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Introduction

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TRADE AS A GUARANTOR OF PEACE, LIBERTY AND SECURITY? THE ROLE OF PEACE IN THE BRETTON WOODS INSTITUTIONS

INTRODUCTION

PADIDEH ALA'I*

At a time when globalization has facilitated transnational commerce *and* transnational terror, it is imperative that we examine the relationship between free trade and peace. On February 24, 2005, the International Economic Law Interest Group ("IELG") of the American Society of International Law ("ASIL") held the Opening Session of a three-day conference at American University, Washington College of Law, entitled: "*The Role of Peace in the Bretton Woods Institutions.*"¹ The goal of the conference was to address the accuracy of the claim made by John Stuart Mill and

* Professor of Law, American University, Washington College of Law and Co-Chair, IELG, ASIL (2003-2005).

1. The IELG is the largest interest group within ASIL and has for many years held annual and bi-annual meetings to promote scholarship and discussion of cutting edge issues in international economic law. Since 1995, the work of the World Trade Organization ("WTO") and its dispute settlement mechanism has been of particular interest to the IELG. Historically, the papers presented at IELG conferences are published in a law review. This year, however, the Opening Session of the conference has been published separately here while the complete proceedings of the conference are scheduled to be published as a separate book by ASIL. This Opening Session panel was co-sponsored by the Washington College of Law ("WCL") International Legal Studies Program and was part of WCL's Founders Celebration.

others that trade is the guarantor of peace, liberty and security. Participants on the panel were: Ambassador Julio A. Lacarte, a former member of the Appellate Body of the WTO and one of the architects of the Uruguay Round trade negotiations; James Boughton, International Monetary Fund ("IMF") historian; Debra Steger, a former Director of the WTO Appellate Body Secretariat and a Canadian representative to the Uruguay Round trade negotiations; and Uri Dadush, Director of the International Trade Department of the World Bank. The pages following this introduction contain the transcript of the remarks of Ambassador Lacarte, James Boughton, Debra Steger and Uri Dadush—edited by the panelists to varying degree—in which they discuss the role of the IMF, the World Bank, and the WTO (collectively referred to as the "Bretton Woods Institutions" or "BWI") in safeguarding and promoting peace.

James Boughton reminds us that for the two intellectual fathers of the IMF—John Maynard Keynes and Harry Dexter White—securing and maintaining peace was central, not peripheral, to the work of the IMF. As Boughton explains, the role of trade in generating prosperity and peace was raised in the aftermath of the First World War by President Woodrow Wilson at the Paris Peace Conference. For a variety of reasons, Wilson failed to have that particular viewpoint reflected in the ultimate outcome of the peace conference. It took another world war to bring to the foreground the relationship between peace and economic prosperity. In the aftermath of World War II, the victorious nations agreed that it was economic deprivation caused by protectionist and discriminatory economic policies that had facilitated the rise of Adolf Hitler and fascism in Europe. At Bretton Woods, the participants vowed to "never again" allow such protectionist policies, and the BWI were set up to help maintain peace by helping to secure economic prosperity.

Ambassador Julio A. Lacarte agrees that it was the failure of the Paris Peace Conference and the resulting protectionist policies of the 1930s, including the passage by the U.S. Congress of the Smoot Hawley Tariff Act, that facilitated the rise of fascism in Europe; Ambassador Lacarte also reminds us of the precarious existence of the General Agreement on Tariffs and Trade from 1947 until the eventual creation of the WTO in 1995. Drawing upon more than fifty years of personal involvement in trade negotiations, Ambassador

Lacarte warns us that although the creation of the WTO has advanced the cause of peace by providing an institutional and regulatory framework for the multilateral trading system, a great deal more must be done by the BWI to address the concerns of the developing countries and thereby advance the cause of global peace.

Debra Steger highlights the unique institutional challenges faced by the WTO, including a lack of compliance with dispute settlement decisions by the United States and Europe, the increasing popularity of bilateral and regional trade agreements, and the WTO's continued ambiguous mandate, which has pitted the United States and Europe against the developing world—a situation that is not conducive to global harmony.

Finally, Uri Dadush points out that trade has *not* always promoted peace and, in some instances, has been the cause of war. Dadush argues that in fact it is peace that is a prerequisite for free trade. Dadush reminds us that unprecedented global market integration in the latter part of the nineteenth century resulted not in peace, but the First World War. He argues that other “drivers of conflicts,” such as ethnic divisions and religious differences, can overwhelm the economic gains from free trade. Dadush posits that we may be living at a moment in history when the champion of free trade is no longer the United States, but China and India.

All the speakers agree that we live in a time of transition. We have seen a period of unprecedented inter-connectedness. The end of the Cold War and the creation of the WTO in the 1990s has set the groundwork for securing peace through international cooperation. There are, however, forces at work that threaten peace as well as the legitimacy of the BWI. Will the WTO membership come to an agreement as to its mandate and the agenda for the next round of trade negotiations? Will bilateral and regional trading arrangements lead to unity or division? How will the United States respond to the growing economic ascendancy of China and India? Will the United States resort to protectionist policies against China? What will the effects of such policies be on global peace and security? Are we destined to repeat the mistakes of the past and have a period of unprecedented global integration followed by disintegration? Answers to these and many other such questions will determine whether the IMF, World Bank or the WTO can promote and

safeguard peace as originally envisioned by Keynes and White at Bretton Woods.

TRADE AS A GUARANTOR OF PEACE, LIBERTY AND SECURITY? THE ROLE OF PEACE IN THE BRETTON WOODS INSTITUTIONS

THE ROLE OF THE IMF IN PEACE AND SECURITY

JAMES M. BOUGHTON*

Thank you very much, Padideh. What Padideh did not tell you about my resume is that my real role in the International Monetary Fund ("IMF") is to speak from time to time on topics that most people think are totally peripheral to what the IMF is supposed to be doing, but that in fact are completely central to the real issues in the world economy today.

In the last couple of years alone I've given talks on the IMF's role in alleviating global poverty, on the IMF and global governance, and on the IMF and Christian ethics and human rights. So when Padideh called me and asked me if I could give a talk on "The IMF and Peace and Global Security," this seemed completely natural for my role in life. When I told some of my colleagues I was going to do this, they said, "You're going to talk about what?" And I said, "No, no, no, this is exactly what we should be thinking a lot more about."

So, I've just prepared a very quick little talk which I will illustrate a little bit as we go along. The first point I'd like to make is that this

* James Boughton is Historian of the International Monetary Fund and has written extensively on international financial issues. Before joining the IMF, he was Professor of Economics at Indiana University. The views expressed in these remarks are those of the author and not necessarily those of the IMF.

topic of the IMF and Peace and Security was absolutely central at the time that the IMF was founded. It was not a peripheral issue at all.

The two intellectual founding fathers of the Fund are shown here in the photograph, sharing a private joke of some kind in the corridors of the Mount Washington Hotel during the Bretton Woods Conference that established the IMF and the World Bank in July, 1944.¹ In the left of this picture is Harry Dexter White, who was the *de facto* head of the U.S. delegation. The much more famous man on his right—the one with the toothy grin—is John Maynard Keynes, the head of the British delegation. These two men together drafted the charters for the IMF and the World Bank in 1944. They worked together throughout the period of World War II, at least since the United States joined the war effort at the end of 1941. They worked very hard throughout 1942, 1943, and the first half of 1944 to create these two great institutions.

As they worked together through this terrible period of World War II, both Keynes and White had a keen sense, which they expressed in many different ways, of the link between establishing an open system of trade and finance and the achievement of both peace and prosperity after the war was over. These were two men who had been young adults during and shortly after World War I. They had seen the kinds of horrors that Ambassador Lacarte talks about, they had seen the failure of the Paris Peace Conference to reestablish either peace or prosperity after the First World War, and they were determined not to let that happen again. Both men also had the full support and backing of their respective governments, led by Churchill and Roosevelt.

At the opening session at Bretton Woods, in July 1944, the Secretary of the Treasury for the United States, Henry Morgenthau, Jr., expressing the sentiments of the Roosevelt administration said, "Prosperity, like peace, is indivisible." Everybody recognized, of course, that peace was indivisible. One country cannot be at peace if others are not. But the idea that prosperity, like peace, was also indivisible, that one country could not sustain development and wealth unless it was shared widely throughout the world, was a much

1. See Diagram, *infra* p. 1125.

more controversial proposition, but one that was pushed very hard by the Roosevelt administration, including at Bretton Woods.

Among the principles that Harry White and Maynard Keynes had grown up with were U.S. President Woodrow Wilson's famous "Fourteen Points," which formed the basis of Wilson's vision for a world order after the Great War, as it was then known. What everybody remembers about Wilson's fourteen points was peace, but prosperity and trade, the role of trade in generating prosperity, was also there. Number three among Wilson's fourteen points was "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." Unfortunately, it didn't happen.

As Margaret MacMillan relates brilliantly in her recent book, *Paris 1919*,² this point number three of Wilson's fourteen points just got lost among all the effort that was spent trying to redraw all the borders of the world in those six months that Wilson spent in Paris with his colleagues from the other victorious powers. He did manage to achieve the creation of the League of Nations, but without the United States being a member and without it having very much teeth to achieve anything.

The League did have an economic section, which worked valiantly throughout the interwar period and even continued during World War II, having left Geneva and setting up camp in Princeton instead. But all the efforts that were made between the two wars to try to establish cooperation were very piecemeal, they were very short lived, and they were difficult to sustain or repeat, because there was no institutionalization of the effort to establish cooperative trade and financial relationships between the wars.

Where Wilson had gone wrong was in failing to institutionalize the process. He had a vision for what needed to be done, but he did not have a well developed strategy for how to achieve it. So there was no real institutional economic structure after the First World

2. MARGARET MACMILLAN, *PARIS 1919: SIX MONTHS THAT CHANGED THE WORLD* (2003).

War, and it was the idea of preventing a repeat of that failure that was very much on the minds of Keynes and White in 1944.

To understand how important international cooperation was to Keynes, it helps to reflect for a moment on his role at the Paris Peace Conference. A dozen years earlier, when Keynes was still in graduate school at Cambridge University, he had sat for the British Civil Service exams with an eye toward working in London at either the Treasury or the India Office. Whoever did best on the exams would get first choice of the open positions, whoever placed second would get the next choice, and so on. Now when Keynes took these exams in 1906, he came in second. He was a brilliant student, but it seems he didn't study very hard. Now what follows is a serious lesson for all the law students in the audience tonight! Keynes' biographer, Sir Roy Harrod, told a fascinating story about the consequences of Keynes not studying hard enough for his exams in 1906. Keynes' first choice was a job at the Treasury, and his second choice was the India Office. The student who came in first took the Treasury job, and Keynes went to work on the Indian economy. He wrote a wonderful book about Indian currency issues, but he was not dealing with the really major issues facing Britain and the world economy.

By the time Keynes was part of the British Treasury delegation at the peace conference twelve years later in Paris, he was a very junior member of the team. He recognized right away that the conference was going to fail, in the sense that the economic ideas that the leaders of the world were talking about in Paris were simply wrong and were going to lead to disastrous consequences. He saw this very clearly, he left the conference, he quit his job, and he went home and wrote a best selling book about it called *The Economic Consequences of the Peace*.³

So Roy Harrod asks, what if Keynes had come in first on his exams? He would have taken the job at the Treasury in 1906. By 1918 when he went off to Paris, he would have been a senior member of the delegation instead of the low man on the totem pole. At that level, he might have been able to convince David Lloyd George, the Prime Minister, that the economic demands that they

3. JOHN MAYNARD KEYNES, *THE ECONOMIC CONSEQUENCES OF THE PEACE* (1919).

were planning to impose on Germany were not going to work. With the force of his intellect, he could also have convinced the Americans, the French, and the Italians to take a more constructive approach, and we would not have had the disastrous economic policies of the interwar period. The German economy would not have collapsed in the 1920s, Hitler would not have come to power in 1933, and we would never have had World War II! If only Keynes had studied harder for his exams . . . Obviously, there are some weak links in Harrod's argument, but it's not as silly as it may seem. The point is simply that the link between trade and peace and prosperity was an issue that Keynes had been thinking deeply about for most of his adult life by the time he got to Bretton Woods in 1944.

On the American side, Harry Dexter White had a similar but even broader vision. Keynes saw the primary purpose of the Bretton Woods institutions as to try to get Europe back on its feet, and in particular of course to get Britain back on its feet. White saw the primary purpose as to establish and preserve peace. Therefore, in his mind the key was not the economic relationship between the United States and Great Britain. The key was the *strategic* relationship between the United States and the Soviet Union.

White worked very hard for six months, throughout the whole first half of 1944, to ensure that the Soviet Union would join the IMF and the World Bank. He made sure they got a large enough voting share, and he made sure that they had special provisions put in the charters that would reflect the tightly controlled and centralized Soviet economic system. He succeeded up to the point of getting the Soviets to sign the agreements at Bretton Woods and agree to join the new institutions, but at the last minute, at the end of 1945, Josef Stalin himself decided that the Soviet Union was not going to join the IMF or the World Bank.

In fact, as long as the Soviet Union existed, until it collapsed in 1991, it never did join the Bretton Woods Institutions. So there was a major failure, and that was the failure of this emphasis on trade and prosperity to forestall the cold war. It had the potential to do that, but in the end it failed. With the Soviet Union on the sidelines, the Soviet satellites gradually quit the game as well. Poland dropped out in 1950; Czechoslovakia was forced out in 1954; Cuba quit after Castro

took power, and so on. Romania asserted itself by joining the Fund in 1972, but it wasn't until the 1980s, with the Cold War winding down and the Soviet system collapsing, that a real movement began. Hungary joined in 1982, Poland rejoined in 1986, and then Russia and all of the other countries that emerged from the Soviet ashes joined in the 1990s.

So we can see both the limitations of the system in failing to prevent the cold war and the potential of this system in helping bring Russia and other countries back into the world economy after the cold war ended. The world has continued, however, to be full of conflicts, and because of that the IMF—I won't say much about the World Bank because Uri will be telling you about that in a few minutes, but this is broadly true of the Bank as well—the IMF has had to adapt its rules to changing situations.

The function of the IMF is to promote open trading and financial relationships among countries. But countries, including notably the United States, will occasionally impose exchange restrictions and assert that these exchange restrictions are solely for national security purposes. Once a country asserts that an exchange restriction is for national security rather than for economic or financial purposes, it effectively takes it out of the jurisdiction of the IMF because the Fund is not a suitable forum for discussing or passing judgment on the validity of military or political disputes. Over the years, this jurisdictional issue has arisen with regards to restrictions on Vietnam, Libya, Panama, and Iraq, among others.

So that is another limitation, a case of the glass being half full, if you will. Conflicts still take place all the time, and whenever a country is caught up in a conflict, there is very little that the IMF or the World Bank or any other economic agency can do except wait for the conflict to end. Otherwise, the institution could just get caught up in the conflict itself. This happened most recently in Iraq. As soon as the military "mission was accomplished" in 2003, the U.N. went back in, the IMF went back in, the World Bank went back in, and then insurgents blew up the building in Baghdad where they were all working. Many people were killed, and several IMF staff were injured, some quite seriously. That forced the Fund to pull its staff out of Iraq until the situation stabilized.

But what happens when conflicts end? How can the Bretton Woods Institutions give hope to countries that help will arrive as soon as it is realistic to do so? The IMF has a policy of providing emergency post-conflict assistance, so that as soon as conflicts end—as in Bosnia, Haiti, Sierra Leone, Timor-Leste and many other places—the Fund can go back in very quickly with policy advice, technical assistance, financial aid and so on. Now this is obviously not a job that the IMF as an institution can do alone. The key to making this whole process work is the kind of cooperation that Ambassador Lacarte discusses, but in an even broader context.

What is important is not just cooperation among the Bretton Woods Institutions, including the WTO, but also a recognition that these agencies are part of the broader U.N. system. Under the terms of a 1948 agreement, the IMF is an independent specialized agency of the United Nations. The management and staff of the IMF participate regularly in various agency meetings throughout the U.N. system. This role has increased over time, and it has become even more intense recently owing to the crucial role of the IMF in helping achieve the Millennium Development Goals to cut world poverty in half.

The IMF, along with the World Bank, is an integral part of that effort, and it liaises quite regularly with the U.N. to that end. What is missing from the systemic architecture, if you will, is a more comprehensive structure for maintaining peace and security in post-conflict countries so that economic assistance can be made more effective. While a real solution to that problem may still be a long way off, in December 2004 the Secretary General of the United Nations proposed the creation of a new Peace Building Commission within the United Nations. And he specifically requested that the heads of the IMF and the World Bank be represented on it, in explicit recognition of the importance of the links between poverty reduction, economic growth, and open trading relationships on the one hand, and the achievement of and maintenance of peace on the other.

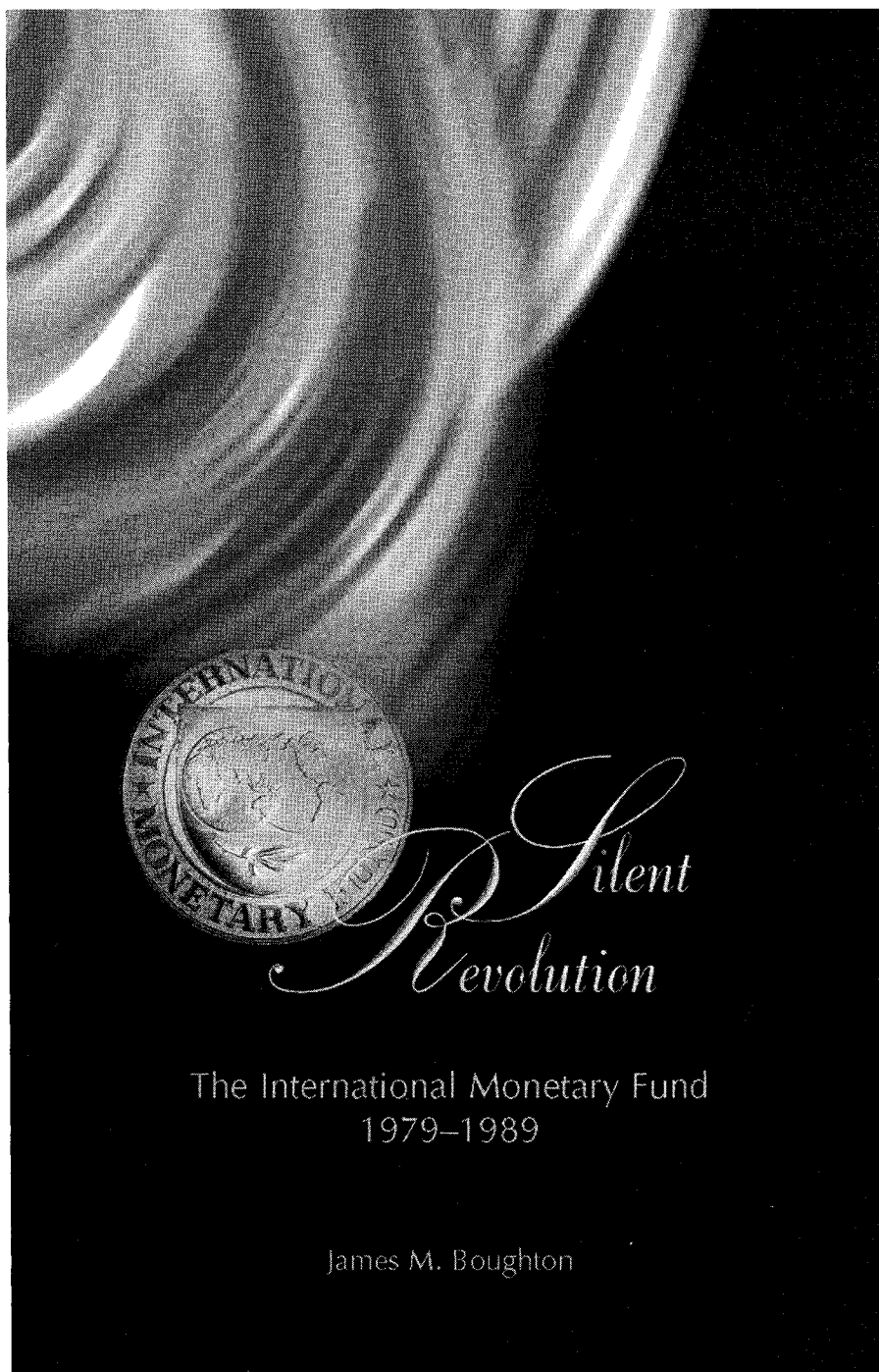
To conclude, the topic of this conference is both historical and very current. If the Bretton Woods Institutions can promote global prosperity, they will go a long way toward promoting peace and

alleviating conflicts as well. If I may be permitted a moment to plug my own book a little bit, as you can see from the illustration,⁴ I gave it the title *Silent Revolution* to advance the idea that globalization of trade and finance is a phenomenon that is taking hold all over the world and is quietly being accepted in the developing as well as the developed world. So I will leave you with that thought. Again, my congratulations to all who have organized this important event. Thank you all very much.

4. See Diagram, *infra* p. 1126.



©IMF Photo



Mr. Boughton's history of the IMF was published in 2001

TRADE AS A GUARANTOR OF PEACE, LIBERTY AND SECURITY? THE ROLE OF PEACE IN THE BRETTON WOODS INSTITUTIONS

JULIO A. LACARTE*

Many of the contributors to this conference will deal with the historical link between trade and peace, yet they will certainly also underline the way in which war, liberty and trade have come together so many times in the past, often in a scenario of conflict and violence.

I find that subject particularly challenging because of its multiple aspects, but I will resist the temptation to refer to them and concentrate on the peace role of the Bretton Woods Institutions.

Before we can fully grasp the implications of this peace role, we need to place it in context. Mankind went through two protracted, bloody and in every way destructive wars in the twentieth century.

In the aftermath of the 1914-18 World War, efforts were made to prevent new such armed conflicts. The creation of the League of Nations answered to this purpose. But the League essentially failed. It never exerted the necessary political authority to prevent war when clouds over Europe grew yearly darker; and earlier the onset of the

* Ambassador Lacarte has served as the Trade Minister of Uruguay and as the Ambassador to EC, India, Japan and Thailand. He also served as the Uruguayan Ambassador to the United States. He played a major role in the creation of the GATT, the United Nations Conference on Trade and Development, and the WTO. During the Uruguay Round trade negotiations (1986-1994), Ambassador Lacarte chaired the institutional negotiations that led to the establishment of the WTO and its dispute settlement system. Most recently, Ambassador Lacarte has chaired WTO panels and served as a panelist on a NAFTA Chapter 11 Investment Arbitration.

Great Depression found it ill equipped to counter the effects of this unprecedented collapse of the world economy.

After peace was signed in 1918, a number of restrictions had been adopted by countries in order to ensure supplies of essential materials, and this process had led to the creation of vested interests which proceeded to entrench themselves against all comers. Thus the new protectionism grew, uncontrolled.

The 1927 League of Nations World Economic Conference was followed by the Convention for the Abolition of Import and Export Prohibitions and Restrictions. But to no avail. World War II was in the offing. Events were on the march. In 1930, the U.S. Congress approved the highly protectionist Hawley-Smoot Tariff. In 1931, the world saw a series of damaging competitive devaluations. By May of 1932, the United Kingdom abandoned its free trade policy and began to apply a general tariff. A few months later, Commonwealth preferences were set up at the Ottawa Conference. The 1933 London Monetary and Economic Conference led to nothing. In the meantime, world trade was collapsing both in volume and value and protectionism and bilateralism were rampant.

There was a ray of light in this gloom: The United States approved the Reciprocal Trade Agreements Act in 1934 as a palliative under which it included a number of bilateral treaties ruled by the most-favored nation clause which allowed it to register more trade with its bilateral partners than with those countries with which it did not make these treaties.

And then, soon after, first Europe and then the world as a whole plunged into a bitter blood-letting that devastated whole countries, destroyed productive resources wholesale and brought anguish and death to countless millions. If there was one thing that people everywhere wanted at the end of hostilities, it was peace. Peace, peace above all.

Already before the end of the war, planning had somehow begun for what was to come. Franklin Roosevelt and Winston Churchill had met on the high seas and proclaimed the Atlantic Charter, which set out a vision of a peace time community of nations.

The FAO in 1943, the ILO in 1944, and the Bank and Fund Bretton Woods conference with its recommendation to reduce obstacles to international trade and promote favorable international

trade relations were pointers to the future. By 1945, the League of Nations had issued its pioneering report on "Trade Policy in the Post-War World."

In June 1945, the U.N. Charter was established with fifty-one signatures. The aims of the U.N. as set out in the charter were:

- Prevent war and maintain peace and security;
- Reaffirm faith in fundamental human rights for all;
- Respect for the obligations arising from treaties and other sources of international law; and
- Promote social and economic progress in larger freedom and for all peoples with full employment.

In the pursuit of these objectives, which placed peace above all, the United Nations would be assisted by a constellation of specialized agencies.

And now we come to the role of the Bretton Woods Institutions in the maintenance of peace. As we all know, the original intention was that the Bank and Fund would be joined by an International Trade Organization. In late 1945, the United States presented its draft charter for an ITO. The proposal went to the Economic and Social Council, it was debated and a Preparatory Committee for a world trade conference was appointed.

By October of 1947, this committee had drafted a charter for the ITO and simultaneously negotiated among its members wide-ranging tariff concessions under the most-favored nation clause which it enshrined in a covering text called the General Agreement of Tariffs and Trade ("GATT").

Between the end of 1947 and early 1948, the fifty-three member Havana Conference negotiated and agreed to the text of the Havana Charter for an ITO. Discussions were vigorous and countries defended their respective positions strongly; yet the success of the conference was never in doubt because there was a general and widely shared thrust towards a final agreement that simply had to be attained. This was the spirit of the times.

It seemed, then, that the Bank-Fund-ITO trilogy was about to materialize. However, the United States Congress failed to approve the Havana Charter. Given the enormous relative weight of the

United States at the time, its rejection was tantamount to condemning the ITO to oblivion.

This is indeed what happened, but out of the ashes of the ITO rose the GATT, as a trade instrument (certainly not an international organization) with the participation of barely more than twenty countries and with only provisional application.

We could say that the GATT, with its precarious existence, low membership and tiny budget and Secretariat, was at best the poor cousin of the Fund and Bank, which were already functioning actively and well.

For a number of years, the GATT very much lived its own life, gradually increasing its membership, mainly through successive tariff negotiating rounds. Institutionally, however, the GATT remained what it had been at the beginning: a trade agreement being provisionally applied and thus at risk that at any time, an important contracting party (such as the United States for example) could cripple it by withdrawing on short notice.

More than once, the GATT responded to a growth of world-wide protectionist measures by carrying out new trade liberalization rounds. This was a significant role that the contracting parties played in countering practices that might lead to restrictions on international commerce. In this way, they held the line against developments that could in some ways parallel the economic events that had preceded World War II.

The years previous to the Uruguay Round saw another dangerous surge of protectionism. Initial GATT efforts did not succeed against this threat and finally contracting parties decided to engage in new multilateral negotiations which begin in 1986 and became known as the Uruguay Round.

A long-standing GATT problem then arose very acutely. In previous rounds, the exchange of concessions had taken place essentially among industrialized countries, and developing countries had found little that would have been to their benefit. In these circumstances, they had simply withdrawn their own offers. As a consequence, while all contracting parties applied the general provisions of GATT, there was a marked difference between the market access facilities enjoyed by the developed and developing countries.

It was clear when the Punta del Este Declaration was eventually approved, that while developing countries as a group would be ready to participate fully for the first time in a GATT Round, they would be alert more than ever before to any prospect that the balance of concessions to be negotiated should turn against them.

The Uruguay Round, in spite of stalemates and deep disagreements, ended up as the biggest ever trade agreement on record and all participating countries accepted its commitments and provisions.

The Uruguay Round meant, at least, two things: developing countries finally participated fully in a GATT Round by granting ample trade concessions and the GATT ended its precarious life by being absorbed into the World Trade Organization ("WTO"), which was established as an inter-governmental body. In other words, we had come full circle and after the failure of the ITO more than forty years earlier, countries had finally set up its modern-day equivalent.

In retrospect, it seems fair to say that the GATT/WTO system has made significant, indeed an indisputable, contribution to world peace by holding at bay time and time again those protectionist forces that constantly threaten the world trading system. International commerce has increased enormously over more than half a century, and this is perhaps the best criterion to apply to the GATT/WTO system, which has also developed over time a dispute settlement mechanism second to none and which constitutes a permanent guarantee to member countries that their rights will be respected irrespective of their size or influence.

Now, the WTO is engaged in the Doha Development Round, which has been treading water after the Seattle and Cancun fiascos. However, this in itself is no cause for despair. In the past, similar and possibly worse episodes have occurred and this is understandable. WTO commitments are hard law. Once entered into, they are extremely difficult to ignore. Very large interests are involved in many WTO decisions and it is unavoidable that everyone should defend their interests to the hilt. What should surprise us is that it should ever be otherwise.

The Doha Round has to surmount two big and apparently intractable obstacles, but it will only succeed if it does so. One is the balance of benefits and concessions to developing countries which

have tabled a series of important grievances. The other is agricultural protectionism, which must not forever continue to be a stumbling block to commerce and a constant source of recriminations and tensions between groups of countries.

In sum, the success of the Doha Round will be another bulwark against protectionism and a renewed stimulus for world trade as a factor for prosperity, development and peace.

Should it be otherwise, the world trading system, which is predicated on the rule of the most-favored nation clause, would tend to emphasize its present important drift towards regionalism and its fragmented preferential treatments. A failure of the Doha Round would also mean that no agreed solutions had been found for agricultural protectionism and this would probably lead to intense and perhaps intolerable pressures on the WTO dispute settlement system, as aggrieved countries had recourse to it to put an end to violations of existing provisions.

All countries, then, whether large or small, have a stake in the combined success of the WTO, and we must expect them to act accordingly. There is not much time left for this to happen.

I might close by expressing a wish. When the three legged stool of Bank, Fund and ITO was conceived, there was the expectation that these organizations would cooperate closely in pursuit of common aims. We are constantly being made aware that economic, financial and trade relations (and their link with development) constitute an increasing intricate web that sometimes seems to escape our control. A significantly closer working relationship among the Fund, Bank and WTO calls for enormous work and preparation as events move fast and globalization advances apace. The Bank, Fund and WTO have still to jointly contribute a great deal more to economic prosperity as a basic pillar supporting world peace.

TRADE AS A GUARANTOR OF PEACE, LIBERTY AND SECURITY? THE ROLE OF PEACE IN THE BRETTON WOODS INSTITUTIONS

PEACE AND PROSPERITY THROUGH TRADE

DEBRA P. STEGER*

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I. VISION AT THE CREATION

“Peace and prosperity through trade” was the basic objective on which the General Agreement on Tariffs and Trade (“GATT”) was founded almost sixty years ago and it remains the fundamental *raison d’etre* of the World Trade Organization (“WTO”) today. Emerging from World War II, governments wanted to build a world in which nations would use international cooperation and negotiation to pursue their mutual interests and to resolve problems. They had a

* University of Ottawa Faculty of Law and Former Director, Secretariat of the WTO Appellate Body (1995-2001).

great vision: to create an international system that would promote economic growth and prosperity thereby securing peace. They believed that by reducing tariffs and trade barriers, standards of living would be increased, full employment could be achieved, and real incomes would grow. All of these things, they believed, were essential to securing and maintaining peace.

You have heard from Ambassador Lacarte, who was present at the creation of the United Nations, the GATT and the WTO, and from Mr. Boughton, who has written about the history of the International Monetary Fund ("IMF"), about the history of the Bretton Woods Institutions. There are important lessons to be learned from history. As history has a way of repeating itself, we must always be very watchful.

II. CROSSROADS TODAY

We are at a crossroads today—a turning point—in history. Ambassador Allan Gotlieb, a well-known former Canadian Ambassador to Washington, has expressed his view that:

We are at one of the great historic disjunctures in world affairs. The most basic concepts, some centuries old, are being re-examined and rethought. Armed humanitarian intervention to prevent gross violations of human rights is superseding classic notions of sovereignty and domestic jurisdiction; the duty to prevent genocide, nuclear proliferation, and imminent terrorist acts of mass destruction raise far-reaching questions about the use of force and authority, and about legitimacy in the international order.

The restructuring of the world's system of governance raises issues of pre-eminent importance and high urgency.¹

In addition to the very serious problems of poverty, terrorism and war, we have the monumental challenges and opportunities brought about by globalization. The international institutions—the United Nations, the IMF, the World Bank and the GATT—were designed in the 1940s by a relatively small number of countries to deal with the

1. Allan Gotlieb, *When Mr. McKenna Goes to Washington*, GLOBE & MAIL, Feb. 21, 2005, at A15.

challenges of the day. As Canadian Prime Minister Paul Martin has emphasized, "The challenge of the next decade is to redesign international institutions so that they will be capable of addressing the problems of the future, to make globalization work for the benefit of all." The Secretary General of the United Nations, Kofi Annan, recently released an extensive proposal to reform that organization. The Director General of the WTO appointed a Consultative Board chaired by former Director General Peter Sutherland, which has released a report recommending several institutional changes to the WTO.

Michel Camdessus, former Managing Director of the IMF, speaking about the international financial and monetary system, put the challenge this way:

Increasingly, during this period, the issue of stability of the international monetary and financial system has been viewed in the context of the broader issue of world economic governance. This is not a reference to some kind of world economic government, but instead to the more limited ambition of finding a global response to inescapable global problems. The task is monumental. Ours is the first generation in history to find itself in the position of being called upon to influence global affairs, not from a position of military conquest or imperial power, but through voluntary international cooperation. The challenge is to find mechanisms for managing the international economy that do not compromise the sovereignty of national governments, that help the smooth and effective working of markets, that increase opportunities for the poorest, that ensure international financial stability but that, also, offer solutions to problems which now transcend the boundaries of the nation state. A tall order indeed!²

Peter Sutherland, former Director General of the GATT who guided the Uruguay Round of Multilateral Trade Negotiations to a successful conclusion and Chair of the Consultative Board that recently issued a report on "The Future of the WTO," has

2. Michel Camdessus, *An Agenda for the IMF at the Start of the 21st Century*, Remarks at the Council on Foreign Relations (Feb. 1, 2000), available at <http://www.imf.org/external/np/speeches/2000/020100.htm>.

emphasized that “multilateralism is a fragile concept—both in practice and in theory.”

Multilateralism and international cooperation, I would suggest, are essential keys to peace. And like peace, they are delicate concepts that must be tended carefully by the international community in order to survive and flourish.

III. CHALLENGES FOR THE MULTILATERAL TRADING SYSTEM

The multilateral trading system has been very successful in many respects since the end of the Great Wars of the last century, but it also faces major challenges. It has been successful in reducing average tariff rates, particularly on manufactured goods in industrialized countries. Reform in agriculture and textiles, however, has been painfully slow. On agricultural subsidies, the major developed countries have moved backwards. The developing countries understandably feel that they got a bad deal in the Uruguay Round, and that the developed countries have not lived up to their commitments. There is a perception of inequity and imbalance in the multilateral trading system that must be rectified.

IV. THE WTO DISPUTE SETTLEMENT SYSTEM

The WTO dispute settlement system is often touted as the “jewel in the crown” of the WTO. Over 320 complaints have been notified to the WTO since 1995, and, of these, approximately one-fifth have been resolved diplomatically in consultations between the disputing parties. Another eighty-five or so cases have been heard by panels, and over sixty-five appeals have been heard by the Appellate Body. The fact that governments, particularly the United States and the European Union, take their disputes to the WTO, rather than threatening unilateral retaliation, is a significant improvement over past practice. Compliance with dispute settlement rulings, moreover, has been relatively good. Despite the common view that compliance has been a problem, in fact, there have been difficulties in only ten percent of the cases.

There are, however, storm clouds on the horizon. The United States and the European Union are finding it increasingly difficult to comply in certain cases. While smaller and developing countries

have an excellent compliance record, the same is not true for the two major players. If the United States and European Union continue to evade compliance, there is a risk that other countries may follow their example. As the renowned Professor Robert E. Hudec has observed, the WTO dispute settlement system will remain effective only as long as its Members are willing to comply. If that willingness begins to erode, there could be serious problems ahead for the WTO dispute settlement system.

Another storm cloud looming is that some very tough cases are currently being brought in the WTO. Cases involving agricultural subsidies (the peace clause has expired), food safety, preferences for developing countries, and trade in services are being brought in increasing numbers. In the absence of a successful conclusion to the negotiations in the Doha Round, and without effective rulemaking mechanisms in the WTO, the dispute settlement system will continue to be confronted with some very difficult issues in the foreseeable future. Many of these difficult and complex political issues would be best resolved by negotiators. There is a limit to how much “gap filling” and “ambiguity clarifying” the Members of the WTO will allow the dispute settlement system to do. However, the WTO does not have effective rulemaking procedures and until reforms are implemented, an undue amount of pressure may be put on the dispute settlement system. No doubt, difficult cases will continue to be brought, but if the dispute settlement rulings are not ultimately followed, respect for the system will diminish and this will not enhance the legitimacy of the WTO.

V. GOVERNANCE OF THE WTO

Another major challenge for the WTO lies in the area of governance. Membership has grown from around 100 states when the WTO was established ten years ago, to almost 150 today. China is now an active Member of the WTO and another thirty countries are in the process of accession, including Russia, several Arab states, Vietnam and Cambodia. The system has changed. The overwhelming majority of Members are developing countries. The larger developing countries—India, Brazil and China—are major players in the Doha Development Round. At Cancun, they developed the G20, which has become a new geopolitical force in multilateral trade

negotiations. Developing countries want to have, and must be given, a real voice in the multilateral trading system.

Better, more inclusive decision-making and rulemaking processes need to be developed in the WTO to ensure that all developing countries, including the least-developed, have an active voice in the system. The days when the United States and the European Union could negotiate agreements and impose them on other countries are long gone.

Developing countries are not a homogeneous group. They do not have similar powers or interests. The larger ones—India, Brazil and China—are all doing well economically. They are also negotiating regional agreements with neighboring countries. In many respects, these countries do not need the Doha Round, but the multilateral trading system needs them.

VI. REGIONALISM

Another issue is the growing spectre of regional trade and investment agreements, the so-called “spaghetti bowl.” The Sutherland Report on “The Future of the WTO” warned that regionalism is a potential serious threat to the multilateral trading system. There are over 300 regional trade agreements in the world today, and there are over 2000 investment agreements. Left unchecked, this will cause great fragmentation in the multilateral system.

VII. AMBIGUOUS MANDATE

The WTO appears to have an ambiguous mandate. There are pressures in the United States and the European Union to expand the WTO’s mandate to include investment, sustainable development, competition, labor standards and other “non-trade” issues. Observers have suggested that the WTO should become the “World Economic Organization” and expand its jurisdiction to include all matters of an international economic nature. The developing countries are overwhelmingly opposed to such expansion of the WTO’s mandate. They, however, would like the WTO to take account of their development needs as well as the particular concerns of smaller economies.

There is no common view of the purpose and mandate of the WTO. It is no longer obvious that trade liberalization is the fundamental guiding objective of the multilateral system. The old adage that trade liberalization is like riding a bicycle, you have to keep going in order to avoid falling off, is no longer applicable. Sylvia Ostry, a well-known international economist, has characterized the present system as a bus careening down a hill—no one knows where it is going, but there are a lot of people hanging on for their lives.

VIII. CHALLENGES TO LEGITIMACY OF THE WTO

The WTO also faces the challenge of legitimacy *vis-à-vis* the outside world, that is, in its relationship with business, consumers and civil society. The WTO is not the GATT. It deals with many areas of domestic regulation that were previously the exclusive domain of sovereign governments, such as food safety, health and protection of the environment. To the extent that policies relating to these important subjects affect trade, government actions can and do come under WTO scrutiny.

Businesses, consumers and civil society are all stakeholders in the multilateral trading system. The WTO takes decisions that affect their interests. Governments must find better ways to consult with their publics in trade negotiations. The WTO must also do more to explain its mission in order to allay the pervasive fears many have, which are based on a fundamental misunderstanding of how the system functions.

IX. CONCLUSION: THROUGH THE LOOKING GLASS

Looking through the prism of the past into the future, the objectives in many ways are the same as they were in the 1940s. That is, to make the world safe and secure, to alleviate poverty and secure peace by giving the poor countries of the world the means to achieve economic growth and prosperity. Trade is, and has proven itself to be, a major engine for economic growth. However, trade liberalization will never be the only answer to all of the world's

problems, including the eradication of poverty, but it is an essential part of the solution.

The twenty-first century has been marked in its early years by political instability, economic recession, war and terrorism. These are difficult times. The world faces many of the same fundamental choices that confronted it after World War II. Governments must ask themselves whether they want to proceed along the path of peace and prosperity through liberalized trade, and continue to foster economic growth through international cooperation, or retreat into a world divided by its isolationism, regionalism and protectionism. If the latter course is taken, the losers will be the smaller and poorer countries of the world.

The stakes are high; the choice is clear. We can only begin to meet the daunting challenges of the twenty-first century through enhanced international cooperation. Let us hope we have learned that much from the lessons of history.

TRADE AS A GUARANTOR OF PEACE, LIBERTY AND SECURITY? THE ROLE OF PEACE IN THE BRETTON WOODS INSTITUTIONS

URI DADUSH*

Well, I'm very impressed to be on the same panel with Ambassador Lacarte, Debra Steger and Jim Boughton of the IMF. I'm very happy to be here. I was very interested in the topic of the conference and I decided to talk about peace and trade. Not because I'm especially qualified to talk about politics and peace—maybe I'm a little more qualified on trade—but really because I'm interested in the subject and maybe I can share the little bit of light from my experience in trade work at the Bank.

So, trade and peace—it is clear to me anyway—that there are circumstances where trade helps consolidate peace. However, John Stuart Mill's presumption that trade assures peace is clearly not borne out by the evidence. One is more sympathetic to the view of the causality running the other way that peace helps promote trade,

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or is a prerequisite to successful and durable trade relations, though here too the evidence is mixed.

Let me talk first about the effects of trade on peace. There are actually many examples of trade failing to assure peace. We have heard one today. The two World Wars were preceded by a period of unprecedented global market integration in the second half of the nineteenth century. It led people to say in the 1910s and in the 1920s after the First World War, that this would be the end of war.

A more recent example that I have a little bit of familiarity with, because I lived in Jerusalem in the end of the 1960s, is the very deep integration of the Palestinian and Israeli economies in the 1970s and 1980s, following the June War in 1967, which was associated with a large rise in living standards in the territories. The economic integration, however, led to great economic dislocation and did not prevent the two intifadas.

There are also examples where trade itself contributes to tensions and therefore may cause conflict. Regionalism, which we have heard about a lot today and which is proliferating, is often justified on the basis of enhancing peace and security; witness recent European history. But, the model does not always apply. In this country, for example, a common market and common external tariff contributed to the tensions that led to the Civil War, as the agricultural South wanted cheap industrial imports, which the industrial North was determined to protect.

Another point. Were trade such a powerful antidote to war, then you would expect the gains from trade to be widely understood by the public and perceived by the public to be large. In fact, as I know firsthand from trying to argue for trade reforms in various contexts, trade is very rarely an easy sell; it is a very difficult sell. There is, of course, large theoretical and empirical evidence that trade can be a source of enormous gains, but these gains are difficult to demonstrate and defend politically, in part because the largest source of these gains (what we call the dynamic source of gains, that is, the increased productivity and innovation which comes from competition from imports) are intrinsically disruptive. To compound the problem, as is often said, the losses to the import competing sectors are highly concentrated and visible, while the more offsetting gains to the consumer are thinly and widely spread.

Furthermore, the distributional effects of trade reforms are large. So most models of trade liberalization would suggest that the estimates from trade liberalization are in the range of one to two percent of GDP. But the associated income gains and losses from redistribution across factors can be two to three times larger. So, if you assume that the initial factor shares are about equal, the factor employed intensively in imports loses proportionately two to three times more than the nation gains on average. The opposite happens to the factor employed intensively in the export sector. So changes in the trade regime and trade disputes around an existing trade regime can be a source of tension, as well as a source of gain.

This relates to new trade liberalization. However, you can say that once an open trade regime is achieved, it presumably contributes to changes in the political landscape, which promotes its continuation. This should be especially evident in the case of deep economic integration, which entails not just increased trade, but big cross-border investments, large sum costs in export-dependent factories and now we have labor specialization along lines of comparative advantage.

It stands to reason that new and powerful interest groups can then form, whose welfare depends on the continuation of open markets. But history shows that the drivers of conflict, when they exist, can be extremely intense: ethnic divisions, differences in religious beliefs, ideological rifts and the struggle for resources. In the end, these forces will overwhelm the gains for trade, even if they are perceived to be large, which is often not the case.

Now, I would like to make some observations about the effects of peace on trade. I'd like to make three observations where the effects are in the other direction. I will start with a brief anecdote from the World Bank's last—which was also the IMF's last—mission to Iraq, that Jim Boughton mentioned, just before the explosion of the Canal Hotel. I happened to be on that mission and I found myself arguing with the coalition authorities.

Trade liberalization should be nowhere near the top order of business in Iraq. It is a very unusual situation for me to argue that trade liberalization is not important. I simply reasoned that few entrepreneurs were courageous enough to invest in transforming Iraq into a diversified exporter until their personal security and that of

their employees was assured, and until an adequate power supply was restored. This is my little anecdote to underline the importance of peace for trade.

We often survey how developing countries have fared over the last fifteen years of extremely rapid global economic integration. We find that about two-thirds of the people in the developing world reside in countries where per capita income has been rising at historically rapid rates—two-and-a-half or three percent or faster. This includes India and China. But also there are at least a score of other developing countries besides China and India, many with large populations, that are growing very fast.

However, excluding the special case of countries in transition, about five percent of the population in developing countries reside in countries where per capita income actually declined. When you go and look at those countries, the most relevant reason that you can point to for their decline in per capita income is the presence of either civil or international conflict.

Third point. In a report on globalization that the Bank published in 1997, we asked whether the current global integration was irreversible. We surveyed the experience of the nineteenth and twentieth centuries to try and address the question. Our conclusion was, probably not.

Probably not, because economic activity, I'm quoting, "Takes place in a web of political and social relationships that are not always well understood or managed." The history of the nineteenth century of global integration provides some obvious, but still useful, lessons. The revival of protectionism then took place against the backdrop of mounting great power rivalry, nationalism, and eventually, preparation for war.

The bottom line of our review was that if history is a guide, the continuation of a global integration process is not inevitable. It depends critically on continued peaceful relations among the great powers, avoidance of major macro-economic instability, and a perception—and this is important—that the social inequalities, incomplete distribution and increased migration that has resulted from technological change has been adequately addressed.

I would like to make a couple of points on the current situation; very quickly since many in the panel have mentioned it. I second the

points made by Ambassador Lacarte and the other speakers about the importance of moving forward on the Doha process, the importance of agricultural reforms in particular, and the importance of getting the developing countries more engaged in the process. I believe that we are at a serious risk at the moment. The Doha process will either not conclude, which is less likely, or more likely conclude in what is frankly from a development perspective, a known event.

I know I've been somewhat pessimistic in my comments. I would like to end with a note of optimism. There is a huge change happening in the world, and I'm referring to the rise of China and the rise of India. I was just in these countries a month ago, talking to the trade policymakers. I believe that China will be the world's largest economy in ten or fifteen years. India is quite a ways behind, but may very well surprise us in the rate of its progress in the course of the next decade. In my view, there is enormous change happening.

Both of these huge countries are discovering—China has already discovered it—that the WTO and the world trading system is a viable, open, rules-based trading system that is actually part of their vital national interests. There is a scenario—an optimistic scenario—where these two huge countries will become the biggest defenders of the system because both of them are discovering enormous export interests.

Part of the difficulties we are living with at the moment may be the result of the fact that we are between two periods; a period where the United States was the biggest promoter of the system to a period where China and eventually India would be the biggest promoters in the system. But we are now inbetween, where no clear leadership exists.