Chapter Two

ECHOES OF PAST

“Our task is to explore the ruins of our international order and discover on what fresh foundations we may hope to rebuild it; and like other political problems, this problem must be considered from the standpoint both of power and of morality.”

Carr, 1964, p.226

It is not easy to compress centuries into pages; even an attempt to do so leaves behind more questions than answers. But lessons from past are pointers to the future. The aim of this chapter is to identify the main political and ideological factors that have shaped the present global economic order. It is necessary to examine them to have a richer appreciation of India’s interface with the WTO over time.

We attempt to trace the beginnings of international trade with a view to establish the salience of international trade in a country’s growth and prosperity. The idea is to highlight how trade becomes a major policy area for nations and how national interest determines policy choices in this area. This leads us to the question of diverse economic interests within a sovereign nation and the conflicts associated with them. We refer to the historical moorings of the North-South divide and the impact of trade on it. We then come to the question of the need for a trade regime to govern relations among nations. We examine historical evidence to determine whether a regime has been instrumental in avoiding conflicts among nations and whether the type of regime which existed hitherto can persist in today’s changed economic order.

While tracing the evolution of international trade, we analyse the origins of the post-world war international trading order with a view to clarifying the bearing the North-South divide had on this system. While
doing so, negotiating strategies of nations are alluded to as well. Finally, we refer to a nation's vital stakes in engaging with the international economic system. We shall also indicate the political considerations that determine the actions of nation-states in specific trade regimes within the international economic order.

2.1 HISTORICAL CONTEXT OF FREE TRADE

2.1.1 EVOLUTION OF TRADE

"Trade plays a vital role in providing the highest possible level of living for the peoples of the world."

Ingo Walter

Any attempt to paint the canvas of the world economy with colours of past must necessarily begin by sketching the role of trade. The evolution of trade clearly shows the significance it has, not just in world economy but in the national social, political and cultural realms as well. This leads us to the question that what is the need for trade in a country's political economy.

Trade as a regular series of acts of exchange can be traced to the lives of primitive peoples. The principle of reciprocal transfer of goods, of giving and taking is deep-seated in human nature. The psychology of the trading process revolves around the central factor of desire for rational gain, for securing objects of economic utility, otherwise un procurable owing to variations in natural conditions or specialized skill. Trade is therefore explicable as a mechanism, which emerges in response to certain needs and is conditioned by the natural situation and the social structure of the community, which it serves.

People have traded with each other for centuries in order to overcome local scarcity of goods. Countries trade because it is economically more 'efficient'
for them to do so. Rangarajan has elaborated three reasons for trade among people:  

- Trade helps to redress the uneven distribution of resources and goods and hence adds to welfare,
- It offers a greater freedom of choice to consumers, and
- The increasing dependence brought about by trade adds up to the possible sources of insecurity for both the state and the individual.

It emerges that nations trade with one another because there are profits to be made in international trade - profits emerging from the purchase of goods at lower prices in one country and their subsequent sale at higher prices in another country. This difference in prices can be said to account for a common-sense explanation of trade: ‘It pays to trade.’ Besides, international trade has also been used as tool for increased national power, for achieving foreign policy goals and, in recent times, trade has been linked to development. This link, as we shall examine in our later chapters, has become the vital question governing international trade.

Understanding the evolution of international trade is essential to recognise that some of the larger differences between nations today stem historically and have only been cemented with the passage of time.

It is an established fact that prior to the emergence of the nation-state in the 17th century, trade did occur among a host of political units and it was of substantial importance to the economic activities in these units. Monuments of large cities of antiquity show that trade and commerce existed in all empires of Sumeria, Babylon, Hebrew and Persia. These empires could not have grown without the continuous import of grain and building materials. In Egypt, for example, next to agriculture, trade provided the most important source of royal revenue. In Mesopotamia, commerce was more extensively developed.
The genesis of different kinds of economies governing the world today lies herein. This could be said to be the beginning of "the division of the world into exporters of primary products and exporters of manufactures", as correctly reasoned by W. Arthur Lewis (1978). His argument that high agricultural productivity and a good investment climate allowed countries in Northwest Europe to industrialize rapidly; and the favourable terms of trade they enjoyed also assured them continuing dominance over the tropical countries, thus has a historical basis.

The nature of world trade has changed continuously; sometimes changing with the socio-political as well as economic needs, and sometimes causing the socio-political and economic equations to change. It has been a long journey for trade from a simple exchange of goods to be termed as 'the engine of growth'. According to Gilpin, "Trade has expanded in every epoch because societies have sought goods not readily available at home and this expansion has produced many related results: (1) Technological diffusion, which contributes to the economic welfare of all peoples (2) a demand or Keynesian effect on the economy that through the operation of the 'multiplier', stimulates economic growth and the overall efficiency of the economy (3) benefits for individual firms as trade increases the size of the market, promotes economies of scale and increases the return on investment while also stimulating the overall level of economic activity in the economy as a whole (4) increased range of consumer choice and (5) reduction in the cost of inputs such as raw material and manufactured components, which then lowers the overall costs of production". (1987, p. 171)

2.1.2 RISE OF CAPITALIST ECONOMY

The two most significant landmarks in the historical journey of trade were the Barter System and the rise of the Capitalist Economy.
Trade in earlier societies, as we have seen, was a means to fulfill rather elementary needs of their inhabitants. The first semblance of order in trade emerged from the Barter system.

The Barter System can be said to be the first valid form of trade consisting of direct transfer of goods against goods; it contained the seeds of the principle of reciprocity which would go on to become the key principle of the multilateral trading regime in the 20th century. Barter implied agreement as to rates and presumed an approximate equilibrium in the value of goods and services exchanged. It was regardless of the inequalities between trading communities. The disadvantage of a lack of medium of exchange led to the disintegration of the Barter System.

In the ‘era of specie money’ trade was conducted by established weights of gold and silver. They were a neutral medium of international exchange. This made the international political system apolitical as the value of ‘money’ was largely outside the control of individual states. A change in this pattern occurred when Western Europe’s trade which was restricted to the Orient, started getting adversely affected. As European traders were forced to send precious metals in exchange for commodities, the balance of trade shifted heavily in favour of the East (Perhaps the only time to do so!). The solution as perceived by the West was to produce more gold. The annual output of gold and silver was quadrupled by the 16th century. During the same period, European coinage was increased about twelve-fold. This development was the first move towards state intervention in trade. As Gilpin says, “money had been transformed from a gift of nature to a creation of state.” The ramifications were immense. The tremendous increase in monetary wealth was one of the fundamental factors in transforming society from the medieval concept to that of modern times. As more wealth gave an impetus to demand, trade was greatly stimulated. The volume of trade especially in England, showed a marked increase. Her exports at the end of the 17th Century amounted to $ 32,000,000 and her imports were about $ 27,000,000. (Swain, 1992, p.409) There were changes in the social and political
order and trade could not remain unaffected by them. In the new social order created by the Reformation, wealth was not regarded as irreligious and money was itself a commodity. This commercial revolution was in no way less significant than the modern-day globalization in terms of change in social attitudes, liquidity and availability of consumer choice. The capitalist economy became the accepted policy framework of trade for governments to operate in.

2.1.3 WESTPHALIA AND MERCANTILISM

There were simultaneous changes in the political order as well. The Treaty of Westphalia played a significant role in the rise of the nation-state. It was the birth of a new international covenant based on existence of separate sovereign states in an international society. Adam Watson captured the Westphalian moment very aptly by calling it, "the charter of a Europe permanently organized on an anti-hegemonial principle" (The Evolution of International Society, Chapter 17). Though a balance of power was presumed in this new system, there was no doubt that each state wanted to augment its citizens' welfare and take measures to procure the maximum monetary gains for them. This led to the rise of the first important trade ideology—that of mercantilism, meaning government regulation of economic affairs, especially trade and industry. As Polanyi (1944, p.55) has commented:

"From the sixteenth century onwards markets were both numerous and important. Under the mercantile system they became, in effect, a main concern of government, yet there was still no sign of the coming control of markets over human society"

The mercantilists believed that the accumulation of precious metal in the national coffers was crucial to the welfare of the state. The central idea behind this economic nationalism is the primacy of state and the subordination of economic activities to the goal of state building. Economic nationalists favoured protectionism and state control over international trade because of their
overriding concern for power and independence. National security implied having a surplus balance of trade. Government control over trade was seen as an imperative towards meeting this end. Government regulation could ensure maximum exports and minimum imports, thereby tilting the balance of trade favourably. The trading company was developed to facilitate pursuits of mercantilist goals. Consortia were established under which merchants would pool their resources and under government charter engage in long-term and often risky trading ventures, by establishing and colonising enclaves in their respective trading areas. The age of colonial and imperial expansion which took root later was thus an outgrowth of mercantilist ideas and policies.

The emergence of trade as a significant factor in a nation’s policy choices was a more imminent consequence of mercantilism. The linking of trade with the objective of meeting of national welfare contains the initial ideas of inherent conflicts in the trading systems. This, as we shall see in the next section, led to the need for regulation in trade regimes. The changing nature of trade regimes, thus evolves from this basic idea of preserving the national interest. This finding is further developed in later chapters.

To sum up, trade evolved from a basic need to an agent for state’s power and welfare. It influenced the socio-political setup and grew tremendously in its impact over all aspects of life. However, though it had become a means for enhancing the power of state, it was to further influence the relations between nations in a most ubiquitous manner. This process began with the Industrial Revolution.

2.1.4 HARBINGER OF CHANGE: THE INDUSTRIAL REVOLUTION

The significance of the Industrial Revolution is pointed out by Polanyi (1944, p.40) in the following words:
"The story has been told innumerable times: how the expansion of markets, the presence of coal and iron as well as a humid climate favourable to the cotton industry, the multitude of people dispossessed by the new eighteenth century enclosures; the existence of free institutions, the invention of the machines, and other causes interacted in such a manner as to bring about the Industrial Revolution. It has been shown conclusively that no one single cause deserves to be lifted out of the chain and set apart as the cause of that sudden and unexpected event."

The Industrial revolution was a time for change for better and for worse. The commercial revolution and the capitalist economy had already prepared Western Europe for the change in economic environment (by creating more wealth). The significant change lay in the new mode of production - the factory system. This coupled with an abundance of inventions in varied fields that mainly substituted the source of power and raw material defined the Industrial Revolution.

Polanyi's explanation of the causes of the revolution is elaborate:

"We submit that an avalanche of social dislocation, surpassing by far that of the enclosure period, came down upon England; that this catastrophe was the accompaniment of a vast movement of economic improvement; that an entirely new institutional mechanism was starting to act on Western society; that its dangers, which cut to the quick when they first appeared, were never really overcome and that the history of nineteenth century civilization consisted largely in attempts to protect society against the ravages of such a mechanism. The Industrial Revolution was merely the beginning of a revolution as extreme and radical as ever inflamed the minds of sectarians."

He goes on to raise the ever-relevant question as to "how could there be social catastrophe where there was undoubtedly economic improvement"? And goes on to say that the Industrial Revolution was "an economic earthquake which
transformed within less than half a century vast masses of the inhabitants of the English countryside from settled folk into shiftless migrants”.

Similarly, according to Hobsbawm (1969, p.52) Industrial Revolution meant that “some time in the 1780s and for the first time in human history, the shackles were taken off the productive power of human societies, which henceforth became capable of the constant, rapid and up to the present limitless multiplication of men, goods and services.” He goes on to say,

“Nothing could stand in its way. The gods and kings of the past were powerless before the businessmen and steam engines of the present.”

In his 'Lectures on the Industrial Revolution in England' (1884) Arnold Toynbee has rightly said:

"The essence of the industrial revolution is the substitution of competition for the medieval regulations which had previously controlled the production and distribution of wealth. On this account, it is not only one of the most important facts of English history, but Europe owes to it the growth of two great systems of thought - Economic Science & its antithesis, Socialism".

With competition came job specialization and changes in the nature of production. Transformed economies of scale made England, 'Workshop of the World.' There was a structural change in the economic organization of English and European society. The Revolution caused the shift from a traditional agrarian society to that of an industrial economy based on capitalist methods and principles. It was also testimony to the fact that revolutions change societies and if the response of the society is not heard on time it can lead to a social catastrophe that can scar the future. Maclver, in his foreword to Polanyi’s monumental work, has elaborated on precisely this point. According to him, "The major tragedy attendant on the Industrial Revolution was brought about not by the callousness and greed of profit seeking capitalists-though there was inhumanity enough in the record-but by the social devastation of an uncontrolled
system, the market economy. Men failed to realize what the cohesion of society meant. The inner temple of human life was despoiled and violated. The tremendous problem of the social control of a revolutionary change was unappreciated; optimistic philosophies obscured it, shortsighted philanthropies conspired with power interests to conceal it, and the wisdom of time was still unborn." (in Polanyi, 1944, p.x)

This relates to the first finding of our argument that though economic change might be inevitable, ignoring the social fall-out can be devastating. The Industrial Revolution also led to the birth of new economic theories whose effect on international trade was singularly significant.

2.2 IDEOLOGICAL IMPACT OF FREE TRADE

The birth of the liberal ideology that came to govern international trade can be credited to the Industrial Revolution. In the 1830s and 1840s, restrictive regulations were repealed in England. These were the first steps of economic liberalism. The ideological assumption that markets evolve to fulfill inherent economic needs of human beings became the basis of liberalism; and liberalism became an end in itself.

Adam Smith's *Wealth of Nations* appeared on the eve of the Industrial Revolution in 1776, and illuminated the path of free trade which Britain and Europe were to follow. The seeds of protectionism inherent in mercantilism had led to many wars of tariff. The prevalent feeling was that barriers against the exchange of goods hindered rather than promoted economic growth.

Smith investigated the causes of wealth and aimed at the substitution of industrial freedom for a system of restriction. "The production of wealth and not the welfare of man" was what Adam Smith had primarily before his mind's eye. In his own words, "the great object of the political economy of every country is to increase the riches and power of that country." (Toynbee, ibid). Smith's assertion
that trade should be free and nations should specialise in what they could do best to become wealthy and consequently powerful was followed by Ricardo's theory of comparative advantage. In his *Principles of Political Economy and Taxation*, Ricardo created a powerful rationale for international trade by arguing that the "flow of trade among countries is determined by the relative (not absolute) costs of the goods produced" (Gilpin, 1987, p. 173). Thus, every country will enjoy a comparative advantage in certain commodities, making exchange of goods imperative for obtaining 'gains from trade'.

These arguments formed the foundation of the free trade theory that was to govern the western world in the times to come.

### 2.2.1 THE NORTH-SOUTH DIVIDE

The liberal theories of free trade as expounded in the previous section assume a 'harmony of interests' among nations. However, an inequitable world with inherent conflicts is a more realistic perspective symbolized by the North-South divide. The beginning of the North-South divide can be traced to the Industrial Revolution.

The causes and effects of the Industrial Revolution in England and Europe are well etched but a puzzling question of history is that why did the rest of the world, especially the tropical nations fell behind in industrializing their societies. We again turn to W. Arthur Lewis (1977, p. 7) for an answer.

He says that "as the Industrial Revolution developed in the leading countries in the first half of the nineteenth century, it challenged the rest of the world in two ways. One challenge was to imitate it. The other challenge was to trade." As most countries did not react to this, "this was the point at which the world began to divide into industrial and non-industrial countries."
He argues that though the example of industrialisation would have been easy to follow, the rest of the world did not immediately adopt the techniques of the Industrial Revolution. The political answer to this viz. that the imperial powers were hostile to industrialization in their colonies is not entirely feasible because countries like Brazil, Argentina and the rest of Latin America were free to industrialize but did not. He relies on the economic explanation, which is the dependence of an industrial revolution on a prior or simultaneous agricultural revolution. Agriculture has to be capable of producing the surplus foods and raw material consumed in the industrial sector and the affluent state of the farmers enables them to be a market for industrial products. High agricultural productivity and a capitalist environment led to the Industrial Revolution, while the rest of the world responded by taking up the opportunity to export agricultural products.

He goes on to say, "And so the world divided: countries that industrialized and exported manufactures, and the other countries that exported agricultural products. The speed of this adjustment, especially in the second half of the nineteenth century created an illusion. It came to be an article of faith in Western Europe that the tropical countries had a comparative advantage in agriculture." (1979, p.11) This however, turned to be a fallacy as proven by the next argument he gives on 'terms of trade'. He ascribes the low productivity levels on the tropical countries and the levels of international migration as the basic cause for the unfavourable terms of trade. These nations continued to trade on unfavourable terms of trade, leading to under-development and poverty, from which they couldn't recover. Thus, the Industrial Revolution marked the beginning of the North - South divide.

Hobsbawm has also given a cause – effect relation to the above fact in the following words:

"one part of the world thus swept forward towards industrial power; another lagged. But the two phenomena are not unconnected with each other. Of all the economic consequences of the age of dual revolution,
this division between the advanced and the underdeveloped countries proved to be the most profound and the most lasting." He goes on to say that what was created were economic dependencies of the west... "No fact has determined the history of the 20th century more firmly than this."

2.2.2 COLONIALISM AND IMPERIALISM

Although mercantilism had seen the birth of colonies, it was with the Industrial Revolution that Colonialism grew. The political dominance of Great Britain and the new liberal economic system propelled by the huge surplus of manufactured goods as the economics of scale were transformed by the Industrial Revolution, led to search for new markets. Consequently 'the sun never set on the British Empire.' Such was the power of trade that the world soon saw the last stage of capitalism 'Imperialism' wherein "the political victors controlled investment and trade, regulated currency and production and manipulated labor, thus establishing structures of economic dependency in their colonies which would endure for longer than their actual political authority" (Spero, 1977, p.7).

The significance of colonialism and imperialism in transforming the trading system can not be denied. The idea and concept of a 'hegemon' grew out of such colonial and imperial policies. At the same time, they brought to the fore the issue of nationalism and the right of self-determination of colonized people. Lastly, they gave rise to Dependency theory which was utilized to explain international trade among nations for quite some time.

Thus, we can sum up by saying that as trade grew in significance, it was shaped by both ideological factors as well as distinct political equations among nations. It was only in the latter part of the 20th century that international trade acquired a multilateral dimension and the political-economic pyramid of world trade began to grow.
2.3 FREE TRADE IN THE 20th CENTURY

2.3.1 1900-1945: ‘BRAVE NEW WORLD’

The new imperialism which began in 1870 and lasted till the outbreak of World War-I was marked by the prominence of the British Empire. As the hegemonic power in early 20th century, Britain became the chief promoter of free trade. Consequently, world trade as a whole expanded rapidly and a high proportion of it was British trade. The total value of UK exports and imports in 1913 exceeded those of Germany or France, and was 80% more than it had been twenty years before. This period also saw significant change in the trading pattern of the world. Asia, Africa and Australia became more important in British overseas trade relations. As Germany and the US grew in productivity and trade, they imported less from Britain and instead started to compete with Britain for markets. As there was less direct matching between exports and imports markets, trade became a three-cornered or four-cornered operation and the world economy took on multilateral dimensions. (David Thomson, England in the 20th century, 1997, p. 22).

In this new multilateral system of trade, there was still no concept of a regime. The newborn, hesitant but intricate trade network and its accompanying creed of free trade were soon ravaged in the aftermath of World War-I.

i) World War - I: Victory of Nationalism

Though the environment for free trade had blossomed under the care of Great Britain, there had been simultaneous growth of an aggressive ideology of nationalism which eventually ate into the Laissez Faire dictum. Europe consisted of about fifteen sovereign states in 1871, which had risen to twenty five by 1914. Rising nationalistic aspirations led to imperial disputes among major powers which became an important contributory factor to World War-I. The unification of Germany and its rapid industrialization wherein the industrial production quadrupled, the agricultural output doubled and the overseas trade more than...
tripled, disrupted the calm prevalent within the balance of power system at that time. The Germans were not satisfied with the carving up of international markets in a manner, which left them with little or no share. Gaining colonies was an economic imperative for them. Thus, with instances like the annexation of the French-territory of Alsace-Lorraine in 1871 and the power vacuum in the Balkans, the stage was set for dynamic alliances that ensured Britain, France, Russia on one side and Germany, Australia, Hungary on the other, that eventually led to the catastrophe of World War-I.

The war marked the collapse of the "doctrine of harmony of interests", as elucidated by E.H.Carr. His postulate was that the paradise of laissez-faire popularized the doctrine of the harmony of interests. It emerged from the concept that removal of state control was justified because the interests of the individual and the community were similar. Similarly, universal free trade was justified on the ground that the maximum economic interest of each nation was identified with the maximum economic interest of the whole world. The doctrine bloomed alongside the expansion of free markets. According to him, "the tacit presupposition of infinitely expanded markets was the foundation on which the supposed harmony of interests rested." (Carr, 1964, p.45) However, the Darwinism in politics that led to elimination of unfit nations in Africa and Asia by the imperialist powers, clashed with the doctrine of harmony of interests. Moreover, divergent national interest, as we have seen, became increasingly paramount, Brewing discontent among nations was as much responsible for the collapse of harmony of interests as Darwinism.

Thus, World War I demonstrated the need for creation of a trade regime which would foster rule-based activity in the international system. However, it was also perceived by the liberal institutionalists that to sustain, a regime would still need a benign hegemon that would provide leadership. This led to the next important system of global trade.
ii) Hegemony and Regimes

After 1919, Europe saw the birth and the predominance of the nationalist creed which rested on the assumption that as no harmony of interests exists, interest must be artificially harmonized by state action. Planned economy became significant as a policy choice for many nations. However, the US continued on the path of liberal economy and by 1929 came to assume the pivotal position in the global economy that Britain had occupied prior to the war. It produced 42% of the world’s industrial output. After postwar recovery, the US experienced pronounced boom in the economy. The stock market crash of 1929 changed the course of events. Kindleberger has given a penetrating analysis of the post-World War I collapse of the global economy. He has concluded that the international system battered by the war was not undermined by deep disturbances but was itself fundamentally unsound. Speaking of the ‘Great Depression’ in 1929, he has argued that, in the post-World War-I period, the difficulty lay in considerable latent instability in the system and the absence of a stabiliser. “Before the First World War, Britain could not act as a stabiliser and the United States would not”. The true cause of the 1929 depression was the lack of capable and willing leadership. The depression was "so wide, so deep, and so long because the international economic system was rendered unstable by British inability and US unwillingness to assume responsibility for stabilizing it by discharging five functions:

(1) Maintaining a relatively open market for distress goods;
(2) Providing counter cyclical or at least stable long-term lending;
(3) Policing a relatively stable system of exchange rates;
(4) Ensuring the co-ordination of macroeconomic polices;
(5) Acting as a lender of last resort by discounting or otherwise providing liquidity in financial crisis.”(Kindleberger, 1987, p. 289)

This brings us to the issue of hegemony and whether it is required for maintenance of peace and of world economic stability. As Kindleberger has
stated, it is clear that "national economic interests are sometimes complementary, sometimes opposed, with no one or two countries determining the outcome, which rather depends upon the action of them all. In these circumstances, the international economic and monetary system needs leadership, a country that is prepared consciously or unconsciously, under some system of rules that it has internalized to set standards of conduct for other countries and to seek to get others to follow them". (1987, p.11)

Keohane (1996) has argued that international regimes can substitute for hegemony. "Regimes are institutionalized habits of co-operation. They are more precisely defined as principles, norms, rules and decision making procedures around which actor, expectations converge in a given issue-area" (Baylis & Smith, 2001, Chapter 14) Keohane argues that regimes are a response to the existence of unclear property rights, high uncertainty and heavy transaction costs in international politics. They monitor behaviour and make it more sensible to cooperate by lowering the likelihood of being double-crossed. The absence of both a hegemon and a regime in the post-Depression years, resulted in the major capitalist states seeking to isolate their economies from the vagaries of international market. Free trade was abandoned in favour of protectionist 'Beggar-thy-Neighbor' policies wherein high tariff barriers were erected to dissuade imports. This led to retaliation so that each country ended up in a worse position from having pursued its own gain. "When every country turned to protect its national private interest, the world public interest went down the drain and with it the private interests of all" (Kindleberger, 1987, p. 291).

Economic collapse made extremist political actions appear attractive. The construction of Nazi and Fascist States by Hitler and Mussolini can be attributed in some measure to adoption of high Protectionist trade measures by European nations. Thereafter, the meek League of Nations and the rising industrial aggressiveness of Japan set the stage for World War-II. The causes of the second World War were widely debated but its fallout on the global economy was
sharp and the post-war economic order began to take shape from the late 1940s.

### iii) The Brettonwoods System

The need for a regime was acute in the post World War-II international economic system. The challenge was to avoid the impediments to trade that had fragmented world trade during the 1930s and also to ensure a stable monetary system. Attempts to restore the global economy had begun even prior to the War. There were precursors to the Brettonwoods Conference. The World Economic Conference in 1933, London\(^{13}\) which had a draft agenda of tariff reduction and restoration of gold standard anticipated the decision of Brettonwoods. Thereafter, an open trading regime became the major foreign policy goal of the Roosevelt administration.\(^{14}\)

Brettonwoods\(^{15}\) institutionalized these goals and formulated the first multilateral trading regime under US hegemony.

According to Gilpin, "The Brettonwoods system reflected fundamental changes in social purposes and political objectives. Whereas the 19th century gold standard and ideology of laissez faire had subordinated domestic stability to international norms and the interwar period had reversed these objectives, the postwar regime tried to achieve both. The state assumed a greater role in the economy to guarantee full employment and other goals, but its actions became subject to international rules. The system did usher in an era of unprecedented growth and increasing global economic interdependence. It was brought down by the inherent flaw in the system-that of making the American economy the principal engine of world economic growth" (1987, p. 133).

However, it was the first time that a range of measures to stabilise the international financial system and facilitate the expansion of trade were formulated and agreed to by nations. The main consensus was on anchoring the exchange rates to a dollar-gold standard, created by the US government's
promise to convert all dollars to gold. The other achievement was the creation of two formal institutions-International Bank for Reconstruction and Development (IBRD) or World Bank and International Monetary Fund (IMF). Brettonwoods also contained the seeds of another institution - the International Trade Organization (ITO) which was to govern international trade but which as we shall see later, could not materialise. It, however, led to the birth of General Agreement on Tariffs and Trade (GATT) in 1947. The fact that the Western powers deliberately limited the scope of GATT to industrial goods, in which they had comparative advantage, leaving out agricultural products and raw materials showed their intention to maximize the gains of free trade towards fulfillment of their national objectives. This selfish adherence to national interest continues even now, and is manifest in the lack of a political will to create a more equitable world. But what is not recognized is that without such a will, regimes cannot be sustained. The fall of Brettonwoods illustrates this and should be kept in mind today. As stated by Rangarajan, “when one of the three legs of the open economy tripod was sawn off into half a leg, the resulting system became inherently unstable. The deliberate preference of the rich countries for free trade in manufactures but protectionism in primary commodities is one of the main causes of the great divide between the industrialized temperate zone North and the poor tropical South”. (in Strange, 1985, p.137)

Brettonwoods system collapsed in 1971 with Nixon’s announcement that the US would no longer convert the dollar into gold. It also announced a 10% surcharge on import duties in order to improve its trade balance. Thus, the regime was without hegemon. Meanwhile, a second regime had been growing out of the "institutional troika" conceived by the Brettonwoods, which took its mandate, as we shall see next, from the political events unfolding at that time.
2.3.2 FREE TRADE AND THE COLD WAR

It was said of T.S. Eliot that he had a "sense of many things happening at once". The same can be said of the world scenario in 1945. The period is marked by three significant events - the cold war, the wave of decolonization and the functioning of the GATT regime. Each has a bearing on the way the global economy transformed and moved towards a truly multilateral trading regime where an institution-based system was essential, each contained the seeds of aspiration for a regime change and each caused increasing interdependence between nations. We shall hence examine each one of them, keeping in view this broad picture.

i) The Cold War

The cold war has been called a contest between ideas and systems. In economies, it implied a struggle between the open system in which governments encouraged the private sector and the centrally planned system where everything was done by government direction.

Though the high points of the cold war were security issues - nuclear strategies, NATO, Korean conflict etc, but it can not be denied that it led and fed divergent economic systems of the East and the West. These separate systems were used as a tool of political confrontation. It was the war of ideologies. The West's cherished concepts of market economy clashed with the administrative economy of the East.

The Revisionist argument that the legitimacy of American hegemony was based on the myth of Soviet threat may be debatable but one of the driving factors behind the cold war was the Soviet refusal in 1947 to let Eastern Europe benefit from the Marshall plan - the grandiose plan by the US which directed massive financial aid to Europe with the aim of rebuilding the war-torn economies of Europe. Growing antagonism between the two powers saw the extension of Central conflicts to the periphery of the international system. The
cold war provided the context to the battle between the West and the East to win allies in the newborn ‘Third World’. As nations gained independence from imperialism, the US attempted to sell development to them through capitalism and market economy; the USSR tried also to sell development via industrialisation through central planning by the states.

The collapse of communism and the resultant end of the cold war represented a turning point in the structure of international politics, in the roles and functions of nation-state and in international organization. This had a bearing on the international trading system which started to change as a corollary. As the political order ceased to be bi-polar, there were new demands on the trading order, which are pertinent to our study and which we elaborate in the ensuing sections.

ii) De-colonization and Development

The momentum of the age derived from the process of decolonization that swept the 1950s. India, Burma and Indonesia became independent in the 1940s, while Ghana, Zaire, Kenya and other African nations got independence in the 1960s. National self-determination was the anchor of these independence movements throughout Asia and Africa and it became a significant factor in the then political order. The UN Declaration on Decolonization, 1960 recognized this. The European empires shed their colonial possessions, as did the US and Japan. Though the political and common explanation for decolonization lay in the recognition of the right to self governance and also in the forceful independent movement but there was another cause, rightly explained by J.K Galbraith (1995, p. 173)

"There was however, another less recognized and quite possibly, more decisive factor, the colonies no longer rendered any justifying economic advantage. Once they had, they were a rich source of raw materials & varied consumer products. In return they were a significant market for elementary
manufactured goods... this was the case no more. The engine of economic well being was now within and between the advanced industrial countries”.

He goes on to say that decolonizing made little economic difference to the colonial powers. “The end of the colonial era is celebrated in the history books as a triumph of national aspiration in the former colonies and of benign good sense and goods will on the part of the colonial powers. Lurking beneath as so often happens was a strong current of economic interest or in this case disinterest”.

The two most significant effects of decolonization were the tremendous importance attached by the nascent states to sovereignty and the ideology of nationalization. This belief shaped the path of their policy choices in key areas of foreign trade.

Secondly, the idea of economic development was born in the age of decolonization. While the erstwhile colonial rulers felt a sense of responsibility to create affluence in their abandoned lands, the new nation states also clamoured for better development options. Together, these two beliefs converged to make “aid the vehicle of economic development.” Moreover, as Galbraith says, the error of imposing the economic and social systems of the advance countries - market capitalism, socialism cum communism, was also committed. As we have seen, the cold war provided the perfect backdrop for this.

It was also a time when global interdependence grew. There was a tug of war between the two superpowers and there were new actors on the stage. Interdependence was just round the corner. Nations were linked by the belief that capitalism/free trade was pacifist. More nations subscribed to the free trade ideology

As democracy became the accepted form of government, liberal economy became closely associated with it. It became the norm to have policy objectives built around liberal economy or free trade. It became vital to the concept of economic growth and development.
iii) The GATT System

The roots of the GATT regime go back to the Brettonwoods system which conceived of an International Trade Organization (ITO) to facilitate multilateral trade. The Havana Charter, 1947, was the first attempt to build an order for International Trade. "It was a complex compromise, an Agreement which embodied in some way the wishes of everyone, but which in the end satisfied no one" (Spero, 1977, p. 67).

The US debate on Havana Charter and the failure in ratification of ITO shows the first conflict between domestic politics and the international obligations, an issue which was to become central in later years and which is also central to our argument. Spero goes on to say that, as the Havana charter died, the General Agreement on Tariffs and Trade – (GATT 1947) "intended to be a temporary treaty to serve until the Havana Charter was implemented" became" by default the expression of the international consensus on trade".

The goal of GATT was to achieve a world trade regime for the conduct of commercial policy. It operated on three basic principles:

(i) Non discrimination, multilateralism and the application of the Most Favoured Nation Treatment (MFN) to all signatories;
(ii) Expansion of trade through the reduction of trade barriers;
(iii) Unconditional reciprocity among all signatories.

The original membership of GATT was 23, which grew to 85 by the 1980s.

The main features of GATT 1947 were as follows:
- it was against export subsidies and dumping (Article VI and XVI)
- it was against imposition of quantitative restrictions (Article XI)
- It dealt with maintenance of import restrictions in the special case of promoting economic development. (Article XVIII)
It was an umbrella under which a series of tariff-cutting exercises were undertaken. GATT was the "compromise of embedded liberalism". (Gilpin, 1987, p.191) It had ample escape provisions and exceptions to the agreements, which as we shall see later became instrumental in augmenting the need for an alternative.

Initially, successive rounds of trade negotiations led to an astounding decline of tariff barriers and growth in world trade. In the US, the average tariff declined by nearly 92% over the 33 years spanned by the Geneva Round of 1947 and the Tokyo Round. From 1953 to 1963, world income grew at an annual rate of 43% and world trade at a rate of 61%. For the period 1963 to 1973, the performance was even more dramatic: 5.1% and 8.9% (Bhagwati, 1983, p.3). The merchandise trade of industrial countries grew from 1950 through 1975 at an average rate of 8% a year. (Gilpin, 1987, p.192)

Free trade became the key to a prosperous and peaceful system; GATT provided the framework for achieving that system. The US again took on a hegemonic role and with its economic strength, led the negotiating rounds with an eye on foreign markets. American initiatives were responsible for the six major rounds from Geneva in 1947 to Kennedy round in 1967. The high point of the Kennedy round was that a new negotiating technique of linear tariff reductions was employed as against the earlier method of tariff reductions on item-by-item basis. It resulted in an across the board tariff rate of 35% on 60,000 products, incorporated an anti-dumping agreement and provided for food assistance to developing countries. (Gilpin, 1987, p.192)

Thus, this period was significant in the acceptance of free trade as an ideology for growth, by the developed countries.

It also established that regimes are required for conducting international trade transactions and that regimes require leadership—whether by nations or by institutions is an issue that we examine later. As Graham Dunkley says;
"The defeat of the proposed ITO, the evolution of GATT and the US sponsored post war Free Trade thrust; all demonstrate a complex overlapping of a wide variety of interests and national concerns which cannot be overlooked in assessing today's passion for the free trade adventure".

(The Free Trade Adventure, 2000, p. 33)

Spero (1977) also gives an emphatic explanation of how the GATT regime worked. She says that the system worked very well for the developed countries. Most quotas and exchange rate barriers were eliminated. In order to maintain the momentum of establishing a free trading system, the US even accepted asymmetrical benefits arising out of tariff reductions. There was substantial liberalisation of rate in manufactured products. Exports became a more important part of gross national products. From 1955 to 1970, the share of exports of goods and services in respective GNPs (at 1963 prices) increased from 8.1% to 14.1% in Japan, from 15.1% to 26.2% for the EEC and from 4.4% to 6.8% in the US.

2.3.3 'WINDS OF CHANGE'

As stated earlier, there were changes in the global economic and political environment. These changes were reflected in the growing concept of interdependence as well as in the disenchantment of the Third World countries with the working of GATT.

The broadening horizons of trade made the concept of economic interdependence a reality. It was increasing interdependence that made the need for structural changes in the trading system acute, both in the developed world and the developing world. It was this recognition that led to the addition of part IV in GATT in 1966, making it possible for the industrialized countries to give tariff preferences to developing countries without demanding equivalent concessions in return. Within the developed world, the rise of Japan as an industrialized nation and the birth of EEC (in 1958), led to a relative decline in the
position of the US. The US trade declined as a percentage of total world trade. These factors led to a perception that there could be better trade relations among nations that would lead to fulfillment of the market needs of the developed countries and the development goals of the South.

The developing countries had been more or less excluded from the chain of events that led to the collapse of Brettonwoods. They were involved with their own teething troubles that independence brought. However, by the 1960s, they sought greater access to the inner wheel of the international economic system. As they realized that the Brettonwoods system shaped their economies but excluded them from management and an equitable share of wealth, generation of their desire for greater engagement and better integration led to what Spero has called "end of the era of their willing acquiescence".

Spero also states that the economic development of the Third World was never a major concern of wartime and postwar economic planning. It was, in fact, argued that Southern interests coincided with Northern desires to create a system based on free trade. Freer trade, according to the North would lead to the most efficient and profitable use of national factors of production. It would increase national income and foreign exchange earnings and it would attract foreign private capital. There was gradual disagreement from the South. In their view the open monetary, trade and financial system perpetuated their under development and their subordination. They sought to revise the rules, institutions and procedures of the system to make possible their development and their economic industrialisation. In fact, they wanted development as the agenda of the international economic system. Their policy was based on the 'Infant Industry' argument that protection was crucial to encourage the development of industries. They, therefore, opposed bans on tariff quotas and on establishment of preferential trading systems. Havana Charter did recognise some of these problems but the GATT which replaced the Charter, excluded the interests of the under-developed countries. The MFN principle which stipulated that a trading concession between any two countries be extended to all contracting parties on
an equal basis, eliminated the possibility of preferential trading agreements for developmental purposes. The GATT rules of reciprocity provided that the trade concessions had to be mutual but the South with its small markets had little to exchange for concessions in its favour. Hence, many under developed countries chose not to join the GATT. They followed the policy of industrialisation through import substitution with a goal of national development leading to their insulation from international market.

However, by the late 1950s the economic situation of the South had worsened. Industrial production still accounted for only a small percentage of the GNP. Unemployment and income inequalities also increased further.

Disenchantment from the existing system and growing domestic crises made the Southern states desire a new regime—they realized that "the way to modify the system was not through modification of GATT from within but through an assault from without".

i) NIEO—A NEW REGIME?

Faced with mounting crises, the South adopted a strategy of "unity and confrontation". The Third world conferences at Belgrade (1961) and Cairo (1962) were important milestones in this. They were the buildups towards the first United Nations Conference on Trade and Development (UNCTAD) in Geneva in 1964. The South wanted to use the UNCTAD for achieving trade reform. The G-77 emerged out of this process and spelt out the voice of dissent for the first time. The Joint Declaration of the developing countries to United Nations General Assembly in 1963, contained the essence of it. It asserted in the following words:

"The existing principles and patterns of world trade still mainly favour the advanced parts of the world. Instead of helping the developing countries to promote the development and diversification of their economies, the present
tendencies in world trade frustrate their efforts to attain more rapid growth. These

trends must be reversed."

It also voiced the new agenda that would make international trade "a more

powerful instrument and vehicle of economic development not only through the

expansion of the traditional exports of the developing countries, but also through

the development of markets for their new products and a general increase in their

share of world exports under improved terms of trade."

However, it was the first oil shock of 1973, which demonstrated to the

South, that they had bargaining power. It demonstrated to both developed and
developing countries that Southern producers of raw materials could pose a
serious threat to the North by withholding or threatening to withhold supplies of
raw materials. The recognition of commodity power resulted in the dramatic call
for a New International Economic Order by the Third World. The idea was born at
the Non Aligned summit in 1973, and the following declaration was adopted by
UN General Assembly in 1974, giving a sense of power to the Third World:

We, the members of the United Nations..........solemnly proclaim our
united determination to work urgently for the establishment of a New International
Economic Order based on equity, sovereign equality, interdependence, common
interest and cooperation among all states, irrespective of their economic and
social system, which shall correct inequalities and redress existing injustices
make it possible to eliminate the widening gap between the developed and the
developing countries, and ensure steadily accelerating economic and social
development in peace and justice for present and future generation ."

The Declaration envisaged a restructuring of the global economic relations
based on equity.

The agenda of the NIEO covered trade, aid, investment, international
monetary and financial system and institutional reform. The distinctive feature of
the NIEO was that while bringing out the North-South divide, it contained a futuristic vision and an orientation towards reciprocity between the developed and the developing nations through the medium of trade. It adopted an integrated approach to global economic problems, viewing the world resources as a 'common heritage of mankind'. 'Developing countries not only sought higher financial aid, but a new system in which they would have an equal voice in the decision-making process.

The NIEO was followed by the Brandt Commission report in 1980, which contained a 'programme for survival.' It was based on mutuality of interest—only a joint endeavour by the North and the South could lead to attainment of common goals of development.

Thus, we see that while the North-South divide that began with the Industrial revolution became acute, there was also a growing sense of interdependence which would later become strong enough to become a pillar for the multilateral trade regime of WTO.


It was against this backdrop of the North-South divide that the Tokyo Round of the GATT took place. It was also a convergence of the disenchantment and disillusionment brewing in the developed and the developing countries. Hence, while the Round aimed at stabilising trading relations among the advanced OECD countries, it also could not ignore the concerns of the Third World for 'Special and Differential treatment.' The Round succeeded in several areas. While tariff barriers were further reduced, the developed countries adopted the Generalized System of Preferences (GSP), which lowered the duties on a number of LDC exports in manufactured products.20

As Gilpin has stated, "In retrospect, it seems remarkable that the Tokyo round succeeded as well as it did. The 1970s were a decade of economic
upheaval. The problem of hyperinflation, the OPEC revolution and the collapse of the Brettonwoods system strained international economic relations severely. With the spread of global stagflation after 1973, pressures for trade protectionism mounted. In these circumstances, the Tokyo round and its many years of intense negotiations were indicative of the transformed nature of the international trading regime" (1987, p.198).

The presence of a regime was perhaps the safety valve that prevented various crosscurrents of protectionism, underdevelopment and economic nationalism from creating the catastrophe called war. However, what could not be prevented and was further aggravated in the ensuring decade was the need for a change in regime.

iii) The Lost Decade

The manipulation of the second oil shock in 1979 by the US led to the demise of the NIEO. It showed that the euphoria of the South was short lived. Moreover, the UN General Assembly had no power to implement the agenda of the developing nations. The 1980s also saw a new set of governments in the US, the UK and the Federal Republic of Germany, which had relatively less sympathy for the concerns of the South. Consequently in the 1980s there was a serious regression in most developing countries, specially in countries like Mexico and Argentina, leading to an unprecedented 'debt crisis'. This led to a change in the role of IMF and the World Bank. The IMF was made the watchdog of the loans given by the developed nations to the developing nations. This brought in the concept of Structural Adjustment Programme (SAP) in the indebted countries and they were pushed towards market-oriented strategies for their debt repayments.

Declining GDPs, rising interest rates, commodity price fluctuations, declining terms of trade as well as stringent structural adjustment policies led to economic fatigue in most of the Latin America, African and Asian nations. The
widespread pessimism made the 1980s 'a lost decade'. Clearly, there was need for yet another regime change.

Neoliberal polices that sought to roll back the state and the role of the government, leaving decisions about allocation, production and distribution in the economy to the market, threatened to overthrow the hitherto prevalent Keynesian policies of government intervention. These policies coalesced into the Washington Consensus, which was to play a significant role in moulding the new regime and about which we shall later dwell upon. However, it was also recognized that the gap between the world's richest and the poorest had widened explosively. By the late 1980s, the developing countries as a group, had suffered rapid economic decline. The orthodox theory of 'the trickle down' had failed. Though the dependency theorists may have regarded this failure as inevitable, they could not provide any alternative to it.

The only alternative then came from the neo-liberals who perceived that regimes and institutions help govern a competitive and anarchic international system and they encourage and at times require, multilateralism and cooperation as a means of securing national interests. This then led to the birth of what is one of the focus of this study: THE WORLD TRADE ORGANIZATION.

2.4 ANALYSIS

While this chapter appears like a historical narrative of events, the aim has been to first identify the evolution and growth of trade, and second, to examine the factors that influence the trading patterns. These are mainly political but as we have seen, there is an economic underpinning running across most of events be it the Industrial revolution, the World Wars or the Cold War. This shows that political power cannot be separated from economic power.

The unfolding of events has also shown the ideological currents creating them. There has been a cyclical swing of Protectionist and Liberal forces causing regime changes. This is evident first in the growth of capitalist economy followed
by mercantilism leading to aggressive nationalism of the World War-I era replaced by the free trade order of Brettonwoods.

We also see that the divide between North and South is rooted in history. Adverse terms of trade for the Southern countries have been perpetuated by historical events like the Industrial Revolution.

The Industrial Revolution also shows that any change in the political and social order can not ignore the social upheaval.

The collapse of the doctrine of harmony of interests in the two World Wars shows that there is always need for a regime whether one with leadership of a nation or with an institution based one. Brettonwoods provided some stability and norms for the monetary system and established the foundation of a trading regime. Its collapse also showed that a hegemonic regime would always be subservient to the hegemon and hence, this could said to be the beginning of the idea of an institutionalized trade regime which was member-driven.

The consequent GATT regime accentuated the North-South divide because of the manner in which it was unable to resist the New-Protectionism of developed countries. The last sections of the chapter dwell upon how the disenchantment of the Southern countries from the existing system led to their need for change in regime. Their desires for change towards meeting their development goals led to their acceptance of the Neo-liberal ideology. This meant the creation of a free-trade regime which was more equitable and in which the developing countries could have their say as well. This leads us to our next chapter, which focuses on how this led to the creation of the WTO.

To sum up, while regime changes are inevitable, to sustain itself, a regime has to transcend the inherent inequalities among nations, for "just as inequality of wealth and opportunity between the classes often led to revolutions, so similar inequality between the nations is calculated, if not peaceably adjusted, to lead to explosions of a much graver character."(Mussolini, quoted in Carr, 1964, p. 228).
A regime has to be democratic in the sense that it has to allow voices of dissent. If it doesn't take a holistic view of divergent concerns, it may collapse and result in catastrophe. The failed attempt to create NIEO establishes that a more equitable regime can come only if developing countries stay inside the regime and choose to change the rules of the game in their favour. This requires integration in the regime at all levels. These are the two most significant findings to which we shall refer in Chapter Seven.
Chapter Notes

2. See Encyclopaedia Britannica for more details.
6. The Treaty of Westphalia in 1648 saw the birth of nation-state as we know today. It recognized sovereign jurisdiction and assumed a balance of power to prevent rise of any hegemon.
9. Dependency theory draws from the structural school of IPE developed by Raul Prebisch in 1930s. Andre Gunder Frank is another exponent. Third World countries are underdeveloped because they are structurally dependent within the world capitalist system. It speaks of chronic underdevelopment because wealth is systematically transferred from the periphery to the core.
12. The Smooth-Hawley Tariff Act by the US in 1930 which contained the highest tariffs ever imposed by the US and the highest tariff in the world at that time, is the classic illustration of this.
13. Eichengreen Barry and Uzan Marc have called it an "Instance of failed International Cooperation."
14. Article IV of the Atlantic Charter 1941, declared that "All countries should have access, on equal terms, to the trade and to the raw material of the world which are needed for their economic prosperity."
15. In August 1944, the US, Britain and 42 other countries met at Brettonwoods, New Hampshire to sketch out rules and formal institutions to govern their trade and monetary relations. John Keynes and Harry White were the main architects. The US dominated the proceedings. Although it was successful in reviving the international economy, it was seriously flawed as a long-term economic strategy.
16. As a keystone of US foreign policy, Marshall plan set a precedent for helping countries by giving $17 billion US Aid. It was initially proposed by Secretary of State George C Marshall in 1947. Its influence led to the creation of USAID. Its purpose was declared to be "the revival of a working economy in the world so as to permit the emergence of political and social conditions in which free institutions can exist." For further details see www.usaid.gov.

17. The UN General Assembly on 14th December 1960 adopted the 'Declaration on the Granting of Independence to Colonial countries and Peoples,' calling 'alien subjugation' an impediment to world peace and cooperation.


19. The UNCTAD provided a key forum in the 1970s for discussions of NIEO. It was a permanent international organization with a Secretariat. It reflected primarily the doctrine of its first Secretary-General Raul Prebisch, in adhering to a structuralist analysis of North-South relations. It worked as a forum for Southern unity and aimed at bridging the trade gap between the North and the South.

20. See Gilpin, Supra Note 5, for details of the Tokyo Round Negotiations, p. 196-7.