Stabilizing the World Economy, 1941-73

Shadow of the Interwar Years: 5 Lessons

1. Economic isolation does not work
2. Trade wars $\Rightarrow$ 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)

(a) *Fixed Exchange-Rates*	*(b)* *International Capital Mobility*	*(c)* *Domestic policies aimed toward full employment*	
YES	YES	NO	= Gold Standard
YES	NO	YES	= Bretton Woods
NO	YES	YES	= 1971 - today

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

Name	Dates	Objective
Geneva	1947	• adoption of GATT
Annecy, France	1949	• tariff reduction
Torquay, England	1951	• tariff reduction
Geneva	1956	• tariff reduction
Geneva ("Dillon")	1960-62	• tariff reduction
Geneva ("Kennedy")	1962-67	• tariff reduction • GATT negotiation rules

Tokyo	1973-79	• overall reduction of tariffs to an average level of 35% and 5-8% among developed nations
		• non-tariff barrier codes
		    • government procurement
		    • customs valuation
		    • subsidies and countervailing measures
		    • antidumping
		    • standards
		    • import licensing

Uruguay	1986-94	• broadening of GATT
		    • limit agricultural subsidies
		    • include services trade
		    • include intellectual property
		• establishment of the WTO (World Trade Organization)

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.