Stabilizing the World Economy, 1941-73

Shadow of the Interwar Years: 5 Lessons

1. Economic isolation does not work
2. Trade wars ⇒ shooting wars
3. Harsh war settlements a mistake
4. Gold standard too constraining
5. US must provide global leadership

Role of the United States Government

– Planning during the war (Atlantic Charter, Lend/Lease)
– Marshall Plan
– Domestic politics of US internationalism
– Anticommunism and internationalism
Origins of the Bretton Woods System

• The Issues
  – The “Inconsistent Trinity.” Cannot have (a) fixed exchange-rates, (b) free capital mobility, and (c) modern democratic policies aimed toward full employment all at the same time.
  – Gold standard had (a) and (b), but not (c).
  – Keynes/GB: (c) most important. Sacrifice (b) and (a) to get it.
  – Harry D. White/US: (a) and (b) most important.

• Design of the Bretton Woods system
  – Exchange rates fixed but adjustable. Softened (a).
  – Controls on international capital flows explicitly allowed. Sacrificed (b).
  – IMF set up as referee for exchange rate adjustment and as a source of loans for temporary payments problems.
  – A kinder, more gentle system in the context of (c).
History of Bretton Woods

• **“Key” role for the United States Dollar**
  – U.S. dollar pegged to gold, all other currencies pegged to the dollar—a “gold exchange” standard with the dollar the “key” (reserve) currency
  – Made the system dependent on US macroeconomic policy—system stability required stability in US macroeconomic policy

• **U.S. as a stabilizing force, 1945-58**
  – US trade surpluses and global liquidity -- the dollar “gap.”
  – Accommodating role of US foreign aid programs (i.e., the Marshall Plan), and overseas military expenditures (e.g., the Korean War).
  – Foreign aid and macroeconomic discipline at home aided world economy
End of Bretton Woods and the Rise of Floating Rates

• **U.S. as a destabilizing force, 1958-71**
  – expansionary domestic (Great Society) and foreign (Vietnam) policies are financed by inflation.
  – Key status of the dollar meant US could export inflation and avoid macroeconomic adjustment
  – Crisis in confidence in convertibility of the dollar into gold—runs on the dollar
  – “Nixon Shocks” of 1971
  – Summary: Macroeconomic laxity at home *harmed* world economy.

• **Floating Exchange-Rates, 1973-98**
  – Context of high international capital mobility (Euromarkets)
  – Variability in rates much greater than expected
  – The US dollar in the 1980s
  – Coordinated efforts to stabilize rates (e.g., Plaza Agreement)
Diagram: The Inconsistent Trinity  
(only 2 of the 3 following objectives is possible at any one time)

<table>
<thead>
<tr>
<th>(a) Fixed Exchange-Rates</th>
<th>(b) International Capital Mobility</th>
<th>(c) Domestic policies aimed toward full employment</th>
</tr>
</thead>
<tbody>
<tr>
<td>YES</td>
<td>YES</td>
<td>NO = Gold Standard</td>
</tr>
<tr>
<td>YES</td>
<td>NO</td>
<td>YES = Bretton Woods</td>
</tr>
<tr>
<td>NO</td>
<td>YES</td>
<td>YES = 1971 - today</td>
</tr>
</tbody>
</table>
US Foreign Trade Policy, 1947-98

• Origins of the GATT
  – antecedents in the Reciprocal Trade Agreements Act (RTAA) of 1934
  – Havana Charter for the International Trade Organization (ITO) of 1947
  – failure to ratify the ITO
  – GATT born a provisional (informal) institution in 1948
  – GATT subsumed in 1995 by World Trade Organization (WTO)

• Theoretical Underpinnings of the GATT/WTO
  – Economics: benefit of free trade according to the theory of comparative advantage
  – Politics: domestic politics biased toward protection via theory of collective action
  – GATT principles (rules): Reciprocity (principal supplier rule), Multilateralism (Most-favored-nation rule)
Successes and Stresses in the GATT

- Eight "Rounds" of Multilateral Trade Negotiations
  - Successes in reducing barriers to manufactured goods trade
  - Problems in agriculture
  - Structural changes and the rise of the New Protectionism in manufacturing

- The Uruguay Round, 1986-1993
  - The agriculture deal: "tariffication”
  - Services
  - Intellectual property
  - Dispute settlements and the WTO
# GATT Rounds

<table>
<thead>
<tr>
<th>Name</th>
<th>Dates</th>
<th>Objective</th>
</tr>
</thead>
<tbody>
<tr>
<td>Geneva</td>
<td>1947</td>
<td>• adoption of GATT</td>
</tr>
<tr>
<td>Annecy, France</td>
<td>1949</td>
<td>• tariff reduction</td>
</tr>
<tr>
<td>Torquay, England</td>
<td>1951</td>
<td>• tariff reduction</td>
</tr>
<tr>
<td>Geneva</td>
<td>1956</td>
<td>• tariff reduction</td>
</tr>
<tr>
<td>Geneva (&quot;Dillon&quot;)</td>
<td>1960-62</td>
<td>• tariff reduction</td>
</tr>
<tr>
<td>Geneva (&quot;Kennedy&quot;)</td>
<td>1962-67</td>
<td>• tariff reduction, GATT negotiation rules</td>
</tr>
<tr>
<td>Tokyo</td>
<td>1973-79</td>
<td>• overall reduction of tariffs to an average level of 35% and 5-8% among developed nations</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• non-tariff barrier codes</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• government procurement</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• customs valuation</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• subsidies and countervailing measures</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• antidumping</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• standards</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• import licensing</td>
</tr>
<tr>
<td>Uruguay</td>
<td>1986-94</td>
<td>• broadening of GATT</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• limit agricultural subsidies</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• include services trade</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• include intellectual property</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• establishment of the WTO (World Trade Organization)</td>
</tr>
</tbody>
</table>
Main differences between the WTO and the GATT

- GATT was ad hoc and provisional. The General Agreement was never ratified in members' parliaments, and it contained no provisions for the creation of an organization.

- The WTO and its agreements are permanent. As an international organization, the WTO has a sound legal basis because members have ratified the WTO agreements, and the agreements themselves describe how the WTO is to function.

- The WTO has "members". GATT had "contracting parties", underscoring the fact that officially GATT was a legal text.

- GATT dealt with trade in goods. The WTO covers services and intellectual property as well.

- The WTO dispute settlement system is faster, more automatic than the old GATT system. Its rulings cannot be blocked.