruction and Development (World Bank) that ultimately emerged from the Bretton Woods negotiations was barely a pale shadow of these initial plans.

These efforts to construct multilateral economic regimes did not succeed until the 1950s. Only then had European leaders acquired the confidence to undertake the process of liberalization. The European Economic Community had been formed, the IMF agreements became fully operational, and successive rounds of GATT negotiations got under way that would virtually eliminate tariff barriers to trade and unleash the most sustained period of economic growth

ever. Getting from "here to there" required massive doses of direct U.S. assistance: economic assistance in the form of the Marshall Plan, and security assistance in the form of NATO.[9] With the Marshall Plan bearing the brunt of European reconstruction financing, the World Bank's initial mission, the Bank slowly turned its attention to becoming a development finance institutions. These changes went hand in hand with an overall reorientation of U.S. foreign policy, whereby the United States moved from being "arsenal" of to an "agent" for reconstruction abroad.[10] In the process, the monetary and trade regimes lost the universalism that would have been provided by socialist membership, whereas European and Japanese particularisms were encouraged.

PATTERNS OF CHANGE AND CONTINUITY

In a major survey of international monetary reform published in 1985, *The Economist* wrote: "How easy to say that, in the early 1970s, the Bretton Woods system 'collapsed' or was 'swept away.' Easy but unfortunate." It went on to exclaim: "Of course, fixed rates were replaced by floating ones—but was that the change that mattered . . . ? Certainly, governments were freed of the external discipline of maintaining parity; but didn't they still face other disciplines . . . ?"[11] In point of fact, neither the monetary nor the trade regime has ever functioned as designed. What is more, over the course of time, specific instruments of the two regimes have been abandoned; deviations from rules have not been unusual and may be becoming more frequent; and even core norms are sometimes disregarded with impunity as governments pursue their national objectives. All of this is well known and beyond dispute. What remains in contention is its significance, and what it signifies.

How can perfectly reasonable and intelligent observers differ on so basic an issue as whether or not a regime has collapsed? Because they bring very different mind-sets to bear on the question. At least three such sources of distortion have been identified in the monetary realm. Peter Kenen cites one: "Without always knowing, most of us have judged events, decisions, and proposals by an idealistic, cosmopolitan criterion. We have asked how far each step has taken us toward the creation of a world money to which national monies would be subordinated and by which they might some day be sup-

planted."[12] Seen in this light, most efforts at monetary reform may well look like "slapstick comedy," which is how Robert Triffin dismissed the 1976 Jamaica Accords that enshrined floating exchange rates.[13] Yet the governments involved appeared to take it reasonably seriously. *The Economist* describes another prevalent mind-set. "Some people like to have things written down and agreed: to them, the international monetary system should indeed be a system, complete with charters and pacts. Others feel that messy evolution is inevitable, and better for it." As it happens, governments appear to prefer changes of the messy sort. Finally, Robert Aliber sardonically characterizes yet a third widespread mind-set as the willingness on the part of some analysts to "risk sacrificing the state to save the constitution"—that is, to expect governments to adhere rigidly to rules, no matter what the conditions, and no matter what the consequences.[14] Governments have not been prone to oblige. Similar mind-sets are at work in commentaries on the trade regime, except there the emotive appeal of orderliness and texts if anything is heightened by virtue of the greater involvement of international legal scholars.

Assessing the efficacy of international economic regimes, then, is not an easy or straightforward task, like checking off a list of performance criteria for a home furnace or an automobile engine. The underlying core problem is that, ultimately, there exists no Archimedean point from which regimes can be viewed as they "truly" are. In the final analysis the "reality" of regimes resides in the principled and shared understandings of desirable and acceptable forms of behavior among the relevant actors. Adaptations to new and unforeseen developments, attenuating circumstances, the rationales and justifications for deviations that are proffered, as well as the responsiveness to such reasoning on the part of other states, all are critical in assessing the efficacy of regimes. As *The Economist* put it, "even the breaching gives the government a chance to explain why some departure from plan was necessary or inevitable."[15] Such communicative dynamics may tell us more about how robust a regime is than actual behavior alone.[16]

From the vantage of this perspective, international regimes are not expected to produce saints from sinners, but only to keep their sins within more or less mutually permissible bounds. Nor are international regimes defined by an unwavering commitment to specific instrumentalities, which *should* change so as to accommodate the

many situational differences that inevitably emerge over time, but by how compatible these instrumentalities remain with the underlying normative understandings that animate the regimes, given currently prevailing circumstances. Governments in the trenches, not analysts perched on Archimedean points, are the ultimate judges of what constitutes compatibility.[17]

Next, I briefly examine the most commonly discussed changes in the monetary and trade regimes; and I suggest that there is less to fear from the conventional problems than is typically assumed.

The Monetary Regime

Seen against the background of the abusive currency practices of the interwar period, a singular achievement of the postwar monetary regime has been the creation of a nondiscriminatory system of currency exchanges. All major currencies are fully convertible into one another; none is governed by multiple exchange rates or other rationing schemes; and the remaining deviations either are insignificant, which is the case for controlled Third World currencies, or, as in the case of the socialist country currencies, are undergoing the slow and wrenching process of moving toward greater convertibility. This core dimension of multilateralism in monetary relations, the desire for which so animated the Bretton Woods negotiators, is so deeply instituted and taken for granted today that it is rarely even mentioned in assessments of the monetary regime.

When analysts today speak of the collapse of Bretton Woods they have in mind two other—and in my judgment, two lesser—features: fixed rates of exchange, and the gold convertibility of the U.S. dollar. And what they fear most is that excessive variability of exchange rates and increased disaffection with the management of the dollar, in addition to generating economic inefficiencies, will lead to greater monetary and trade protectionism, thereby indirectly evoking discriminatory practices.

Fixed Exchange Rates. Let us begin with fixed rates of exchange. We would do well to remind ourselves that under a system of *truly* fixed exchange rates, governments are expected to subordinate their domestic policies to the maintenance of parity: "monetary policy, as usually conceived, ceases to be a discretionary instrument

of policy. The money supply on any meaningful definition must be altered if necessary to preserve the exchange rate."[18] It is safe to say that no government present at the Bretton Woods conference would have accepted this stricture had it been proposed. But of course it wasn't. Under the Bretton Woods arrangement, exchange rates were *expected* to change if necessary to correct "fundamental" disequilibria —a concept that remained undefined because governments would only know one when they saw one.

Thus, exchange rates were not fixed but were on an adjustable peg. This system in turn proved flawed because of several well-known factors. Surplus countries, particularly Germany and Japan, basking in the presumed virtue of surpluses and enjoying the competitive advantage of undervalued currencies, refused to revalue upward as much or as frequently as required. Deficit countries for their part were afraid of losing face and waited until the last minute to devalue. And the United States was prevented from making any change in the value of the dollar against other currencies because its price was fixed in terms of gold. For all practical purposes, then, there never was an effective means of routinely adjusting currency values to fundamental disequilibria. The adjustable peg system therefore was inherently unsustainable; only the timing of its demise was in doubt.

What is more, although controls on capital movements were not formally mandated by the Bretton Woods scheme, Richard Cooper points out that its internal logic required them, and they were expected to remain in place.[19] This too would have proved unsustainable in the long run, as it presupposed the ability to differentiate sharply between current and capital account transactions, a distinction that would have become murky as the volume of direct foreign investment and long-term trade credits continued to expand. But governments in addition deliberately chose to liberalize capital markets as a matter of policy preference. This combination of capital mobility and discrete exchange rate changes in turn "produced the celebrated one-way option for currency speculation" that was responsible for the recurrent exchange rate crises of the 1960s—when decisions to change rates were delayed so long that their inevitability provided a sure bet to speculators.[20] The inherent incompatibility of these two features of the monetary regime, capital mobility and pegged rates of exchange, both of which were deemed desirable in

their own right, sooner or later would have forced the abandonment of one or the other. The surging U.S. inflation of the Johnson era, produced by expenditures for Vietnam and Great Society programs that were funded by monetary expansion rather than taxes, provided the proximate cause.

Accordingly, by the time governments adopted floating exchange rates in 1973, the choice *as they understood it* was "not between floating and fixed rates, but between rates changing by small amounts on a day-to-day basis and those changing at longer intervals by substantial percentages and usually only after macroeconomic policy debacles, welfare-reducing direct controls, and repeated foreign exchange crisis."[21] And they adopted a system of floating rates in the hope of securing greater domestic stability while preserving the relatively open trading and financial systems—objectives that surely were in keeping with the political framework of Bretton Woods. Besides, most of the world's currencies do not float even today but are pegged to a small handfull of key currencies that do.[22]

The Gold-Convertible Dollar. We saw earlier that the liquidity provisions of Bretton Woods were ambiguous from the start and proved inadequate in the event. As a result, the dollar exchange standard was already in trouble when the monetary regime first began to function as designed. In 1958, just as the Europeans were resuming full convertibility of their currencies, U.S. gold reserves fell permanently below U.S. overseas liabilities. And before the next year was out, Professor Triffin articulated the famous "dilemma" that bears his name.[23] Throughout the 1960s, a seemingly endless series of stop-gap measures was tried in an effort to devise what Robert Roosa, former Under Secretary of the Treasury, called "outer perimeter defense" for the dollar. Roughly speaking, these measures were designed to make gold conversion of dollars financially unattractive, to increase the capacity of the IMF to supply liquidity, and to increase the capacity of central banks to neutralize the flow of speculative capital. The United States also "taxed" its allies for military services provided by obtaining offset payments from them and through the exercise of seigniorage. And the United States undertook limited domestic measures to reduce its payments deficits while pressuring surplus countries to revalue their currencies. By 1968, however, the

dollar had become in effect inconvertible into gold; it was declared formally so in 1971.

It is absolutely crucial to note, however, that although the link of the dollar to gold may have been "psychologically important," it was "technically tenuous."[24] That is so because it had not provided a principled basis for determining the overall world monetary condition in the first place. As Cooper explains, pegging the value of currencies in the manner of the Bretton Woods scheme "determines the price level of each country in relation to the others, but it does not determine the world price level."[25] So long as the United States pursued domestic economic policies that were conducive to international monetary stability, the problem remained masked. As the United States became unable and unwilling to perform that international public service, the problem became unmasked. But it had been no more resolved before 1971 than it is today; the problem has existed throughout.

It should also be noted that none of the major monetary powers has rushed forward with structural solutions to this congenital defect in the Bretton Woods regime. Like the United States, they have been content to patch things up around the edges. When the dollar has gone on one of its periodic wild gyrations—the sharp depreciation of 1978 and the staggering appreciation of 1981–1985 being prime instances—they of course have shown irritation; they have jawboned the United States; and the Europeans specifically have sought to limit the dislocating effects among themselves through further monetary integration. These governments have also from time to time coordinated extensive exchange market interventions, as in the Plaza Agreement of 1985 that sought to assure a "soft landing" for the dollar once its ascent had reversed. And they have provided substantial unilateral assistance: the financial analyst David Hale recently quipped that the Bank of Japan should have had to register as a GOP political-action committee in the 1988 U.S. presidential election, so helpful was it to supporting the dollar and thus to the Bush campaign.[26]

But to date none of these governments has been prepared to have their currencies play a truly significant international reserve currency role. There is no desire among them to return to a full-fledged gold standard, nor a consensus to construct a different commodity-based reserve asset, nor even to expand significantly the use of the IMF

collectively created Special Drawing Rights. Indeed, so modest a modification as the Substitution Account proposed in 1979, whereby some portion of "unwanted" dollars could have been traded in for an IMF asset, was rejected in part over squabbles about the allocation of exchange rate risks and interest payments—just before the dollar glut was overtaken by a renewed scramble for dollars as a result of the second oil shock.

One final point deserves mention here. The specter of "currency blocs" is often adduced as a possible outcome of current international monetary practices, with the shadow of the 1930s projected ominously over today's exchange markets. The major candidates today are blocs organized around the U.S. dollar, the yen, and the European monetary system. The predicted emergence of these blocs may turn out to be correct; but the implied deleterious consequences simply do not follow. Peter Kenen has put this very well: "A currency bloc does not imply discrimination against outsiders, nor does it necessarily imply the internal exploitation that arose in some blocs during the 1930s."[27] Pegging one's currency to that of a neighbor, or closely aligning currencies within a group, in and of themselves are entirely neutral with respect to the norm of nondiscrimination. Only in the service of discriminatory norms do they become discriminatory practices. In contrast, under present circumstances such blocs actually may be helpful, by muting protectionist pressures on the trade front, reducing the vulnerability of the monetary regime to the fate of the dollar, and lowering the transaction costs of policy coordination among the three leading monetary authorities.

Volatility. Even most critics of the current international monetary arrangements agree that they helped absorb the extreme duress of the 1970s: the two oil shocks, double-digit inflation in the major OECD countries, and a complete and sudden reversal of prevailing current account balances that was unprecedented in peacetime. Floating exchange rates and liberalized capital markets were the central mechanisms of adjustment; the formal apparatus of the IMF played a relatively minor role. At the same time, there exists a growing unease that these mechanisms, far from providing the long-term international stability and relative domestic autonomy their advocates promised, are also responsible for increased volatility of exchange rates that have real and adverse consequences, both domest-

ically and internationally. Once again, the facts are clear but the implications more ambiguous: "Market-determined exchange rates have exhibited wild instability beyond the fondest nightmares of fixed-rate fanatics, yet trade and investment flows seem relatively unaffected by these changes."[28] The answer to what appears to be going on here has two elements.

A clue to the first can be found in the relationship between the U.S. current account balance and the dollar exchange rate between 1981 and 1985: it defied all conventional understanding. While the U.S. trade deficit exploded from some $9 billion to over $100 billion, and as the United States was shifting toward net debtor status, the exchange rate of the dollar *appreciated* some 60 percent in real terms! Trade may well have "the last laugh," as *The Economist* claims,[29] but clearly the capital account gets some chuckles along the way. For what happened in the case of the United States was a vast inflow of foreign funds, attracted by interest rates, investment opportunities, a favorable fiscal environment, and political stability.

This case illustrates a deeper and more profound institutional development in the world economy: international capital markets have been cut loose from their role as servants to international trade. Their relative magnitude now dwarfs world trade flows. In 1984, world trade amounted to some $2 trillion; Eurocurrency deposits alone were about $2.4 trillion; and international capital movements as a whole ranged somewhere between a low estimate of $20 trillion to a high of $50 trillion.[30] Moreover, whereas capital movements historically reflected business decisions to finance trade or to establish production facilities abroad, "it seems apparent that the dominant proportion of the investment funds actually in movement internationally today reflects instead decisions concerning portfolio holdings . . . , shifts among holdings of various kinds of intangible assets."[31] Finally, as far as the international capital markets are concerned, the major currencies in the process have become simply one of those intangible assets. "The central message of the post-1973 experience is that the foreign exchange market is an asset market and that the economic laws governing exchange rates are fundamentally similar to those governing other asset prices, with stock and bond markets providing obvious domestic analogies. In fact, while exchange rates have indeed been volatile, their volatility has been less than that of stock prices."[32]

A clue to the second element of the answer to what is going on follows from the conclusion of the first. If exchange markets indeed have become like other asset markets, then it is entirely possible that economic actors have learned to treat them accordingly. Volatility, therefore, does not *ipso facto* constitute a fatal flaw of the international monetary regime, for volatility in and of itself tells us nothing about actor expectations and anticipation. Students of international regimes should appreciate this point: after all, they define regimes in terms of *convergent expectations,* not actual outcomes. An attempt by Allan Meltzer to differentiate expectations and outcomes across international monetary regimes from the 1890s to the 1980s yields some interesting (though preliminary) results. To begin with, Meltzer finds that not all measures of variability in actual outcomes have in fact increased over time: variability in nominal and real GNP was higher under the classical gold standard than in the post–World War II era, though variance in price level is higher now; money growth shows no consistent pattern. What is most interesting, however, is Meltzer's finding that variation in forecast errors has declined both in absolute value and relative to the variance in actual outcomes. As a result, though some measures of volatility may be higher today, risk and uncertainty are uniformly lower. "By prewar standards, the period of fluctuating exchange rates has been remarkably stable, if stability is measured by short-term predictability (the variance of errors in quarterly forecasts)."[33] In sum, not only actual volatility, but also expectations about it and thus presumably adaptations to it, need to be considered when predicting its effects.

The increasingly complex and indirect relationship between exchange rates, current account balances, and capital flows, together with Meltzer's conclusions about declining macroeconomic risks and uncertainties under managed monetary regimes, take us a long way toward explaining why the obvious volatility in exchange rates of recent years has had only limited effects on trade and investment flows and on the attitudes of governments. They also suggest why exchange market intervention by governments as a means to stabilize exchange rates is bound to be of limited utility. And they indicate why fundamental reform would necessarily entail a measure of new capital controls, and/or a more closely coordinated set of domestic policies, at a minimum monetary policy, among the leading currency countries.[34]

This discussion has not tried to make the case that we live in the best of all possible monetary worlds. We do not. I have suggested only that the regime is not in danger of imminent collapse, at least not from any endogenous source; and I have suggested some of the reasons why. Above all, the monetary regime remains thoroughly multilateral in character. The basic political compromise of Bretton Woods continues to hold among the major monetary powers, and of course it does so most effectively when their governments share a roughly similar political orientation, as they did throughout the conservative 1980s. Moreover, this political compromise continues to hold despite the fact that the Keynesian instruments through which it was enacted in the past have weakened in efficacy. Institutional deviations or inventions on the whole have been undertaken on the belief that previous mechanisms were unsustainable or no longer served their purpose, not to gain unacceptable unilateral advantage. And no other fundamental reforms have been forthcoming because no new consensus has formed among economists, let alone governments, about the viability of fundamentally different institutional designs that would not at the same time deprive governments collectively of policy instruments or market mechanisms that they now hold clear.

The Trade Regime

As a result of successive rounds of negotiations conducted under the GATT, tariffs today are so low as no longer to constitute a significant barrier to international trade: barely 5 percent on industrial products, down from an average of over 40 percent in the immediate postwar years. Moreover, as the 1980s drew to a close, growth in world trade was resuming its postwar norm of increasing well in excess of 5 percent per annum and outpacing the growth of world output.[35] Some two thirds of the absolute increase in world trade during 1988 consisted of exports of capital goods, reflecting a widespread investment boom in the developed market economies and suggesting yet further trade expansion ahead. A number of developing countries in Africa and Latin America still were making little headway in their decade-long struggle against debt, inflation, stagnation, and capital flight, but overall exports from developing countries in 1988 increased by 13 percent. The socialist countries

almost uniformly were seeking fuller participation in the world economy, turning their backs on over forty years of central planning and relative economic isolation. And the ongoing Uruguay Round of GATT negotiations was venturing into the uncharted domain of trade in services, while holding out some hope for progress on liberalizing international agricultural trade as well.

Few observers question the significance of these accomplishments. But many do question their sustainability in the face of the so-called new protectionism: the battery of nontariff barriers imposed by the leading economic powers on imports from one another and from the newly industrializing countries. Such measures are decried as doubly damaging the international trade regime: not only do they impose quantitative and other administrative restrictions on trade, but they do so in an inherently discriminatory manner by singling out specific countries for differential treatment. One frequently cited observer has characterized the growing incidence of nontariff barriers, particularly bilateral, "voluntary" export controls as well as multilateral "orderly marketing arrangements," as constituting nothing less than the "collapse of free-trade ideology into retaliatory protectionism."[36] Have we thus struggled for over forty years to create and sustain a multilateral trade regime only to embrace the very protectionism that initially animated our efforts? Let use examine the evidence.

The New Protectionism. The facts are straightforward. A recent GATT study reports the bilateral, voluntary export restraint arrangements (VERs) known to have been in effect at the end of 1987. The product categories affected include textiles and clothing (71 arrangements outside the Multifibre Agreement, an OMA or multilateralized form of export restraint); agricultural and food products (58); steel and steel products (52); electronic products (23); automobiles and transport equipment (20); footwear (15); machine tools (13); and miscellaneous (25). "The majority of the arrangements protect the EEC market or the market of one of its members states, followed by the U.S. market; these two account for just over three quarters of the measures listed. The arrangements mainly limit exports from Japan (38 arrangements), the Republic of Korea (35), the EEC (15), and Taiwan (13)."[37] All told some 30 percent of world trade was affected thereby. In addition, many of these same countries were

subject to antidumping and countervailing duty actions. Lastly, it is clear that the use of these mechanisms has increased over the years.

As in the case of the monetary regime, however, it isn't the facts themselves but what they signify that is at issue. The view that these developments indicate a resurgence of "retaliatory protectionism" has to accommodate several sizable anomalies.

First of all, the overall magnitude of nontariff barriers typically is expressed in terms of the *number* of product categories affected; however, those figures tell us nothing about the actual *extent* of effective protection the measures provide. And as we noted earlier both the value and volume of international trade once again are expanding at postwar historical rates. At the very least, then, trade-creating forces are outweighing trade-destroying ones, despite the "new protectionism." What is more, if these export restraints are designed to prevent market penetration by imports, certainly in the United States and perhaps elsewhere they have done a very poor job—and much worse of a job than would be done by tariffs. In a comprehensive survey of every statutory instrument of the so-called new protectionism employed by the United States since 1958, Judith Goldstein concludes that although the government provides adversely affected domestic industries many things, "effective protection was excluded."[38] The U.S. government has been least responsive to pressure from uncompetitive producers and most responsive to instances of unfair trade. But even in the latter, an empirical study shows that a 1 percent increase in the "less-than-fair-value" complaint index yields but a 0.2 percent reduction in import growth rates.[39] Finally, yet another study demonstrates that the effect of these nontariff barriers "is not nearly as large as the protection afforded by tariffs . . . or natural barriers to trade."[40] Thus, when all is said and done, the markets of the industrialized countries are more open today than they were only a decade ago, leading the distinguished international economist Jagdish Bhagwati to conclude: "the growth of protectionism appears significant but its consequences do not."[41]

Compounding the anomaly, governments apparently choose instruments to restrain imports that are not only ineffective, but actually transfer the scarcity rents produced by government intervention to the *exporting* country![42] The case of Japanese automobile manufacturers complying with their numerical quota but exporting more expensive cars to the United States is well known.[43] Less well

known is the fact that in some industries a secondary market in quotas has actually emerged, complete with "quota brokers"—the markets for textile quotas in Hong Kong, South Korea, and Taiwan being cases in point.[44] This phenomenon would seem to demonstrate that although VERs may limit the quantity of imports, they also make the trade more profitable to the exporting country. That of course would explain why exporting countries don't complain more; but, at the same time, it makes this a very peculiar form of protectionism indeed.

In short, if it were the intention of governments to institute effective protectionism by means of OMAs, VERs, and similar measures, then those governments are either very stupid or utterly perverse. Without wishing to overestimate the wisdom of public officials, is it not possible that their objectives are otherwise to begin with? It is not only possible, but highly likely. Take the case of the United States.

Patterns in U.S. Protectionism. One of the most striking aspects of the so-called new protectionism "imposed" by the United States is the systematic patterns it exhibits. A "low track" and "high track" pattern was discerned by J. M. Finger and his associates in one of the earliest studies of the actual effects of "administered protection"—antidumping and countervailing duty cases as well as the escape clause mechanism invoked by the United States between 1974 and 1979.[45] The LFV, or "less-than-fair value," cases (antidumping and countervailing duties) are administered on the low track; very elaborate and precise technical criteria exist, and judgments can be appealed to the federal courts. Moreover, the average case size tends to be small. The escape clause mechanism (EC), on the other hand, is administered on the high track: the criteria are vague and the process is highly politicized, ultimately involving a presidential decision. There is no right of judicial review. And the case size on average is upwards of ten times as large. An econometric analysis of the determinants of outcomes reflects these differences. In LFV cases, whether or not less-than-fair-value pricing is found depends on such factors as comparative costs and the narrowness of the product definition involved in the complaint; whether or not injury to domestic producers is determined (and both are necessary for relief to be awarded) also reflects the size of the petitioning industry's labor force. Other domestic, and all international, factors tend to be insig-

nificant.[46] On the high track of escape clause cases, the International Trade Commission issues findings, but the final decision rests with the president. EC cases tend to be politically visible, or involve petitioners who have the influence to make them visible. But—and here is the crucial fact often ignored in popular accounts—highly visible petitions will also attract opposition, and the nature of the high track offers no technical means of resolving the differences. As a result, the president's desire to reap political net gain or minimize net loss from such decisions is best satisfied *not* by coming down on one side or the other, but in trying to avoid them! "This has two implications for the presidential decision. First, it will push the president toward saying no. Negative decisions will discourage further petitions and will reduce the number of times the president will have to say anything. . . . Second, it will push a presidential affirmative decision as far toward a non-decision as his legally defined options allow."[47] As a result, although these mechanisms may be biased toward protectionism, the bias is not large: only 2.2 percent of U.S. manufactured imports were granted relief under the LFV statutes, and 3.8 percent under the escape clause, in the period covered by the Finger study.

A very similar set of patterns if found by Goldstein in her comprehensive study of all statutory restraints imposed since the 1950s.[48] The evidence shows that, "[a]s trariffs decreased and imports decreased their market share in the 1960s and 1970s, American producers did react by petitioning the bureaucracy for protection."[49] But the government's response failed to mirror the increased petition activity. In determining actual outcomes, technical merit seems to prevail in cases on the low track, a complex political calculus on the high track of presidential involvement:

> When confronted by a choice between giving aid or not, the executive gave no aid. When protectionism was mandated by the bureaucracy, the president often chose to give a transfer payment, to give less than recommended or, in the case of countervailing duties, to sanction a tariff waiver. In dumping findings, legislation leaves no recourse but to assess a duty. However, every effort was made to convince the exporter to halt the practice.

The preferred instruments used by the president to avoid mandated actions were OMAs and VERs. Thus, Goldstein's central finding is that although access to the institutions of administered protection has been progressively eased, and although these institutions have

been increasingly pressed for protectionist measures, they "have not become increasingly protectionist over time."[50]

In sum, two attributes of the so-called new protectionism U.S. style are becoming increasingly clear and compelling. First, unlike classical protectionism, the instruments of the new variant are not unilaterally imposed, but bilaterally negotiated. And in many instances the scarcity rents from protectionism are actually transferred to the exporting country. Second, the government rarely if ever grants effective protection to domestic producers—not even in so central a sector as automobiles, where foreign producers have been allowed steadily to increase their share of the domestic market. Indeed, the evidence suggests that the government does not seek to do so, and that the executive branch, when it has final say, goes a long way to avoid it. Before trying to explain these apparently anomalous findings, two additional attributes of the new protectionism should be briefly noted.[51]

One concerns the duration of restraints. Many observers assume that, once imposed, trade barriers persist in perpetuity. But here too the "new protectionism" seems to differ. Aggarwal et al. suggest that there are at least three patterns of duration.[52] In some cases, restraints are allowed to lapse after an initial period and are not renegotiated. Color television and footwear imports into the United States provide examples. In other cases, the restraints expand and become more complex over time. The Multifibre Agreement for textiles and apparel illustrates this pattern. Finally, some restraints are allowed to lapse but subsequently may be renegotiated. The steel and automobile industries provide instances. What accounts for these differences? Industry structure, according to the authors. Temporary restraints, they argue, tend to be characteristic of small industries with low barriers to entry and exit. Here, in the face of foreign competition, domestic firms use the adjustment period afforded by the restraints to take their money and run. More permanent institutionalized restraints are characteristic of labor-intensive industries with low barriers to entry but high barriers to exit. These firms are politically important and stuck. Finally, sporadic restraints tend to appear in industries with large firms, high entry barriers, but also high adjustment or exist costs. In the case of steel and automobiles, the firms should have used the opportunity afforded by restraints to adjust, but for a variety of reasons they could not or would not. Yet

the long-term preference by the government not to continue the restraints has been established.[53] In short, the import restraints of the "new protectionism" by no means are invariably of indefinite duration.

A final consideration is pertinent to this discussion; it relates to changes in industry preferences. It is well known that export-dependent industries have different preferences regarding protection for import-competing industries. Helen Milner has gone a step further to suggest that the more extensive the multinationality of firms becomes, the less likely they are to demand protection and the more likely they are to resist it, *even if* their industry is under pressure from import competition. Obviously, as firms in the advanced industrial countries become increasingly multinational in scope and ownership, previous pressure for protectionism ought to decline. Milner's case studies of selected U.S. firms in the 1920s and 1970s, and a cross-sectional comparison of U.S. and French firms today, largely confirm the hypothesis.[54] At the same time, however, Milner points out that such firms may increase demands for what has come to be known as "strategic trade policy," that is, demands for governmental action to secure access to foreign markets and to vindicate other norms of fairness in international trade—under the threat of home-country retaliation for failure to comply. Some of the most advanced industrial sectors, including semiconductors, commercial aircraft, and telecommunications, exhibit this pattern.[55] But surely these demands for strategic trade policy are market-opening, not market-closing, in intent.[56]

In the end, perhaps the most confounding anomaly that the "resurgent retaliatory protectionism" view has to accommodate is that, by the logic of its own argument, the 1970s should have been far more protectionist than they turned out to be. The world economy in the 1970s experienced dislocations more severe than any others since the 1930s. Yet there is no comparison at all between the alleged protectionism of the 1970s and the real stuff in the 1930s, and the 1980s, as we have seen, have exhibited even more positive market-opening trends. Something is clearly amiss.

Managing the Public Economy. These anomalies disappear, however, and become fairly consistent patterns of behavior when we view the so-called new protectionism from the vantage point of the

management by advanced capitalist states of their public economy more broadly. Consider, for example, Cameron's analysis of different rates of growth in public expenditures among the OECD countries from the 1960s on. As possible explanations, he examines overall economic growth, tax structure, the nature of partisan political competition, and the institutional apparatus of the state. But his major—and to him, startling—finding is that the "openness of the economy is the best single predictor of the growth of public revenues relative to the economic product of a nation."[57] Greater international openness, he finds, consistently compels governments to expand their domestic role via adjustment and distributive policies—and overrides domestic differences in doing so. Obviously, then, as barriers to trade have declined, governments have become more active in managing the consequences.

Cameron's results have been confirmed by numerous other studies, and extended by some. For example, Blais has examined specifically the incidence of government industrial subsidies, finding that their best single predictor—more important than a country's overall level of affluence, size, and rate of unemployment or than the presence of left-wing parties in its electoral system—is the extent of tariff reductions the country has undertaken. For our purposes, however, Blais's most significant finding is this: "Subsidies may thus be a substitute for tariffs, but . . . they are only a partial substitute. Our results support the argument that *governments merely attempt to mitigate the negative effects of trade liberalization on specific industries and not to offset them entirely.*"[58]

These data echo the conclusion of every empirical study of the actual effects of the so-called new protectionism that we cited earlier. And in the words of Blais, they also "support Ruggie's depiction of postwar policy as 'embedded liberalism,' based on a commitment to multilateral trade with substantial safeguards to minimize socially disruptive adjustment costs."[59]

Unilateralism and Discrimination. A final set of issues needs to be addressed: the danger posed to the trade regime by the unilateralism and discriminatory treatment that is said to inhere in the new protectionism.

One charge can be dismissed readily. It is the charge that VERs and similar measures are "coercive," and thus reduce orderly trade

relations to the law of the international jungle. If enriching exporting countries at the expense of consumers in the importing countries constitutes a form of international coercion, then perhaps a case can be made. But that definition of coercion is bizarre, and I suspect that, all other things being equal, exporting countries would gladly have more of it. The *ceteris paribus* condition must be stressed because not only the threatened unilateral but *even the available multilateral* alternatives to VERs would leave exporting countries *worse off* than VERs do! As Brian Hindley has pointed out, "for most countries confronted with a request for a VER, the alternative, should they refuse, is not unrestricted trade but an Article XIX emergency action [under the GATT]. In that event, the exporting country will find itself faced with a tariff on its exports or by formal quota restrictions on them with the quota rights going to importers . . . rather than to exporters. In either case, the profits of the exporting industry will be reduced. . . ."[60] And by affecting imports from all countries such a tariff or quota restriction eliminates the transshipment option for the exporting country. What is more, unlike the case of VERs, there is no effective time limit on how long Article XIX safeguards may remain in force; VERs typically do have such a limit at the end of which they either expire or must be renegotiated. Lastly, no country claiming injury under Article XIX has ever had its claim challenged! In any practical as opposed to rhetorical sense, therefore, the charge of coercion is specious.

The second charge is somewhat more complex. It is that VERs are discriminatory, and thus undermine one of the central norms of the trade regime. That they are discriminatory cannot be at issue; it is the very reason they are invoked. The real issue is whether VERs or the legally permissible alternative, again Article XIX under the GATT, do more collateral damage to the trade regime. And it is not obvious that Article XIX should be preferred on those grounds. Article XIX permits alteration or suspension of past tariff concessions in a nondiscriminatory manner, provided that interested parties are consulted. But it is clumsy. Precisely because of the necessity to apply it in a nondiscriminatory manner, the invocation of Article XIX is likely to affect innocent bystanders adversely, bystanders who are not causing injury to domestic producers in the initiating country. Thus, it may require widespread and lengthy renegotiation, or even trigger retaliatory suspension, of past concessions. Those who favor Article XIX

have yet to demonstrate that these adverse consequences for the entire trading system are of a lesser magnitude than a VER aimed at a specific party. And simply to retort that Article XIX is to be preferred *because* it is multilateral in character won't do: It is a perfect example of what Aliber describes as "sacrificing the state to save the constitution." No rational government can be expected to follow that precept when well-established and apparently acceptable alternatives are available.[61]

The final charge is too difficult to come to grips with fully here. It concerns unilateralism and its precedential consequences. The culprits here are the so-called Super 301 section of the recent U.S. trade legislation (Omnibus Trade and Competitiveness Act of 1988) and Japan, the main target at which it is aimed—the two are intimately related.[62] On the one side, this dispute has the United States claiming the right to act as accuser, judge, and jury and to impose punishment with no chance of redress. On the other side, the dispute has Japan depicted as being, and sometimes claiming the right to be, a different sort of capitalist economic formation than the more typical competitive market economies but wanting to benefit from the same rules as the others. The potential for deleterious and even destructive consequences for international trading relations certainly is present here, particularly because the measure imposes more severe constraints on U.S. executive branch discretion than its legislative predecessors. Nevertheless, that future potential of deleterious consequences can hardly be cited as evidence in support of the "new protectionism" scenarios that have been propagated for some twenty years now. Moreover, it is important to remember that the goal of the trade regime has been "to maintain a balance of concessions and obligations, not to restructure nations"[63]—which ultimately may well be what is at stake in the U.S.–Japan trade disputes. Finally, if we take the argument and evidence of the present paper seriously, then we are obliged to place at least offsetting bets on the ability of the regime and of the key actors to adapt.[64]

CONCLUSION

There is an inherent danger in writing about progress, whether in international economic relations or in any other domain of human

activity, of being dismissed for being Whiggish if not Panglossian. In conclusion, let me briefly anticipate both of those possible reactions.

First of all, I do not consider the developments described herein to have been inevitable. The Nazis could have built the atom bomb and won World War II; and Hjalmar Schacht had given no sign of being poised to propose a Bretton Woods arrangement for organizing the conduct of international economic relations. Nor are all current international economic arrangements necessarily better than those that went before. Multilateralism is clearly superior to Schachtian bilateralism raised to the level of systemic organizing principle, in my judgment and given my values, but there are no *a priori* grounds for concluding that more benign forms of bilateralism are impossible or undesirable—witness the U.S.–Canada free trade pact. Moreover, certain features of the classical gold standard and free trade may well have been superior to those we have today, as some have claimed. My general view on such matters has always been influenced heavily by the writings of Stephen Jay Gould, not by Darwin or Victorian historiographers: play the tape of life again and very different outcomes are likely to prevail; but once a certain path is taken, it conditions what follows.[65] Thus, let me state my point clearly: statesmen learned from the Great Depression, but different statesmen learned different things. That some of them inherited power rather than others is part of life's lottery, not the product of some evolutionary design. But once their preferences were instituted, the institutional arrangements shaped subsequent developments.

As for Dr. Pangloss, I am not oblivious to very serious imbalances that afflict the international economy today or to the dangers they pose for economic stability and economic justice in the world system. Nor do I believe that the current set of monetary and trade arrangements could not be substantially improved. I would add two thoughts, however. First, on social scientific as well as normative grounds, it is necessary and desirable to learn from accomplishments no less than from failures, as unfashionable as that view may appear. And within the confines of their policy spaces the regimes for money and trade do constitute accomplishments, as I have tried to show. They have provided at least some degree of mutual stability of expectations amidst deep conjunctural crisis and profound structural transformation. Thus, in the language suggested by the editors of this volume, the postwar regimes for money and trade at the least constitute an

example of "instrumental progress" in international relations. Second, of the many things to be worried about in international monetary and trade relations today, the issue of the so-called new protectionism, for the reasons stated, simply is not at the top of my list.

But to close with the *de rigueur* dash of pessimism, I would posit that a development in which several authors of this volume put great stock, the use of knowledge in policymaking, ironically also constitutes one of the greatest potential threats to the monetary and trade regimes in the years ahead! Both monetary and trade policy rely on reams of statistical information processed by advanced technical means. But the figures aren't adding up the way they used to, because the models on which they are based are increasingly anachronistic; policymaking as a result increasingly comes to resemble a high-stakes game of pin-the-tail-on-the-donkey. Exchange rate policy still assumes that currency values follow the trade account, at a time when capital movements outweigh trade flows by a factor of twenty to one. Trade statistics and hence trade policy still conceive of trade as though it were arms-length exchange between two nationally distinct entities, when in fact production is increasingly globalized while trade overwhelmingly takes place within firms—so that IBM is the leading computer exporter of Japan, West Germany, and the United States, and Sony is the leading exporter of U.S. television sets. Even hallowed GNP figures lie by systematically understating the value of services and high-tech productivity increases that constitute the most desirable and most rapidly growing segment of all advanced economies—for example, by *discounting* national wealth when I chose a faster but *cheaper* software package on which to draft this chapter over a slower but more expensive one. In sum, the conceptual and statistical infrastructure of economic policy and economic regimes is frozen in time, with perverse and potentially catastrophic results ahead.[66]

ENDNOTES

Ernst B. Haas critically scrutinized an earlier draft, as he has most everything I have written since I was his graduate student at Berkeley in the late 1960s and early 1970s. I dedicate this paper to him with great affection, deep respect, and enduring gratitude for being an outstanding role model and good friend.

1. Perhaps the most alarmist among serious commentators was C. Fred Bergsten. In a 1972 article ("The New Economics and U.S. Foreign Policy," *Foreign Affairs* [January 1972], Vol. 50) he wrote: "In the summer of 1971, President Nixon and Secretary Connally revolutionized U.S. foreign economic policy. In so doing [they] encouraged a disastrous isolationist trend" (p. 199), "violated the letter and the spirit of the reigning international law" (p. 200), and sought "to export unemployment to other countries" (p. 203). "The policy could easily lead to the first real international trade war since the 1930s" (p. 204). "Trade wars could become full economic wars, precisely as they did under similar international conditions in the 1930s" (p. 206). "These economic effects would have a disastrous impact on U.S. foreign policy, and on our own national security" (p. 207). By 1976, the intervening years had somewhat allayed Bergsten's fears. He felt "reasonably sanguine" about "the longer-run future. . . . The problem is to get there, by avoiding the trade wars which once again loom on the horizon." *Foreign Policy* (Summer 1976), no. 23, p. 31.
2. Stephan Haggard, "The Institutional Foundations of Hegemony: Explaining the Reciprocal Trade Agreements Act of 1934," in G. John Ikenberry, David A. Lake, and Michael Mastanduno, eds., *The State and American Foreign Economic Policy* (Ithaca, N.Y.: Cornell University Press, 1988), p. 102. Or, as Judith Goldstein has put it, "liberalism was accepted only with safeguards." Goldstein, "Ideas, Institutions, and American Trade Policy," in ibid., p. 188.
3. A more detailed historical discussion of the origins and structure of this compromise may be found in my essay "International Regimes, Transactions, and Change: Embedded Liberalism in the Postwar Economic Order," in Stephen D. Krasner, ed., *International Regimes* (Ithaca, N.Y.: Cornell University Press, 1983).
4. This was true even in Great Britain, where Labour sought to institute systematic national economic planning, which would necessarily have entailed discriminatory instruments of foreign economic policy, while Conservatives remained committed to imperial preferences and the imperial alternative to a universal economic order, which was inherently discriminatory in character. See Richard N. Gardner, *Sterling-Dollar Diplomacy in Current Perspective* (New York: Columbia University Press, 1980), ch. 1. In Scandinavia the overriding objective of domestic economic policy was the achievement of full employment, yet it was perceived to be entirely compatible with multilateralism. Tapani Paavonen, "Reformist Programmes in the Planning for Post-War Economic Policy during World War II," *Scandinavian Economic Historical Review* (1983), Vol. 31, No. 3.
5. For the sake of brevity, I am using the appelation "Bretton Woods" generically here, to include money, finance, and trade, even though the trade regime was not negotiated at the Bretton Woods conference.

6. Richard N. Cooper, "Prolegomena to the Choice of an International Monetary System," *International Organization* (Winter 1975), 29:85.
7. Among the other major sources I have drawn on for this discussion of the monetary negotiations are Gardner, *Sterling–Dollar Diplomacy;* Armand Van Dormael, *Bretton Woods: Birth of a Monetary System* (London: Macmillan, 1978); Fred Block, *The Origins of International Economic Disorder* (Berkeley: University of California Press, 1977); Susan Strange, *International Monetary Relations,* Vol. 2 of Andrew Shonfield, ed., *International Economic Relations of the Western World* (London: Oxford University Press for the Royal Institute of International Affairs, 1976); and A. L. K. Acheson, J. F. Chant, and M. F. J. Prachowny, *Bretton Woods Revisited* (Toronto: University of Toronto Press, 1972).
8. Major sources for the trade negotiations include Gardner, *Sterling–Dollar Diplomacy;* William Diebold, "The End of the ITO," *Princeton Essays in International Finance* (October 1952), No. 16; Gerard and Victoria Curzon, "The Management of Trade Relations in the GATT, in Shonfield, ed., *International Economic Relations of the Western World,* Vol. 1; Jacob Viner, "Conflicts of Principle in Drafting a Trade Charter," *Foreign Affairs* (January 1947), Vol. 25.
9. The United States also undertook more direct measures in the domestic politics of other countries, through the Occupation Authorities in Germany, Italy, and Japan, and through transnational adjuncts of American civil society such as the American Federation of Labor, which was particularly active in France and in Latin America, seeking to moderate the structure and political direction of labor movements, encourage the exclusion of Communist parties from participation in governments, and generally to keep collectivist impulses within acceptable Center-Left bounds.
10. A superb discussion of this shift may be found in Robert Pollard, *Economic Security and the Origins of the Cold War* (New York: Columbia University Press, 1985).
11. "Everybody's Business: International Monetary Reform—A Survey," *The Economist,* October 5, 1985; the citations are from p. 11.
12. Kenan, "An Overall View," in Fabio Basagni, ed., *International Monetary Relations After Jamaica* (Paris: The Atlantic Institute for International Affairs, 1976), p. 7.
13. Robert Triffin, "Jamaica: 'Major Revision' or Fiasco," in Edward M. Bernstein et al., "Reflections on Jamaica," *Princeton Essays in International Finance* (April 1976) 115:47.
14. Robert Z. Aliber, "Fixed Exchange Rates and the Rate of Inflation," in Colin D. Campbell and William R. Dougan, eds., *Alternative Monetary Regimes* (Baltimore: Johns Hopkins University Press, 1986), p. 120.
15. "International Monetary Reform," p. 62.
16. This position is elaborated in Friedrich Kratochwil and John Gerard Ruggie, "International Organization: A State of the Art on an Art of the State," *International Organization* (Autumn 1986), Vol. 40.

17. The possible retort that "anything goes" under this criterion would be factually in error. In the 1930s, for example, governments knew well that they were not collaborating with one another, having set out deliberately to pursue autarchic and beggar-thy-neighbor policies. (See Kenneth A. Oye, "The Sterling–Dollar–Franc Triangle: Monetary Diplomacy 1929–1937," *World Politics* [October 1985], Vol. 38, and Oye, "On the Benefits of Bilateralism: Lessons from the 1930s," paper prepared for the Workshop on Change in the International System, University of Southern California, May 5–6, 1989.) And even today, looking approvingly on some aspects of the "new protectionism" does not preclude appreciating the dangers of the real, neomercantilist stuff. (See Brian Hindley, "Protectionism and Autonomy: A Comment on Hager," *International Affairs* [Winter 1982–1983], Vol. 59, critically commenting on Wolfgang Hager's avowedly neomercantilist: "Protectionism and Autonomy: How to Preserve Free Trade in Europe," *International Affairs* [Summer 1982], Vol. 58.)
18. Richard N. Cooper, "A Monetary System Based on Fixed Exchange Rates," in Campbell and Dougan, eds., *Alternative Monetary Regimes*, p. 88.
19. Cooper, ibid.
20. Richard N. Cooper, "A Monetary System for the Future," *Foreign Affairs* (Fall 1984), 63:170.
21. Rachel McCulloch, "Unexpected Real Consequences of Floating Exchange Rates," in Robert Z. Aliber, ed., *The Reconstruction of International Monetary Arrangements* (London: Macmillan, 1987), p. 25.
22. According to a recent GATT report, of a total of eighty-eight convertible currencies, forty-one are pegged to a single currency; eight are linked to a basket of currencies via the European Monetary System; and twenty-three are otherwise actively managed. Only sixteen float independently—of which the most important are the U.S. dollar, Japanese yen, and British pound. *Review of Developments in the Trading System, April–September 1988* (Geneva: General Agreement on Tariffs and Trade, 1988), Appendix I to Section X, pp. 97–98.
23. In essence, Triffin argued that if the United States corrected its balance-of-payments deficit, the result would be world deflation because gold production at $35 an ounce could not adequately supply world monetary reserves. But if the United States continued running a deficit, the result would be collapse of the monetary standard because U.S. foreign liabilities would far exceed its ability to convert dollars into gold on demand. Robert Triffin, *Gold and the Dollar Crisis* (New Haven: Yale University Press, 1960).
24. Cooper, in *Foreign Affairs*, p. 171.
25. Cooper, in Campbell and Dougan, *Alternative Monetary Regimes*, p. 90.
26. Referred to by Kevin Phillips, in "Western World Tilts Left, Leaving Conservative Cycle," *Los Angeles Times*, August 27, 1989.
27. Kenen, "An Overall View," p. 10.

28. McCulloch, "Unexpected Real Consequences," p. 25.
29. "International Monetary Reform," p. 31.
30. Ibid., p. 42.
31. Robert V. Roosa, *Economic Instability and Flexible Exchange Rates* (Singapore: Institute of Southeast Asian Studies, 1982), p. 4.
32. McCulloch, "Unexpected Real Consequences," p. 25.
33. Allan H. Meltzer, "Some Evidence on the Comparative Uncertainty Experienced under Different Monetary Regimes," in Campbell and Dougan, *Alternative Monetary Regimes*, p. 142; see also Stanley Fischer's commentary "Meltzer on Uncertainty under Different Monetary Regimes," ibid.
34. Rudiger Dornbusch, "Flexible Exchange Rates and Excess Capital Mobility," *Brookings Papers on Economic Activity* (1986), Vol. 1, and Stanley Fischer, "Symposium on Exchange Rates, Trade, and Capital Flows: Comments and Discussion," ibid.
35. GATT, *Review of Developments in the Trading System, April–September 1988;* and United Nations Conference on Trade and Development, *Trade and Development Report, 1989* (New York: United Nations, 1989).
36. Robert B. Reich, "Beyond Free Trade," *Foreign Affairs* (Spring 1983), 61:774.
37. *Review of Developments in the Trading System*, ch. 7.
38. Goldstein, "Ideas, Institutions, and American Trade Policy," and Goldstein, "The Political Economy of Trade: Institutions of Protection," *American Political Science Review* (March 1986), 80:17.
39. J. M. Finger, "The Industry-Country Incidence of 'Less than Fair Value' Cases in US Import Trade," *Quarterly Review of Economics and Business* (Summer 1981), 21:274.
40. Peter Morici and Laura Megna, *U.S. Economic Policies Affecting Industrial Trade: A Quantitative Assessment* (Washington, D.C.: National Planning Association, 1983), p. 11.
41. Jagdish Bhagwati, *Protectionism* (Cambridge, Mass.: MIT Press, 1988), p. 56.
42. David Yoffie, *Power and Protectionism* (New York: Columbia University Press, 1983).
43. In point of fact, even though the U.S. has lifted negotiated quotas, Japan continues to maintain them on its own—"but Japan's major manufacturers note that the action is now an annual political gesture that has no effect on the sales of Japanese cars." "Japan Seen Extending Auto Quotas," *New York Times*, January 12, 1990.
44. Brian Hindley, "Voluntary Export Restraints and GATT's Main Escape Clause," *The World Economy* (November 1980), Vol. 3.
45. J. M. Finger, H. Keith Hall, and Douglas R. Nelson, "The Political Economy of Administered Protection," *American Economic Review* (June 1982), Vol. 72.
46. Finger et al. point out that, although antidumping petitions for steel and automobiles were filed, these sectors did not "belong" on the low track

and were not resolved there; petitioners subsequently transferred them to the high track.

47. Ibid., p. 463.
48. Judith Goldstein, "The Political Economy of Trade," and "Ideas, Institutions, and American Trade Policy." Her analysis includes the invocation of five statutory provisions to restrain imports (escape clause, antidumping, countervailing duties, adjustment assistance, and allegedly unfair practices related largely to patent claims) over a longer period of time, from 1958 into the 1980s.
49. "Political Economy of Trade," p. 169.
50. "The Political Economy of Trade," pp. 180, 178. See also Douglas Nelson, "The Domestic Political Preconditions of U.S. Trade Policy: Liberal Structure and Protectionist Dynamics," prepared for the conference on Political Economy: Theory and Policy Implications, The World Bank, Washington, D.C., June 17–19, 1987.
51. A full comparison with the prevailing practices of the European Community and Japan is well beyond the scope of this paper; both are extremely complex cases. To begin with, the "European Community is not only itself a discriminatory trading arrangement, if looked at as a collection of separate countries, but is embedded in concentric circles of discrimination"—consisting of preferences and export restraints—such that its bound MFN tariff "is largely the tariff applicable to the United States." Martin Wolf, "The European Community and the Developing Countries in the International Trading System," *Aussenwirtschaft* (Heft 1, 1987), 42:56–57. The case of Japan is taken up briefly later.
52. Vinod K. Aggarwal, Robert O. Keohane, and David B. Yoffie, "The Dynamics of Negotiated Protectionism," *American Political Science Review* (June 1987), Vol. 81.
53. In the case of automobiles, the Reagan administration phased out the VER regulating Japanese imports, though as already mentioned, the Japanese themselves have kept it in place. In steel, the Bush administration announced in the summer of 1989 that it would phase out quotas over the ensuing thirty months, whereas the steel industry had expected to be protected for another five years. *Wall Street Journal,* July 26, 1989.
54. Helen V. Milner, *Resisting Protectionism: Global Industries and the Politics of International Trade* (Princeton, N.J.: Princeton University Press, 1988).
55. Helen V. Milner and David B. Yoffie, "Between Free Trade and Protectionism: Strategic Trade Policy and a Theory of Corporate Trade Demands," *International Organization* (Spring 1989), Vol. 41; and Yoffie and Milner, "An Alternative to Free Trade and Protectionism: Why Corporations Seek Strategic Trade Policy," *California Management Review* (Summer 1989), Vol. 31.
56. However, if the openness of markets is judged by bilateral trade balances —for example, if Japanese willingness to import beef is judged by the amount of beef it purchases specially from the United States—then

strategic trade policy becomes a form of neomercantilist market-*sharing* rather than market-opening. See Bhagwati, *Protectionism*, ch. 4.

57. David R. Cameron, "The Expansion of the Public Economy: A Comparative Analysis," *American Political Science Review* (December 1978), 72:1254.
58. Andre Blais, "The Political Economy of Public Subsidies," *Comparative Political Studies* (July 1986), 19:210; emphasis added.
59. Ibid., p. 208. Cf. Robert O. Keohane, "The World Political Economy and the Crisis of Embedded Liberalism," in John H. Goldthorpe, ed., *Order and Conflict in Contemporary Capitalism* (Oxford: The Clarendon Press, 1984).
60. "Voluntary Export Restraints," p. 321.
61. Hindley similarly dismisses criticisms of VERs on the grounds that they are illegal. "A much better analogy is the out-of-court settlement of civil legal actions, a procedure whose outcome is constrained by the law, but which both parties to the dispute expect will leave them better-off than undergoing the expenses of the full judicial process. No legal system will collapse as a result of such agreements (on the contrary, if there were no such agreements, collapse would be very much more likely)." "Voluntary Export Restraints," pp. 331–332.
62. See Jagdish Bhagwati, "Super 301's Big Bite Flouts the Rules," and Leslie E. Grayson, "For Its Own Good, Japan Needs a Shove," *New York Times*, June 4, 1989. I discuss this issue more fully in chapter 4 of my book manuscript, "Return to World Order: The United States and the Future of Multilateralism," on which this paper draws.
63. Patricia Kalla, "The GATT Dispute Settlement Procedure in the 1980s: Where Do We Go from Here," *Dickinson Journal of International Law* (Fall 1986), 5:95.
64. Thus, although the original section 301 of the Trade Act of 1974 eased domestic access to the instruments of administered protection, at the same time it "encouraged the United States to make greater use of the GATT dispute settlement process. . . . [O]f the sixteen GATT complaints filed by the United States between 1975 and 1985, eleven complaints arose out of section 301 investigations." Julia Christine Bliss, "GATT Dispute Settlement Reform in the Uruguay Round: Problems and Prospects," *Stanford Journal of International Law* (1987), 23(1):45.
65. See, most recently, Stephen Jay Gould, *Wonderful Life: The Burgess Shale and the Nature of History* (New York: W. W. Norton, 1989).
66. Fred Block has a good preliminary discussion of the significance of this issue in "Postindustrial Development and the Obsolescence of Economic Categories," *Politics & Society* (1985), Vol. 14, No. 1.

7

PROGRESS FOR THE RICH: THE CANADA–U.S. FREE TRADE AGREEMENT

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Progress in international relations among the wealthy liberal democracies lacks the drama of advance in many other spheres. Nonetheless, we think the concept can be useful. This chapter attempts to specify the dimensions of such progress in Canadian–U.S. economic relations by focusing on the Free Trade Agreement (FTA) concluded in December 1987.

Prime Minister Mulroney formally committed himself to FTA negotiations in September 1985. The Canadian decision to propose the FTA negotiations seems to have been based principally on two considerations. First, the U.S. "administered protection" mechanism—that body of law and institutions designed to protect U.S. producers from surges of foreign imports and "unfair" foreign practices—was seen by Canadians as increasingly threatening to their economic well-being.[1] Second, Canada's attempt in the 1970s to engage in a protective industrial policy and to limit foreign investment failed to stop the increasing dependence of the Canadian economy on U.S. trade, although it did precede a decline in Canadian productivity growth.

The United States greeted the Canadian initiative with interest. The FTA promises both lower potential costs and lower probable