4 Multilateral and bilateral trade policies in the world trading system: an historical perspective

DOUGLAS A. IRWIN

1 Introduction

Events of the past two decades have generated increasing concern about the direction of the world trading system. While the General Agreement on Tariffs and Trade (GATT) helped orchestrate the substantial reduction in tariffs after World War II, the multilateral approach to trade liberalisation has encountered difficulty in stemming the proliferation of non-tariff trade barriers and in extending international rules to new areas of trade. Meanwhile, the appearance of bilateral or regional trade arrangements in Europe, the Americas, and elsewhere provides an alternative track for expediting trade reform, but also risks deteriorating into exclusionary, trade-diverting blocs that possibly may bring harm to world welfare.

The loss of momentum in the multilateral system and the movement toward bilateral agreements have sparked renewed debate over the relative merits of the two approaches to trade liberalisation. This chapter aims to provide some historical insight into this debate by examining whether multilateral or bilateral trade policies have been more effective in promoting trade reforms in the past. How has trade liberalisation been achieved in the past, and which types of policies have proved constructive or detrimental to multilateral cooperation on trade policy? Throughout the chapter the focus will be almost exclusively on trade policies in Europe, not only because Europe accounted for the bulk of international trade during these periods but because trade policies set much of the agenda for the rest of the world.

Historical analysis is useful for a related reason. Because most economists and policy analysts agree that multilateral free trade should be the ultimate objective of international commercial diplomacy, concern is often expressed that bilateral agreements may divert attention away from this goal, and thus substitute for rather than complement efforts at multilateral reform. This deep-seated support for the multilateral framework and critical caution about the bilateral approach is derived in part from a common generalisation about two historical episodes in which international trade policies differed sharply. In the late 19th century, a network of treaties containing the most favoured nation (MFN) clause spurred major tariff reductions in Europe and around the world. These treaties ushered in a harmonious period of multilateral free trade that compares favourably with – and in certain respects was even superior to – the recent GATT era. In the interwar period, by contrast, discriminatory trade blocs and protectionist bilateral arrangements contributed to the severe contraction of world trade that accompanied the Great Depression. The disaster of the interwar period strengthened the resolve of policymakers during World War II to construct a sound multilateral trading system that would prevent any return to discriminatory bilateralism in trade policy.

These two periods have indelibly shaped our ideas about multilateral and bilateral trade policies. The architects of the postwar world trading system, who lived through both periods, concluded that the 19th century exemplified the virtues of non-discriminatory multilateralism and the interwar experience demonstrated the vices of preferential bilateralism. These conclusions continue to underlie the trade-policy debate about whether bilateral or regional agreements contribute to or detract from the ultimate objective of multilateral free trade. In probing these conclusions by focusing on these two key historical episodes, this chapter finds that these generalisations are somewhat inaccurate. The 19th-century liberalisation was attained entirely through bilateral agreements, with an utter absence of multilateral cooperation. In the interwar period, multilateral institutions and negotiations failed to reverse the spread of protectionism and promising bilateral attempts at trade reforms were actually discouraged by these multilateral gatherings.

This chapter first discusses the formation of customs unions (CUs) within a sovereign state as an important prelude to trade negotiations between nations, negotiations that had their European origins in the 1780s. Then the growth, maintenance, and decline of the 19th-century multilateral treaty network is described, along with a comparison of its strengths and weaknesses in relation to the current GATT system. Finally, the contribution of bilateralism to the unravelling of the world economy during the interwar period is analysed, with particular attention being paid to the forms of bilateralism that emerged and the obstacles they posed to multilateral cooperation in trade policy. A conclusion draws together the themes and lessons that emerge from this retrospective look at the world trading system.
2 The origins of European trade liberalisation

Mercantilist trade policies of the 17th and 18th centuries aimed to achieve several objectives, such as an inflow of specie via a balance of trade surplus or a large market share in world trade. The mutually advantageous expansion of trade through tariff reductions was not one of these objectives. The most prominent commercial treaty of the period was based explicitly on mercantilist grounds and gave bilateral trade agreements a poor reputation among economists that has continued to this day. The Methuen treaty between England and Portugal in 1703, granting Portuguese wines preferential access to the English market and English woollens to the Portuguese market, was sought by England to improve its trade balance with a country that had a direct source of bullion through its new world colonies. Adam Smith ridiculed the treaty for encapsulating what he thought was the gross mercantilist error of confounding specie with wealth. David Hume heaped scorn on the treaty on grounds of trade diversion: ‘But what have we gained by the bargain? We have lost the French market for our woollen manufactures, and transferred the commerce of wine to Spain and Portugal, where we buy worse liquor at a higher price’. The English classical economists continued this tradition of hostility toward discriminatory or preferential trade arrangements, with J.R. McCulloch calling all treaties of commerce ‘radically objectionable’.2

While commercial treaties between sovereignties on the treatment of each others’ merchants and shipping can be traced back centuries, negotiations over tariffs became a significant feature of the world economy only when full CU’s (i.e., internal free trade with a unified external tariff) had been established within the nation-state. Nearly all European states emerged from the medieval period riddled with internal tolls and customs areas that reflected remnants of local power. The centralisation of political control within a given region, however, provided no guarantee that a national CU could be easily or quickly formed. England and Scotland united under a single monarch in 1603, for example, but successive attempts to reach agreement on commercial union failed until the Act of Union in 1707. Although politically unified under the king for centuries, France remained divided – even after several reforms – by 1600 internal tolls and tariffs when the French Revolution enabled their abolition in 1790. At this same time over 1800 customs frontiers littered the various states in central Europe that later comprised Germany. Prussia made incremental moves toward economic union from 1808, culminating in the formation of the Zollverein in 1834 when most German states adopted Prussia’s external tariff. Each canton in Switzerland retained tariff autonomy until 1848 and the Italian CU was not completed until the 1860s.3

Successful European tariff negotiations also had to wait for an opportune political environment. The Treaty of Utrecht in 1713, for example, governed Anglo–French trade for much of the 18th century, but the important Articles 8 (establishing MFN treatment) and 9 (abolishing prohibitions) were never passed by the British parliament for fear that they would undermine the Methuen treaty and harm the balance of payments. Furthermore, as long as the colonial trade of major European countries was flourishing, there was no pressing need to undertake efforts to expand intra-European trade, which was less complementary and hence more apt to increase import competition and offend domestic producers.

The first real impetus to negotiations on liberalising European trade came with the collapse of colonial trade routes in the 1770s, when Britain and France lost among others their North American colonies. This shock severely affected Britain's trade in particular – export volume fell nearly 20 percent between 1772-3 and 1780-1 – and the share of British exports destined for north-western Europe rose from 15 percent to 28 percent over the same interval (Mitchell, 1988, p. 496). These events naturally shifted British attention to the high tariff barriers impeding trade with the continent. Indeed, writing in 1783 to a government official named William Eden, Adam Smith saw opportunity in the colonial loss: ‘By an equality of treatment to all nations, we might soon open a commerce with the neighbouring nations of Europe infinitely more advantageous than that of so distant a country as America’ (EHIII, 1962, p. 202).

Prime Minister William Pitt shared this recognition, and dispatched Eden to conclude treaties of commerce with major European countries. The resulting Anglo-French accord of 1783 involved the elimination of prohibitions and a modest reduction of duties on bilateral trade to eliminate smuggling and raise tariff revenues for both governments. While this agreement ranks among the first significant modern action on mutually advantageous trade liberalisation, Britain’s unprecedented attempt at trade negotiations was most notable for its utter failure. From 1785-93, interminable negotiations with Portugal, Spain, Poland, Prussia, and several other important trading partners in Europe (and even Ireland) failed to produce any agreements. European fears of import competition and a variety of political and diplomatic considerations account for this failure. Even the accord with France lasted less than six years as the French revolution led to cross-channel tensions. The subsequent Napoleonic wars severely disrupted European trade for nearly two decades and extinguished any immediate hopes for progress on tariff reform.
2.1 Britain's lead to free trade

The end of European hostilities in 1815 brought a steep fall in agricultural prices as normal commerce resumed. Import protection for agricultural producers was established throughout Europe in response as landowners, not merchants, retained control of economic policy. Yet this only temporarily delayed continuation of the prewar liberalisation effort: despite the passage of the highly protectionist Corn Law of 1815, Britain still recognised the value of foreign markets for its manufactures. With the Reciprocity of Duties Act (1823), the Board of Trade strove to conclude reciprocal agreements with foreign governments for MFN treatment of goods and shipping. Although several such agreements were signed, they did not eliminate prohibitions or reduce tariffs, and were therefore of limited consequence. Tariffs were later the subject of what proved to be unsuccessful negotiation. Britain deliberately maintained high tariffs on sugar, coffee, wines, and spirits for bargaining purposes, but all to no avail. In 1836 Britain offered to abolish its timber duties for Prussia in exchange for lower tariffs on British textiles, but Prussia held out for a reduction of the Corn Laws and no agreement was reached.

Efforts at reciprocal tariff reductions thus failed in the 1830s and 1840s, just as they had in the 1780s and 1790s. As Brown (1958, p. 132) put it, 'the drive to open markets in the countries of western Europe for British industry, and particularly in the years 1838-40 the British cotton industry, was uniformly unsuccessful'. Frustration and discouragement with reciprocity accumulated: trade negotiations were 'ever pending, never ending'. This lack of progress set the stage for unilateral tariff reforms in the early 1840s, which culminated in the repeal of the Corn Laws in 1846. As Prime Minister Robert Peel explained that year, 'Wearyed with our long and unavailing efforts to enter into satisfactory commercial treaties with other nations, we have resolved at length to consult our own interests, and not to punish those other countries for the wrong they do us in continuing their high duties upon the importation of our products and manufactures, by continuing high duties ourselves'. By adopting unilateral free trade, Britain resolved to forsake the bargaining motive for tariffs henceforth applying its tariff without discrimination, enacting tariff reforms on its own timetable, and leaving other countries free to determine their own tariff policies.

So complete was the conversion to unilateral free trade that treaties came to be viewed as dangerous, as tempting compromise with Britain's principles of non-discrimination and of bargaining abstinence. No longer desirable yet unobtainable, treaties of commerce became entirely disreputable and any effort toward them was dismissed as entirely counterpro-ductuctive. W.E. Gladstone, the future Prime Minister who served at the Board of Trade during this period, later reflected about the legacy of the 1830s and 1840s, which was the period during which England was most actively engaged in the endeavour to negotiate, with the principal states of the civilized world, Treaties for the reciprocal reduction of duties on Imports. The task was supplied on our side with sufficient zeal; but in every case we failed. I am sorry to add my opinion, that we did more than fail. The whole operation seemed to place us in a false position. Its tendency was to lead countries to regard with jealousy and suspicion, as boons to foreigners, alterations in their laws, which, though doubtless of advantage to foreigners, would have been of far greater advantage to their own inhabitants (Tooke and Newmarch, 1857, p. 398, emphasis in original).

Foreign countries were unprepared to reduce trade barriers in part because of the suspicion that to do so would be mainly to Britain's advantage.

British policymakers were left to hope that other countries would see the benefits of unilateral free trade and follow Britain's example. In the decade following the repeal of the Corn Laws, Britain's unilateral policy was not an overwhelming success in establishing free trade abroad, although free-trade activism was widespread (see Kindleberger, 1975). Some trade liberalisation occurred in the United States, which passed its most liberal tariff of the ante bellum period (timed clearly in conjunction with the Corn Law repeal) in 1846, and in Holland, Switzerland, and Portugal, where tariffs were eased significantly in the early 1850s. But the movement toward free trade did not overtake the rest of Europe until the Anglo-French commercial treaty of 1860, a treaty that heralded the beginning of a liberal international trading order which lasted until the outbreak of World War I in 1914.

2.2 The Anglo-French commercial treaty (1860)

Diplomatic considerations weighed most for both France and Britain in deciding whether to pursue a trade agreement. Tensions were high in Europe — indeed, there was a real possibility of war — as a result of France's opposition to Austria's influence in Italy. Domestic political and economic factors generally ran against such an agreement. Though the French emperor Napoleon III had initiated some tariff reforms in the 1850s, he worried about reducing tariffs too much and offending protectionist interests in the legislature. Britain was also somewhat reluctant to pursue an agreement as that would violate its policy of unilateral free trade. But both governments saw a commercial treaty as a way of defusing
tensions and improving diplomatic relations, and an agreement was quickly reached. There was one important political economy reason for pursuing an agreement as well. Though abandoning its policy against bargaining over tariffs, Britain had a rare opportunity to provide a mechanism that would enable the French emperor to circumvent domestic protectionist interests. Unlike the strong support for free trade in the British parliament, the French legislature overrepresented import-competing interests that wholly opposed lower tariffs. Although the legislature was responsible for all tariff legislation, Napoleon III had the authority under the constitution of 1851 to sign foreign treaties without legislative approval. Consequently he embodied the tariff changes in a diplomatic accord with Britain.7

According to the terms of the treaty, France abolished all prohibitions and imposed specific duties not exceeding 30 percent ad valorem, or 25 percent after 1865, although in practice most duties were set at 10–15 percent (Ashley, 1926, pp. 299–300). Britain cut the number of dutiable goods from 419 to 48 and reduced the wine tariff. The treaty was subject to renewal after 10 years, and either party could withdraw from the agreement after giving a year’s notice. Perhaps the most important element of the treaty was Article V of the complementary convention, which stated: ‘Each of the contracting powers engages to extend to the other any favor, any privilege or diminution of tariff which either of them may grant to a third power in regard to the importation of goods whether mentioned or not mentioned in the treaty of 23d of January, 1860’ (US Tariff Commission, 1919, p. 395). Inclusion of the MFN clause eliminated the need for renegotiation in the event that either country lowered tariffs with a third country and automatically preserved non-discriminatory access of both countries in each other’s markets. The unconditional MFN clause became the linchpin of the 19th-century commercial treaty network.

3 The 19th-century open trading regime

The systemic effects of the Anglo–French treaty were of much greater significance than its importance to either country alone. The treaty sparked a spectacular movement toward the liberalisation of world trade, the initial impetus for which was the trade diversion that promised to accompany the integration of Europe’s two largest economies. While Britain insisted on making its own tariff reductions applicable to all nations, France lowered its import duties on British goods only, adopting a two-tiered tariff system of ‘autonomous’ tariff rates for MFN countries and higher ‘conventional’ rates for others. Only Britain benefited from the new lower rates and other countries were left at a substantial disadvantage in exporting to the large French market.

As other European states quickly sought agreements with France to secure equal treatment for their own goods, the Anglo-French treaty—which began as a purely bilateral arrangement without abiding support in either country—rapidly cascaded into a series of bilateral trade agreements, all linked by the inclusion of an unconditional MFN clause. France extended the unconditional MFN trade network by concluding commercial treaties with Belgium in 1861, the Zollverein in 1862 (effective in 1865), Italy in 1863, Switzerland in 1864, Sweden, Norway, Spain, and the Netherlands in 1865, and Austria in 1866. These agreements entailed significant new tariff reductions for those joining the arrangement, and the unconditional MFN clause proved to be a remarkably efficient instrument that encouraged other countries to join and also receive MFN treatment. The increase in treaty participants extended the coverage of low tariffs to virtually all of Europe.8

What triggered the swift acceptance of a new, low-tariff regime in Europe? Some bargaining models suggest that free-rider and other problems create difficulties in sustaining trade liberalisation under the MFN clause.9 But in this period when MFN treatment was sought by most countries in Europe, the clause propelled trade liberalisation and acted as a strong inducement for others to join the treaty network, thereby building the number of treaty participants. Once Britain and France initiated the move to lower tariffs, the smaller countries of Europe clearly had an economic interest in obtaining equal treatment in the French market. The addition of the Zollverein, where a mix of political and economic motives were present, built particular momentum to the Europe-wide movement and added further incentives for other European states to join the chain of unconditional MFN treaties.10 Britain, Belgium, Italy and others then signed agreements with the Zollverein in 1865 to receive MFN treatment. Thus, through a variety of fortuitous circumstances, a single bilateral agreement to reduce tariffs blossomed into dozens of bilateral accords, resulting in an effectively multilateral arrangement under which international trade entered an unprecedentedly liberal era. Under the treaty arrangement, tariffs were generally set at about 8–15 percent with a maximum of 25 percent (Liepmann, 1938, p. 369). Bairoch (1989) suggests that the period of free trade in Europe peaked from 1866 to 1877, although not just this narrow window but much of the half-century to 1914 was marked by low government barriers to trade. At the start of 1908, Britain had MFN agreements with forty-six countries, Germany with thirty countries, and France with over twenty countries (Hornbeck, 1910, p. 57).
It is important to note that diplomatic objectives and tariff-bargaining were not the sole impetus behind European trade liberalisation. Additional unilateral reforms by Britain resulted in essentially four items taxed for revenue purposes (i.e., tariffs as the application of domestic excise duties to comparable imports) by the 1880s. Internal free-trade interests prompted Germany to enact substantial tariff reforms independently of treaty obligations when the Reichstag voted in 1873 to eliminate virtually all import tariffs by 1877 and to reduce those on textiles substantially. Consequently, tariffs on chemicals were eliminated at the beginning of the 1870s and all tariffs on grains and iron products (except fine iron goods) were to be phased out by the end of the decade (Ashley, 1926, p. 40). The same was true to varying degrees in other countries, even if protection was not entirely erased across Europe.

Even the colonies were brought into the liberal trading order. In the 19th century, the developing countries of today were, for the most part, colonies of the major European countries, each traditionally maintaining reciprocal preferences for each other’s goods. In the mid-1840s and 1850s, Britain eliminated all tariff preferences for colonial supplies of timber, sugar, and other raw materials and also granted tariff autonomy to its self-governing colonies, allowing them to abolish preferences that favoured British manufactures. In dependencies such as India, Britain maintained a non-discriminatory ‘open-door’ policy of applying the same low tariffs on foreign and British goods.11

In the trade treaties signed after 1860, the MFN clause was widely interpreted to include colonial trade and open-door policies were practised by other countries.12 French colonies adopted the same tariff code as France, thus completing a full CU. German, Belgian, and Dutch colonies operated with low, non-discriminatory tariffs. At the Conference of Berlin in 1885, the European powers established that all colonies in central Africa would be open to trade with any country on the same terms, and this practice was maintained elsewhere to a remarkable degree. The European powers also took active steps to open up new regions to international trade on a non-discriminatory basis, often using military power to force autarkic countries to trade and fixing their tariffs at low levels. China lost its tariff autonomy with the Treaty of Nanking of 1842, which set its import duties at 5 percent ad valorem for over fifty years, and Japan faced similar externally-imposed constraints on its tariffs after 1858.13

3.1 The 19th-century treaty system and the GATT

The 19th-century treaty system invites comparison with the post-World War II trade regime led by the GATT. The main features of the two
regimes are compared in Table 4.1. A key similarity between the 19th-century order and the postwar GATT system is the principle of non-discrimination through the use of the MFN clause in its unexceptional and unconditional formulation. In the 19th century, MFN treatment would be granted to all countries with which an MFN agreement had been signed, and not just countries explicitly named in the treaties, as had been earlier practice. The MFN clause was also unconditional, meaning that the lowest available tariff would be applied automatically without requiring reciprocal concessions. The MFN clause ensured that all countries participating in the treaty network would continue to receive the best available tariff treatment, even if other countries engaged in further tariff reductions. Either an exceptional or a conditional interpretation would have slowed the initial advance of trade liberalisation by complication or extending the process of negotiation, although it is less clear that MFN was useful in sustaining lower tariffs. The unconditional form of the MFN clause became so well established that, despite the growth of protectionist pressures after the late 1870s, the conditional interpretation was not adopted. As with the treaty network, the GATT is based on the similar rule of granting unconditional MFN treatment to member states.

The treaty system also had significant weaknesses vis-à-vis the GATT. After the initial tariff cuts embodied in the agreements of the 1860s had formed the core of the 19th-century treaty arrangement, further progress on tariff reductions was not guaranteed. Most of the commercial treaties after this initial negotiating period ensured only non-discriminatory tariff treatment and did not place any limit on tariff rates, leaving each country free to set their tariffs without an effective external constraint on tariff behaviour. Nor was there any commitment to ensure progress toward even lower tariffs. In addition, the treaties were subject to periodic renewal and set to expire with regularity. The GATT, by contrast, established a contract in perpetuity that fixes and binds tariffs at a low level for the life of the agreement and provides for trade negotiating rounds. In principle the GATT also details a mechanism for compensation to penalise countries that nullify tariff obligations. At least in the 19th century, tariffs – with very few exceptions – were the only major government policy impediment to international trade. While this has been legally true under the GATT, quantitative restrictions (QRs), orderly marketing arrangements (OMAs), and voluntary trade restraints (VTRs) continued to exist outside of the GATT's purview. It could have been that tariff flexibility in the 19th century enabled countries to avoid resorting to these more pernicious barriers.

Unlike the GATT which arose as an institution by design, the 19th-century trade regime arose spontaneously from an uncommon confluence of events. Indeed, the 19th-century order was more an informal arrangement than a system. There was no primary sponsor with the economic standing or diplomatic ability or willingness to cajole or manage the arrangement, to punish defectors or free-riders, or to consolidate the abundance of bilateral treaties into a more soundly-based multilateral system. The most obvious candidate to play such a central role, Britain, failed to nurture the treaty network, provided no systemic guidance, and clung to a unilateral, laissez faire policy regarding international trade. Soon many of these weaknesses came to the fore.

3.2 The erosion of the liberal economic order

The outbreak of World War I in 1914 ensured that the treaty network never had the chance to break down completely. But tariff rates began to rise and tariff disputes became more frequent after the late 1870s, even if adherence to unconditional MFN remained intact and there was no turn to regional or preferential arrangements.

The general turn to higher tariffs in Europe in the late 1870s can be traced to one key source: the decline in agricultural prices in the late 1860s and into the 1870s, which created difficulties for the liberal trading order just as the oil shocks of 1970s contributed to a revival of protectionist pressures in the postwar period. The extension of railway networks into Russia and the United States brought a flood of cheap grain to Europe: grain imports by Belgium, France, and Germany averaged only 3 percent of domestic production a year in 1862–6, but had climbed to 20 percent by 1876–80 (Bairoch, 1989, p. 47). With Prussia having shifted from a net exporter to a net importer of grains, the 'iron and rye' coalition facilitated passage of the Bismark tariff of 1879 that increased protection to agriculture and, to a lesser extent, manufactures. Other countries, such as France, Belgium, Switzerland, and Sweden, followed with tariff increases in 1880s.

The backsliding in trade policy that followed the decline in agricultural prices was later compounded by a concentration of expiry dates for the European trade treaties. According to Bairoch (1989, p. 54), of the fifty-three treaties with expiry dates in force in 1889, twenty-seven were due to lapse in 1892 and twenty-one by 1895. Renegotiation of these treaties was more contentious than earlier because protectionist pressures were greater. The result was increasing acrimony and even tariff wars after 1885. Tariff wars often originated with a country repudiating a trade agreement to establish higher tariff rates. France and Italy (1888–9), Germany and Russia (1892–4), and France and Switzerland (1892–5) engaged in some of the more disputatious trade wars of the period. In a
'non-system' such as that in the 19th century, the threat of retaliation served as a constraint on domestic discretion in tariff matters and helped to maintain a low tariff equilibrium. But the realisation of retaliation, as during this period, suggests that the threat of retaliation was no longer a sufficient deterrent to ensure continuity of the low-tariff status quo.

Multilateral action was not taken to contain the rise in protectionist pressures. As early as 1875, several British officials sought to persuade their government that a European tariff conference should be convened to stem the growing threat of protectionism. But the government, specifically the first Gladstone Administration, remained firmly opposed to tariff-bargaining and still adhered to unilateral free trade as the basis for its policy (see Gaston, 1987). Britain also had precious few tariffs with which to bargain (the Treasury objected to reducing any revenue duties) and threats to exclude others from its market were not credible and were never made. While perhaps there was little it could do about higher European tariffs, Britain did not even attempt to seize the initiative and seek a multilateral agreement that would freeze tariff levels at existing levels.

The European trade policy environment did deteriorate after 1879, but the extent of the deterioration should not be exaggerated. Capie (1983), for example, suggests that effective rates of tariff protection remained relatively low through the final quarter of the 19th century to 1914. Germany returned to a more liberal policy in the 1890s and, under Chancellor Caprivi, signed several treaties that again reduced tariffs on agricultural goods and textiles. Yet tariffs were now being established for bargaining purposes; according to the US Tariff Commission (1919, p. 467), countries (particularly in central Europe) 'framed their general schedules not with a view to their being made operative but with reference to the advantages which they may offer as a basis for negotiations'. Furthermore, the increased specialisation of tariff categories meant effective tariff discrimination, with maximum advantage given to treaty partners and minimum advantage to other countries despite the MFN clause. The number of items in the German tariff code, for example, rose from 387 in 1879 to 946 in 1906.14

In several respects, however, the recent deterioration of the GATT system has been sharper than that of the 19th-century treaties. In the 19th century, unconditional MFN did not give way to regional or colonial preferences, as previously mentioned, and quantitative restrictions or prohibitions did not reemerge. Perhaps more significantly, unlike the present there was no recourse to anti-dumping (AD) actions or countervailing duties (CVDs) despite the appearance of a 'fair trade' movement in Europe in the 1890s (see Viner, 1923). Canada enacted a 'less-than-fair-value' law in 1904 and was soon followed by other self-governing colo-

nies, but such laws were entirely absent in Europe despite increased concern about dumping. In 1892, Belgium was the first European country to institute a CVD law, but few countries followed this practice before 1914. Many commercial treaties of the period contained anti-bounty pledges, but they neither prevented export subsidies (which were uncommon) nor were they enforced. Even the first prominent 'managed trade' issue was resolved in a rare multilateral agreement that achieved a liberal outcome.15

The foremost achievement and great success of the 19th-century treaty network was the establishment – through the widespread use of the MFN clause – of non-discrimination as the fundamental principle of European trade policy. This achievement stood as a solid advance over the centuries of discrimination in European markets. In addition, for at least twenty years after 1860 European countries enacted unprecedented tariff reductions. However, the 19th century achieved only part of what might have been hoped for. The lack of binding constraints on tariff levels allowed countries to backslide toward greater protection after 1879. The interwar period would see not only the absence of movement toward this higher objective, but even the substantial loss of the principal 19th-century accomplishment.

4 The interwar trade policy experience

The bilateral treaty regime ended abruptly in August 1914 with the outbreak of World War I. Tariffs, quantitative restrictions, prohibitions, and exchange controls were rapidly instituted around Europe to protect industries associated with national security and to secure foreign exchange for state-determined allocation. At the Allied Economic Conference of 1916, Britain, France, and Italy gave the first indication that the postwar international economic order would not resemble the prewar one. They resolved to cooperate on commercial policy after the war, but hinted at creating trade preferences for Allied countries by ruling out the extension of MFN treatment to Germany and other wartime opponents. The United States – now taking a more prominent role in the world trade arena – opposed any such discrimination and the third of President Wilson's Fourteen Points called for 'the removal so far as possible of all economic barriers and the establishment of an equality of trade conditions among all the nations consenting to the Peace and associating themselves for its maintenance' (League of Nations, 1942, p. 15).

But European countries were ill-inclined, and interwar institutions were ill-equipped, to restore commercial policy to its prewar basis. The Covenant of the League of Nations in 1919 weakened Wilson's call for 'equality'
of treatment, insisting in Article 23(e) only upon ‘equitable treatment’ in trade. And making no provision to ensure the reduction of trade barriers, the Covenant instead invited departures from this course by sanctioning trade controls owing to the ‘special necessities’ of economic recovery.

To be sure, the depression of economic activity and high rates of unemployment in the early 1920s were scarcely conducive to achieving progress on liberalising European trade policies. But efforts to coordinate the reduction of trade barriers after World War I were slow to get on track: no formal, multilateral action was ever taken to abolish prohibitions, reduce tariffs, or restore the MFN treaty network, and a consensus in favour of serious cooperative action was never achieved. Although most wartime controls were gradually phased out on a unilateral basis, the far-reaching degree of wartime intervention ensured that the pace of liberalisation was slow and uneven and extended well into the 1920s. As late as 1927 the League of Nations was still calling for the eradication of prohibitions and other restrictions that had been instituted during the war.

In instances where strict wartime controls were abolished, other barriers – mainly tariffs – rose to take their place. The United Kingdom, for example, did not return to its prewar free trade policy, but enacted the Safeguarding of Industries Act (1921) to extend wartime tariff protection to scientific instruments and other goods. After President Wilson left office, the United States passed the Fordney-McCumber tariff in 1922 to raise import tariffs substantially. Throughout the 1920s, European countries also took the opportunity to raise tariffs as normal commerce resumed. As Table 4.2 indicates, even by 1927 when many wartime prohibitions and restrictions had been eliminated or scaled back, tariffs – particularly on manufactured goods – were higher than before the war.

The restoration of some degree of economic stability in Europe by around 1925 put efforts to reach a European trade accord on a firmer basis. The World Economic Conference of 1927 called for any action whatsoever – unilateral, bilateral, or collective – to stabilise and then reduce trade barriers and restore the effectiveness of the MFN clause. Though the conference was not an official diplomatic meeting, many governments endorsed its recommendations and it was hailed as a success when several countries abandoned plans to revise their tariff codes. Stabilisation of tariff levels was thought to have been achieved when the number of countries revising their tariffs fell from sixteen in 1926 to five in 1928 (League of Nations, 1942, p. 42). A committee of the League even began considering particular formulae – either specifying maximum tariffs or taking percentage reductions – to be used in multilateral negotiations for tariff reductions on semi-manufactured goods. In addition,

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*The ‘potential’ tariff level refers to each country’s tariff on 144 representative commodities using European-wide trade weights.

Source: Liepmann (1938) p. 413.

the MFN treaty network showed faint signs of resurrection. The failure of the United States to join the League of Nations was compensated in part by its adoption of the unconditional interpretation of the MFN clause in 1922. France readopted the MFN clause when signing a trade agreement with Germany in 1927, and the number of countries linked by commercial treaties rose from thirty in 1927 to forty-two in 1928. Although serious discussion of tariff reductions on either a multilateral or a bilateral basis had yet to be undertaken, the upward drift in tariffs appeared to have been broken and a path to freer trade was emerging. At this point scarcely a decade had passed since the end of the war and continued economic recovery in Europe promised an ever-improving environment for the reform of trade policy. But a year later any hope of progress on trade liberalisation was dashed with the onset of the Great Depression.

4.1 The onset of the depression

The temporary respite from higher tariffs ended in the summer of 1929 when a sharp fall in agricultural prices prompted tariff hikes in Germany, France, Italy, and elsewhere by the year's end. The initial outbreak of protection in response to lower agricultural prices had some similarities with the late 1870s, but the situation deteriorated much more rapidly in the early 1930s. The passage of the Smoot–Hawley tariff in the United
States in June 1930 sparked another round of tariff increases, retaliatory and otherwise, throughout Europe. As the depression deepened, even the United Kingdom imposed emergency duties in late 1931, followed by the general tariff of February 1932. Table 4.2 illustrates how tariffs rose substantially in many other European countries between 1927 and 1931 and were heavily skewed toward protecting agriculture.

The unravelling of the world trade regime after 1929 made the mild erosion in the low-tariff era prior to World War I appear entirely trivial. Widespread deflation, increasing unemployment, and financial crises in the early 1930s landed devastating blows at what remained of the open trading system. Agricultural interests were behind the initial resort to higher tariffs and achieved some sectoral favouritism, but protection arose so rapidly and became so broadly based as the depression spread and deepened that its rise can perhaps be explained only as a desperate attempt to insulate all sectors from falling prices and to stimulate overall economic activity in response to a crisis of major proportions.

And further unlike the period after 1879 when there were no multilateral conferences held or actions taken to resist the tariff increases, the interwar period was replete with meetings and pronouncements reflecting international concern about maintaining open trade, but without any real political resolve to resist growing protectionism in the face of economic collapse. As Gordon (1941, p. 33) put it, ‘the complete failure of every attempt to secure multilateral action in the sphere of commercial policy in 1930 and 1931 resulted in large part from the unwillingness of nations to commit themselves to international obligations which would limit their freedom to combat the depression through autonomous measures’. Conferences sponsored by the League of Nations aimed to declare a ‘tariff truce’ in 1930 and 1931, for example, but failed in part because agricultural states in central and eastern Europe insisted on further protection and demanded preferential treatment for their goods in industrial Europe. As the League of Nations (1942, p. 101) later observed, ‘the international conferences unanimously recommended, and the great majority of Governments repeatedly proclaimed their intention to pursue, policies designed to bring about conditions of “freer and more equal trade”; yet never before in history were trade barriers raised so rapidly or discrimination so generally practiced’.

The policy instruments of the ‘new protectionism’ of the 1930s were blunt: quantitative restrictions, prohibitions, exchange controls, and clearing agreements. State bureaucracies were created to monitor or manage each international transaction, whether financial or merchandise. The market mechanism in international trade was subordinated to state planning and the priority of state requirements; the extent of government regulation of international trade across Europe had perhaps never been so pervasive and detailed. Protectionism consequently became much more entrenched than in the 19th century when only non-discretionary tariff barriers had to be grappled with.

Yet countries varied distinctly in the degree to which they adopted protectionist measures. Just as Eichengreen (1992) describes how the magnitude of a country’s macroeconomic difficulties during this period can be linked to its policy toward the gold standard, the stance of a country’s commercial policy was also crucially related to its position in the international monetary system. In the early 1930s, deflationary pressures in many countries arose from a loss of foreign exchange or gold reserves. These countries faced a choice between import restrictions or devaluation as a means to stimulate the domestic economy while preserving external balance. The gold-bloc countries led by France clung to the gold standard and strove to maintain their currencies at par. In acceding to the accompanying deflationary pressures, these countries experienced a severe overvaluation of their currencies. This worsened the merchandise trade balance and forced resort to quantitative restrictions and import licensing to stem the further loss of reserves so that gold-standard parity could be maintained and devaluation avoided. By contrast, the sterling-bloc countries led by Britain took their currencies off the gold standard in September 1931. The depreciation of sterling against gold relieved the deflationary pressures arising from the balance of payments, alleviated macroeconomic distress, and consequently tempered the demand for severe import restrictions.

This relationship between direct controls on trade and commitment to the gold standard is illustrated in Figure 4.1. The proportion of total imports (by value) subject to licensing or quota restrictions in 1937 (for countries that maintained freedom in foreign exchange dealings) was highest for the gold-bloc countries—France, Switzerland, the Netherlands, and Belgium. Particularly surprising is the degree to which Switzerland and the Netherlands, traditionally free-trade countries, adopted direct trade controls. By contrast, the sterling-bloc countries—Sweden, the United Kingdom, Norway, and Ireland among them—faced less pressure to institute import restrictions because they opted for exchange rate depreciation. This cross-country pattern of import regulation appears more consistent with trade protection that had its origins in the macroeconomic depression rather than in the lobbying efforts of various interest groups. 16

A third group of countries, mainly those in central and eastern Europe, curtailed trade directly through stringent controls on foreign exchange transactions. The collapse of international lending by western creditors to
Germany and eastern Europe after 1929 resulted in severe balance of payments difficulties for these debtors. A financial panic in 1931 prompted Germany to lead these countries to restrict international payments by introducing controls on foreign exchange. Virtually every other east European country, from Poland and the Baltics in the north of Yugoslavia and Greece in the south, followed in rapid succession. Italy and Poland regulated nearly every foreign exchange transaction, while other countries such as Austria, Czechoslovakia, and Greece restricted substantial shares of such transactions (see Haberler, 1943).

While varying in their degree of stringency, these controls choked international trade and were followed by exchange-clearing arrangements aimed at eliminating bilateral trade imbalances and stemming the flight of capital. Clearing agreements were instituted to avoid the use of foreign exchange transactions in international trade to preserve liquidity and reserves. Through the Schacht agreements, Germany took deliberate steps to divert imports from those countries demanding payment in convertible currencies to those accepting German exports as payment, mainly countries in south-eastern Europe and Latin America. In many instances, trade in eastern and central Europe was reduced to barter. In South America, different exchange rates and multiple tariff rates were used to discriminate against countries with which a country had a trade deficit.

The consequences for world trade of this pattern of restrictions among the exchange control group and the gold- and sterling-bloc countries are not difficult to predict. Table 4.3 shows that the restrictions imposed by the exchange control group were so severe that even the depreciation of their currencies against gold could not stimulate their trade. Their share of world exports fell from 27 percent in 1931, when the controls were largely introduced, to 22 percent in 1937. Gold-bloc countries also saw their share of trade shrink in the face of quantitative restrictions and overvalued currencies. The trade of other countries, mainly the sterling group, accounted for a larger proportion of world trade as exchange rate depreciation boosted trade directly and avoided need for trade restrictions. The share of these countries rose despite ‘exchange-dumping’ measures, i.e., tariff surcharges to offset exchange rate changes, taken against them by other countries.

In seeking to eliminate all losses of foreign exchange reserves by ensuring balanced trade on a bilateral basis, the exchange control group gave rise to a ‘pernicious’ bilateralism in trade policy. This bilateralism stifled and diverted trade by bureaucratic fiat. Similarly, the harsh trade measures adopted by the gold-bloc countries were also inherently discriminatory, if not strictly ‘bilateral’ in nature. However, these policies were rooted in the difficulties of the international monetary system. Countries that opted for exchange rate depreciation did not resort to protectionist trade barriers to the same degree.

To be sure, explicit discrimination through tariff preferences was a feature

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**Figure 4.1 Licence or quota restrictions in 1937**

*Source: Haberler (1943, p. 19)*

**Table 4.3. Share of gold value of world exports, excluding the United States, %, 1931 and 1937**

<table>
<thead>
<tr>
<th></th>
<th>1931</th>
<th>1937</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exchange control countries&lt;sup&gt;a&lt;/sup&gt;</td>
<td>27.2</td>
<td>22.5</td>
</tr>
<tr>
<td>Gold-bloc countries&lt;sup&gt;b&lt;/sup&gt;</td>
<td>15.9</td>
<td>12.1</td>
</tr>
<tr>
<td>Other countries&lt;sup&gt;c&lt;/sup&gt;</td>
<td>56.8</td>
<td>65.4</td>
</tr>
</tbody>
</table>

**Notes:**
<sup>a</sup> Austria, Bulgaria, Czechoslovakia, Denmark, Estonia, Germany, Greece, Hungary, Italy, Latvia, Lithuania, Poland, Portugal, Roumania, Turkey, Yugoslavia.
<sup>b</sup> France, Belgium, the Netherlands, and Switzerland.
<sup>c</sup> Principally sterling-bloc countries.

Table 4.4. Shift in trade patterns, 1929–38

(a) Share of intra-imperial trade, 1929 and 1938, %

<table>
<thead>
<tr>
<th>Trade of</th>
<th>Share of</th>
<th>Imports</th>
<th></th>
<th></th>
<th></th>
<th>Exports</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>1929</td>
<td>1938</td>
<td>1929</td>
<td>1938</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>United Kingdom</td>
<td>British Commonwealth, colonies, protectorates</td>
<td>30.2</td>
<td>41.9</td>
<td>44.4</td>
<td>49.9</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>France</td>
<td>French colonies, protectorates, mandated territories</td>
<td>12.0</td>
<td>27.1</td>
<td>18.8</td>
<td>27.5</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Belgium</td>
<td>Belgian Congo</td>
<td>3.9</td>
<td>8.3</td>
<td>2.6</td>
<td>1.9</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Netherlands</td>
<td>Overseas territories</td>
<td>5.5</td>
<td>8.8</td>
<td>2.6</td>
<td>1.9</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Portugal</td>
<td>Overseas territories</td>
<td>7.9</td>
<td>10.2</td>
<td>12.7</td>
<td>12.2</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Italy</td>
<td>Colonies and Ethiopia</td>
<td>0.5</td>
<td>1.8</td>
<td>2.1</td>
<td>3.3</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

(b) Regional preferences in the trade of Japan and Germany, 1929 and 1938, %

<table>
<thead>
<tr>
<th>Trade of</th>
<th>Share of</th>
<th>Imports</th>
<th></th>
<th></th>
<th></th>
<th>Exports</th>
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<td>1929</td>
<td>1938</td>
<td>1929</td>
<td>1938</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Japan</td>
<td>Korea, Formosa, Kwantung, Manchuria, Six south-eastern European countries and Latin America</td>
<td>20.2</td>
<td>40.6</td>
<td>24.1</td>
<td>54.7</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Germany</td>
<td></td>
<td>16.7</td>
<td>27.6</td>
<td>12.8</td>
<td>24.7</td>
<td></td>
<td></td>
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</tr>
</tbody>
</table>


But preferential tariff treatment should hardly have been the major concern of the day. The shift in trade patterns described in Table 4.4 was probably accomplished more through exchange rate agreements, clearing and payments arrangements, bureaucratic allocation of import quotas and the like rather than through tariff preferences. The League of Nations (1942, p. 119) observed that 'effective discrimination by methods which did not violate the letter of the [MFN] clause continued to be widely practiced' throughout the 1930s. Non-tariff restrictions became so far reaching as to render tariffs — even discriminatory tariffs — the least important trade barrier to be surmounted. In an environment of quotas and exchange controls, attempts to reestablish non-discriminatory MFN tariff treatment among major countries were absolutely meaningless. As Nurkse (1944, p. 175) observed, 'Real equality of treatment, aimed at ensuring multilateral trade in accordance with market criteria, is ... impossible when the control determines not only the purposes, commodities and firms but also the countries to which exchange is allotted.'

Yet the League and other international gatherings during this period constantly emphasised the need to restore MFN treatment in Europe. These efforts were misplaced and probably even counterproductive by harming the chances for trade liberalisation. The instability in the international financial system that bred the use of 'hard core' non-tariff barriers (such as licences, quotas, and exchange controls) was the root source of the protectionist trade policies in the 1930s. Removal of the underlying instability by improving international macroeconomic policy and the 'tarification' of existing restrictions would have been a more useful allocation of multilateral effort. With an international economic environment so vastly different from that in the 19th century, stress on unconditional MFN in the 1930s stymied what little effective support there was for trade liberalisation. High-tariff countries refused to accept any exception to MFN treatment by others unless they were to be recipients of the lower tariffs. This intransigence over the interpretation of the MFN clause posed a barrier to regional liberalisation that at least would have allowed some countries to end and reverse the upward movements in tariffs. With the benefit of hindsight, even the League of Nations (1942, pp. 119–20) conceded that 'instead of facilitating, the clause tended to obstruct the reduction of tariffs', noting that when it became apparent that multilateral negotiations on an almost universal scale were not likely to succeed, certain groups, especially the Oslo group of countries, were anxious to achieve the general objects advocated in international conference within a more restricted area. Had general support of such endeavours been forthcoming, it is possible that the practice of reduction through group agreements might have spread and the groups gradually have extended their size. Such a procedure
might have been less favourable to world trade as a whole than the rapid conclusion between a large number of countries of bilateral treaties embracing the MFN clause, but not less favourable than the failure to grant concessions owing to the quasi-universal implications of the MFN.

For example, the Second Conference with a View to Concerted Economic Action, in late 1930, recognised that the chances for a multilateral agreement did not exist and that bilateral agreement was the only feasible path to liberalisation. But the conference encouraged this path only if tariff reductions from those agreements were extended to others through unconditional MFN treatment. Later, in mid-1932, Belgium, Luxembourg, and the Netherlands signed the Uchy Convention in which they and any other willing participants agreed to staged tariff reductions amounting to 50 percent of existing tariffs. This could have formed the nucleus of a movement toward freer trade, but Britain and others insisted that the convention would be a violation of the unconditional MFN principle unless the tariff cuts were generalised. This undermined the agreement and the convention never entered into force.

This "progressive" bilateralism, allowing a subset of countries to expand trade through tariff reductions and thereby giving an incentive for others to follow, was squelched while the "pernicious" bilateralism of quantitative restrictions and bureaucracy-administered exchange controls was allowed to fester unchecked. The result was a sharp reduction in world trade: the volume of trade declined 40 percent from 1929 to 1932, while real world output fell only 20 percent. When economic recovery had gradually been restored by the mid-1930s, the volume of trade lagged severely behind the rebound in income.

4.2 Toward another postwar order

The seeds of more effective international cooperation were sown in the mid-1930s after the trough in economic activity had passed. Though not of sufficient strength to save the decade of the 1930s, international cooperation, particularly between Britain and the United States, helped set the groundwork for the next postwar international economic order.

The Tripartite Agreement of 1936 was a success in initiating cooperation on financial matters between the United States and western Europe. France, Switzerland, the Netherlands, and Italy finally devalued their currencies against gold, thus enabling the gold-bloc countries to dismantle some of their import quotas and licences. The recession of 1937, however, ended this liberalisation of import restrictions.

Of greater significance was the stirring international activism of the United States. Having contributed in no small degree to increased world protection by instituting the Smoot–Hawley tariff in 1930, the United States now played a key role in the Montevideo conference in December 1933 which promised negotiations among western hemisphere republics to reduce tariffs on trade in the Americas. By the Reciprocal Trade Agreements Act of 1934, subsequently renewed in 1937 and 1940, the Congress delegated limited tariff-negotiating powers to the president, enabling him to offer reciprocal concessions amounting to up to a 50 percent reduction in tariffs. The United States had mixed success with the purely bilateral approach to trade liberalisation, although some tangible progress on creating momentum toward lower tariffs was made. By 1938, a full third of American tariffs had been cut by at least 20 percent, and many by the full 40-50 percent, with countries signing agreements with the United States. By 1939, the United States had signed 20 MFN treaties with countries that accounted for 60 percent of its trade. Most notable was the agreement with Britain in 1938 that set the stage for the great Anglo-American cooperation during World War II that eventually led to the Bretton Woods conference in 1944 where the cornerstones for the postwar economic order were established.

While the economic environment for trade liberalisation was improving, if still shaky, after 1934, the political situation in Europe began to deteriorate with the rise of fascism. After the mid-1930s, the League of Nations (1942, p. 149) observed, 'the political foundations for any liberalization of commercial policy had been shattered and the tendencies towards closed economies and rigid state regulation gained impetus from year to year under the exigencies of a near-war economy'.

5 Trade liberalisation in historical perspective

The lessons to be drawn from the trade policy experience of past decades for current concerns about the direction of the world trading system are, unfortunately, somewhat limited. The relative serenity and simplicity of the 19th-century order, with its absence of discrimination, quantitative restrictions, 'fair trade' laws, or industrial policies, cannot be replicated today. And the challenges for trade policy today are nowhere near as urgent as those experienced in the interwar period. Nonetheless, certain themes that have relevance for today's concerns do emerge from this retrospective look at trade policy.

One important lesson about facilitating multilateral free trade is that long periods of macroeconomic stability provide an environment conducive for the adoption of liberal trade policies. That is based on the 19th-century and postwar experiences, a sound international monetary and financial system appears to be a prerequisite for (or at least an
important complement to) an open trading system. Major supply disruptions such as large positive or negative price shocks had proved to be detrimental to an open trade regime. The agricultural and raw material price shocks of 1815, 1879, 1929, and 1973 are each associated with an important shift in the direction of world trade policies toward greater protection.\footnote{17} But avoiding macroeconomic difficulties and large price shocks lie outside the realm of what trade policy can achieve. What lessons emerge about the types of policies that change the world trading system for the better? Here again, the trade policy experience of the past 150 years does not provide clear guidance. Multilateral cooperation on trade policy is not necessary either for the liberalisation of trade policy or for the prevention of illiberal trade policies. Multilateralism was not a feature of the 19th century, whereas multilateral talks were repeatedly held in the 1920s and 1930s to no avail. Similarly, bilateral trade policies cannot be uniquely praised or condemned. A progressive bilateralism flourished in the 19th century, with the prospect of trade diversion from the Anglo-French accord of 1860 leading other countries to join and reduce tariffs rather than to retaliate and raise them. In the interwar period, such progressive bilateralism—the sole hope for freer trade—was extinguished in the misplaced desire to restore unconditional MFN treatment first. At the same time, the pernicious bilateralism that emerged was rooted not so much in terms of international trade policy and tariff discrimination as in the malfunction of the international monetary system, which prompted the bureaucratic allocation of import quotas and foreign exchange to eliminate all bilateral payments’ imbalances.

Although the complexity of international economic issues was greater in the interwar period than in the 19th century, the number and size distribution of European countries did not change considerably between these periods. Britain provided no leadership on international trade negotiations in the 19th century and it is not clear that the vacuum of leadership in the 1920s and 1930s (on the trade policy front, if not in the international monetary system) was the primary source of the period’s failures.

Yet the fact that multilateral cooperation was absent in the 19th century and failed in the interwar period is no excuse to ignore its great success since 1947 and abandon this path to the reform of policy owing to current difficulties. The GATT eliminated the tariffs and the discrimination in international trade that was established in the interwar period, thereby restoring world trade to its pre-World War I basis. To top the 19th-century achievement, the GATT also imposed restrictions on the imposition of new trade barriers, however imperfect those restrictions may be, and set up a dispute settlements mechanism, however weak that mechanism may be, and ensured ongoing liberalisation, however time-consuming and complex these negotiations have become. While there remain major gaps in its effectiveness, notably dispute settlement and the control of fair trade laws, the GATT in principle represents a substantial improvement over the 19th-century treaty network.

As for bilateralism, it is extremely difficult to judge the trade policy environment and to determine whether the regional blocs of today constitute the progressive or the pernicious variety of bilateralism. Fortunately, the trade blocs of today are at least predicated on the notion of reducing barriers among participants and not raising barriers against non-participants. That the EFTA countries seek links with the European Community and that the several South American trading arrangements have as their ultimate aim to join the North American Free Trade Agreement (NAFTA) provides at least one signal that recent regional blocs exhibit the ability to expand membership rather than remain exclusive. If this expansion can be accomplished without harming efforts to strengthen the multilateral GATT approach, then the liberal postwar open trading system will be far from finished.

\begin{center}
\textbf{NOTES}
\end{center}

1 Bhagwati (1991) makes a vigorous case for preferring multilateralism, and urges that regional trade agreements be harnessed toward improving the multilateral GATT system. Dornbusch (1990) expresses greater scepticism about the viability of the multilateral approach, and argues that bilateral agreements can restore progress on world trade liberalisation.

2 See O’Brien (1976) for a discussion.

3 Although political union often precedes customs union, the converse is less frequent. According to Viner (1950, p. 96), aside from the German Zollverein case, there appear to have been only three instances where substantial tariff unification preceded political union, and in none of these cases can it be held that the tariff unification was in any way responsible for creating a sentiment favorable to political union, or that in any other significant way made a substantial contribution to the eventual realization of political unity.\footnote{16}

4 Britain encountered difficulty in tariff bargaining in part because it refused to grant preferential access to other countries in its own market. Export interests demanded that raw materials, which comprised much of Britain’s imports, be obtained at the lowest possible cost, while Richard Cobden (a founder of the Anti-Corn Law League) argued for non-discrimination in trade as fostering international peace. In addition, Britain found no need to strive for preferential access in foreign markets, remaining confident that its comparative advantage in manufactured goods would ensure the success of exporters, provided only that non-discriminatory treatment of its goods abroad was assured.
The crisis sparked by the harvest failure in Ireland paved the way for the repeal of the Corn Laws, leaving no time for them to be used as a bargaining tool.

Commercial agreements in the form of foreign treaties proved useful in circumventing protectionist interests in the legislature throughout Europe. The treaty mechanism allowed European countries to reduce legislative discretion over tariffs far in advance of the United States and thereby liberalize their policies sooner. In the United States, only with the Reciprocal Trade Agreements Act of 1934 were limited tariff-making powers formally delegated from the legislature to the executive branch. In the absence of a pro-trade executive, however, the lack of broadly-based domestic support for trade liberalisation meant the underlying commitment to such reforms was weak. In France, for example, the Anglo-French treaty was weakened and eventually abandoned after Napoleon was replaced in 1870.

The only major European state that resisted joining the spate of trade treaties in early 1860s was Russia, which finally acceded in 1874. Britain signed a similar number of agreements to secure the MFN treatment it had already granted to others, though it was unable to sign treaties with Spain and Portugal which demanded preferential treatment. The United States also stood outside of the treaty system and sought (by and large unsuccessfully) preferential trade agreements with Latin America. The United States also held to a conditional MFN policy, wherein reciprocal concessions were required before extending MFN treatment to third countries.

A change in the Zollverein’s tariff required unanimous agreement among members, and Prussian grain producers and western German merchants had long been prevented from enacting lower tariffs by the protectionist states in southern Germany. Prussia also sought to maintain its preeminent status in the Zollverein by excluding its rival Austria. Knowing that the current Zollverein agreements were soon up for renewal, Prussia approached France about a trade pact two days after the signing of the Anglo-French treaty and then committed itself to substantially freer trade by signing an agreement with France in 1861. Prussian leaders reasoned that Austria would have no interest in joining the Zollverein at such low tariff levels, and that the southern German states would have either to endorse the accord and align their tariff with Prussia’s or leave the Zollverein. The tactic worked: after sharp resistance, the south German states agreed to stay in the Zollverein, Austria remained outside the agreement, and Prussia achieved greatly enhanced power in the Zollverein. See the discussion in Henderson (1957, 1959).

Sometimes it is asserted that there was a ‘free-trade imperialism’ in China, Argentina, and elsewhere such that the open-door policy was more posture than reality. But Platt (1968a, p. 297) found that ‘the range of government action on behalf of overseas trade permitted by the laissez faire tradition of the time was extraordinarily narrow; official demands on behalf of British interests overseas never went beyond equal favour and open competition’. High trade volumes between the colonies and the European coloniser could persist not because of discriminatory government policy, but because of monetary integration, transactions costs (such as telegraph and shipping links), and trade-related foreign direct investment.

According to Huber (1971), as a result of the forced opening by the West, Japan’s terms of trade improved by a factor of three and its national income rose roughly 65 percent in the transition from autarky to free trade.

In the German tariff of 1902, according to Platt (1968a, p. 93), there was even a tariff category for ‘large dappled mountain cattle or brown cattle, reared at a spot at least 300 meters above sea level, and which have at least one month’s grazing each year at a spot at least 800 meters above sea level’.

A convention in 1864 among major European powers failed to end the subsidisation of domestic sugar beet producers in many European countries. After removing the sugar tariff in 1874, Britain’s colonies complained about competing against subsidised sugar in the British market. Law officers of the Crown ruled in 1880 that CVDs could not be imposed because they would violate the MFN clause of various commercial treaties. The Brussels convention on sugar in 1902 abolished all direct and indirect support for sugar and called for CVDs against countries that continued to subsidise sugar exports. The convention was generally a success, but Britain was so adamant about Not violating the MFN clause that it withdrew from the convention in 1912 on the grounds that either quantitative restrictions or CVDs would violate it.

See Dornbusch and Frankel (1987). State bureaucracies as interest groups, however, would have a much greater stake in import regulation than in allowing the market to function anonymously through a change in relative prices brought about by a devaluation.

It is also instructive to note that the agricultural sector has long been a chronic stumbling block on the path toward free trade. Local ‘policies of provision’ ensured regional self-sufficiency in the mercantilist period, the Corn Laws hindered trade liberalisation in the aftermath of the Napoleonic Wars, the Russian and American grain shock triggered a move to protection and significantly weakened the 19th-century trading system, acute agricultural distress sparked the return to protection in the 1930s, and, of course, agricultural trade has stubbornly resisted all attempts to be brought under the rules of the GATT.

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Discussion

BARRY EICHENGREEN

Commenting on Douglas Irwin’s papers is no fun. They are historically literate. They are elegantly written. They are carefully argued. They leave the discussant little to say. Chapter 4 here is no exception. In an approach to policy analysis near and dear to my heart, Irwin looks back at previous historical episodes of successful and failed trade liberalisations to see what light they shed on current controversies over how to best achieve an open trading system. The motivation, as the chapter makes clear, derives from the trend in recent years away from the multilateralism of the GATT and toward regional – in some cases, bilateral – trade agreements. At issue is whether bilateralism or multilateralism is more conducive to trade liberalisation, a question upon which Chapter 4 seeks to shed historical light.

If the author strongly endorsed one or the other strategy, it might have been possible for us to engage in an entertaining fight. What he has instead done is to conclude – correctly – that the answer depends on the circumstances. There is good bilateralism and bad bilateralism. Bilateral agreements can be trade-creating or trade-diverting. Bilateral agreements can lead to a cascade of other bilateral agreements and to a general opening of trade, or to retaliation against discrimination and to the fragmentation of trade. Similarly, there is good multilateralism and bad multilateralism. Multilateral negotiations can reduce negotiating costs through economies of scale, or they can divert attention away from potentially beneficial bilateral deals.

History provides, as Irwin notes, examples of all of these cases: of benign bilateralism in the 1860s and pernicious bilateralism in the 1930s; of