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I. INTRODUCTION

Thank you very much, Ved. I am grateful for the invitation which has been extended to me to speak in your series of lectures in honor of Myres McDougal. Mac is not only an old friend of mine, as of so many others, but is also one of those rare persons who combines scholarship, thoughtfulness, and a deep conviction that it is possible to improve the way in which we all think about legal issues, and consequently, the policy issues which are heavily infused with legal aspects. He and Harold Lasswell, his long-time co-worker (and in a sense, mentor) are responsible for a whole generation of scholars. I admire greatly their aspirations and their work, though I must confess that I am sometimes a bit confused by my inability to speak what has come to be known as McDougalese.

I have taken as the subject of my talk "The Rules of the Game"—cribbing from the title of a book written some time ago by Kenneth Dam, former Provost of the University of Chicago and Undersecretary of the Department of State. I borrow thus openly, because Ken's book is mainly about trade rules and rules associated with international trade, such as the rules of international finance, and that, in a major sense, is what I want to talk about as well. Stepping timidly in the footsteps of McDougal, I hope to suggest that some of these "rules" of the game, which were confidently enacted in the era of institution-building following World War II, were probably not rules even when they were first adopted, but have become something less even than guidelines at the present. McDougal and Lasswell called for lawyers and scholars to perceive what they understood to be the underlying realities. Somewhat immodestly, I too feel that I am suggesting that we look carefully at what exists, at how the world operates, and from that appraisal derive our con-

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cept of what the working rules are. The formal documents are of course important, but they are far from the entirety of the story. What happens, and why, is the subject of my inquiry.

II. Historical Overview

What then have been the "Rules of the Game" in respect to international trade and finance?

Even during World War II, plans were being made, mainly in the foreign establishments of the United States and Great Britain, for post-war reconstruction. It was evident that much had to be done, not only to rebuild a world—a large part of whose physical plants and equipment had been destroyed by the war, but also to rebuild social and economic institutions, and to redesign them to cope with new issues and new challenges. Moreover, it was thought that lessons had been learned from the events in the economic area which preceded the actual outbreak of war, when the Great Depression had led many countries, not least the United States, to try to export their economic problems by limiting the inflow of imports. In those relatively simple days, this was done mainly by the imposition of high tariffs. Whether the responsibility for these economic problems was due largely to the imposition of high reparation demands on countries which had already been impoverished by World War I, or the expectations of some European countries that they could ensure security and prosperity by impoverishing their defeated former enemies, is an inquiry best left to the historians. The relevant matter here is that there were demands and policies that were at least partially responsible for the crash which followed the feverish post-war period of the 1920's, and that the depression led the United States down the path of protectionism, with the now infamous Smoott-Hawley Tariff Act as a result.

The consensus, thus, in the years just before and immediately after the defeat of the Axis powers in 1945, was that a great effort should be made to construct a better and more economically sensible world, and that this effort was for the benefit of all. One did not, in those early days, consider much the eventual role of Japan and Germany as major trading partners and economic powers. But one did focus on reconstruction, especially of the economies of the former allies, as a major and primary task. Moreover, such reconstructions were to indicate the interdependence of nations, and the fact that international trade and commercial intercourse was a positive sum game—not a zero sum game, in which the gain of one could be accomplished only at the expense of another. Out of these thoughts and this effort arose the Bretton Woods system—named for the New Hampshire town at which the Articles of Agreement of the World Bank and the International Monetary Fund were fashioned.

There were three main legs of the intended system, only two of which were directly the product of Bretton Woods. At Bretton Woods, the International Bank for Reconstruction and Development (with development very much in second place) (the Bank) and the International Monetary

Fund (the Fund) were created. The Fund had as its principal aim the establishment or re-establishment of convertibility at stable exchange rates, and the elimination of the welter of restrictions, multiple exchange rates, and war and post-war restraints on currency transactions which had emerged. There were, of course, transitional phases in the road to stability and convertibility, but the thesis was that there would be a gradual and steady progress toward a world of full convertibility and stable rates of exchange.

The second major Bretton Woods instrument was the Bank, which focussed, in the first instance, on reconstruction, and only secondarily (and without too much thought) on development. Priority, it was thought, had to go to reconstruction of the economies of the major trading nations of the world; it was they that had been the influential actors on the world scene; it was they whose economies (again with the notable exception of the United States) had been depleted and whose physical plants destroyed. The first task was to restore those economies to health. And, though it was largely unspoken, it was thought by most that the so-called developing countries (then less politely called undeveloped or underdeveloped by all but the French) were not likely to play an important role in the reconstruction and development of the post-war world.

Thus when it began operations the Bank focussed on the tasks of reconstruction, somewhat to the distress of the developing nations. (One influential factor was the perceived need to establish the credibility of the Bank as a borrower in the world's capital markets.) It was only with some tardiness that the Bank began to pay attention to developmental needs, and that supplemental institutions, like the International Development Association (IDA), which could make long-term, low-interest loans, came into existence. It was in fact not until the 1960's that countries, led by the United States, began to put together substantial development or grant lending programs for the less developed. And it was not until much later that the Bank and similar institutions began to make funds available for "social" programs—hospitals, health care, water and sewage systems—as well as for the more "bankable" projects, like dams, roads and ports, which could be evaluated more easily in terms of profitability and an ability to earn enough directly to ensure that the loan was likely to be repaid.

Trade was the third leg of this tripod. Reduction or elimination of trade barriers was the aim. Observing the proliferation of trade barriers spawned by the Great Depression, nations were persuaded of the virtues of a multilateral and open trading system. Essentially, the policies were to be similar to those of the United States Reciprocal Trade Program. The heart of this system was to be a multilateral trade negotiation, the object of which would be to reduce tariffs on goods traded between (in the main) the industrialized nations, and to set up a mechanism for: generalizing the concessions which each negotiator would make to the other in a series of related bilateral negotiations, and continuing the process to attain further tariff reductions through an ongoing series of trade talks. Generalization was to be accomplished by means of a fundamental commitment to the principle of unconditional most-favored-nations treatment—a concession accorded to one trading partner would be accorded to all others. Hence there would emerge, from a series of bilateral agreements, a master and generalized agreement, at least on tariffs and on matters essential to guard those tariff crossings. There was to be an organization, the purpose of which would be both to encourage further rounds of tariff negotiations and to supervise the trade agreements. As a concomitant part of the overall scheme, there were to be a series of other agreements, which would guarantee that what was given in a tariff negotiation, for example, would not be taken away by a private cartel arrangement (and still less by subsidies, quotas, or devices intended to distort the trade which the tariff negotiations had liberalized). The instrument for this was to be a new organization—the International Trade Organization (ITO). Among its principal tasks, the ITO was to administer the General Agreement on Tariffs and Trade (GATT).

The basic text of the GATT was completed, after extensive negotiations, in 1948. The GATT was intended to be just what its title indicated —an *agreement* rather than an organization. (The ITO was to be the organization.) It embodied as its "cornerstone" the most-favored-nation (MFN) principle, to which there were several important exceptions. Perhaps most notable was the understanding that there could be common markets or customs unions and free-trade areas. Within a common market (or free-trade area) favorable tariff treatment could be extended to members without extending that treatment to non-members, as is generally required under the MFN principle. The principal exemplars were the European Economic Community (EEC) and the European Free Trade Association (EFTA). Exceptions were also made for developing countries, for agriculture and other situations. Clauses were inserted and designed as safety valves—the "safeguard" provisions of Article 19, for example, which allowed countries, at the price of giving up some concessions, to protect themselves against the effects of unexpected and sudden inflows of imports.

The Charter of the ITO, completed in Havana in 1948, established the world trading organization and contained a number of substantive chapters on rules. These dealt with commodity arrangements, restrictive business practices, and employment practices, as well as dispute resolution. Brief investment clauses were, at American insistence, also incorporated.

The result of what may loosely be called the Bretton Woods process was thus a reasonably complete arrangement—the Bank, the Fund, and the ITO. The Bank and the Fund did come into existence, but the ITO did not, for a series of reasons too complicated to be detailed here. Consequently, on the trade side, the GATT had to suffice and had to double as both agreement and organization. Somehow, mainly through the ingenuity of its first Director, Eric Wyndam White, and the need for some sort of organization, it managed to survive, and for years to do an excellent job. But non-ratification of the ITO was a great mistake. It is now apparent that the substantive clauses of the ITO Charter—which were lost because it could not achieve ratification—were of great value. The simple formulae with respect to the responsibilities and the treatment of private foreign investment anticipated much of the debate swirling around that topic and around "transnational corporations," and, had they been in effect, could immeasurably have bettered the contribution of investment to development. Similarly, the provisions with respect to commodity arrangements, restrictive business practices, and social and labor conditions correctly anticipated problems which have been with us for years.

Thus, we emerged with what could be considered to be a comprehensive system. It did not include all elements of an ideal system—several of what had been considered key elements of the ITO Charter were not to be found in this array—and even within its terms there were numerous imperfections. To paraphrase Wyndam White, the GATT was itself a series of exceptions held together by mutual tolerance of violation. But there it was, operational, able to cope with most aspects of world economic intercourse, and representing an important part of what Ken Dam called "The Rules of the Game."

III. ANALYSIS

My inquiry this evening is whether these "rules" are still adequate. Certainly, for a good many years, they have stimulated a great increase in trade and commerce. During this period tariffs have been reduced, assistance has been given for development, and global production has risen. New international financial institutions have made major contributions. But the 1980's are not the 1960's. Recrimination seems to have replaced cooperation in international economic discourse. The present issues are different—or so it seems. Can the structures stemming from Bretton Woods now do the job? Can they handle the problems with which anyone who reads the daily newspapers is familiar? Perhaps putting it somewhat differently, are there still "Rules of the Game"?

If illustration of the dangers of such analysis and especially of prophecy in this regard were needed, it is provided by reminder that a basic objective of at least one institution—stable and fixed exchange rates—has now been abandoned in favor of "floating" exchange rates. In 1971, the United States, in the administration of President Nixon, effectively abandoned the gold standard, while at the same time imposing a major and unilateral increase in tariffs (later itself abandoned). As someone has said, prophecy in this regard is like trying to tattoo a soap bubble.

One may begin this inquiry by asking how well the system has really worked. Despite the enormous increase in world trade since the early days which I have alluded to, the system has not achieved satisfactory progress in reducing trade barriers. At least in this last decade, non-tariff barriers have been substituted for tariffs. There has been progress, but at quite a price.

One difficulty, evident from the beginning, has been the very uneven application of the "cornerstone of the GATT"—unconditional MFN treatment. As I have noted, Article 24 of the GATT always permitted customs unions, whose members accord to each other treatment much more favorable than they give to outsiders. That license was stretched to "free trade areas," and then extended to then special arrangements such as that between Canada and the United States, and now between the United States and Israel. The favorable treatment originally granted in the GATT to developing countries was eventually formalized and expanded, with the requirements of reciprocity being expressly put aside. The Generalized System of Preferences, designed to assist the developing countries, but with results which may not have been quite that, was adopted and encouraged. How this has affected the notion of unconditional MFN treatment is evident from the proliferation of regional and other preferential arrangements (e.g., the Caribbean Basin Initiative, the several Lomé Agreements, etc.). Moreover, a great many of these arrangements, which perhaps might fit (with difficulty) within the permissive clauses of Article 24 of the GATT or which could have obtained special permission within the framework of the GATT, were simply never even contemplated by the GATT.

Thus, the system of open, fair and non-discriminatory trade based on the MFN principle showed flaws almost from the beginning, and these flaws have greatly increased.

The next deterioration has been an evident rise in non-tariff barriers. As tariffs were drastically reduced, nations exhibited all ingenuity in erecting other barriers. These non-tariff barriers took all sorts of forms. Some of them were quite forthright, such as explicit import quotas. Some of them affected particular industries, such as agriculture, which, from the outset was (in the United States as in other countries), an area in which non-discriminatory trade was hardly known. The developing countries were in a special category and exempted from many of the rules.

Other kinds of discrimination have appeared. There are the so-called "voluntary export restraints," which have been imposed on allegedly willing trading partners, and accepted to avoid something worse. The exemplar of restraint agreements, honored by multilateral acceptance and by time, is the Multi-Fiber Agreement. And there are other discriminations, in areas which had not explicitly been covered by the GATT. These include particular services in the new fields of transborder data transmission, as well as the more traditional areas of insurance, banking, and shipping. In these areas of increasing importance and vague rules, the trend has been toward greater rather than less discrimination.

It has become evident that the mechanisms which we had erected, whether those of the Fund, the Bank or the GATT, were not entirely adequate to handle these problems. For example, the GATT had never given proper emphasis to resolution of disputes, to the way in which one state could settle a dispute with another within the framework of the GATT. In the GATT context, if one state found that another was discriminating against its exports, the response was basically the right to retaliate. Retaliation may be a form of psychological vindication, and it may give pause to others and thus be preventative, but retaliation leads to escalation and seldom to reconciliation. (I note with some bitterness that when the United States "retaliated" in the so-called "chicken war" of the early 1960's, it raised the cost of *my* cognac. I found that retaliation worked against me much more than it did against the French. That is an illustration of why I don't think very much of retaliation as a device for settling trade disputes!)

Perhaps more importantly as the years went on we began to find that even the Bank and the Fund were not able to handle the issues facing them. That is, I suppose, partially because the nature of the issues changed, and partially because the problems became larger than it had been thought they would become. For the Bank, "reconstruction" was finished and it focussed on the problems of development. Reconstruction had been relatively easy. In Western Europe the essentials remained. There had been much physical damage, but the people and their skills remained. They still had the capabilities and education. The tradition of education, the tradition of engineering and of research and all the other things that go to make up a great society were all there. Basically, all that one had to do was to put some money at their disposal, and they went right back to work. The railroads were rebuilt, the factories were restored, and with Marshall Plan money and an expanding world economy, all went well.

But development is a more complicated process than reconstruction. Though the Bank did its best, and institutions like the Development Assistance Committee of the Organization of Economic Cooperation and Development (OECD) were established by developed countries to coordinate and enhance the effectiveness of bilateral development aid, results were, though significant, spotty. Nevertheless, there was some progress, both institutionally and in terms of measurable results. With development occupying a priority in the attention of aid donors, with establishment of the IDA, and with the contributions of the regional development banks, it was possible to hope that indeed the aspirations of the post-war planners would be realized. This was especially so since the needs of the developing countries were coming to be more clearly realized. The Bank came to the conclusion that lending for non-bankable projects—health, education and the like—was within its mandate. It came to accept "program" lending and restructuring of an economy. It began to plow the profits of earlier loans into development. And institutions like the Fund also turned attention to structural adjustments, with long-term benefits.

All of this resulted in a fairly optimistic global picture, but the 1970's brought reverses. That was the period of successive oil shocks, when the price of oil went suddenly to levels which placed inordinate demands on the world economy, especially that of the non-oil-producing developing countries. Global recession had a severe effect. Faced with difficulties of a new order of magnitude, the consensus with respect to the benefits of liberal trading policies, while nominally still the accepted gospel, became more honored in the breach than in the observance. What had been the exceptional concessions to straying from precepts of MFN treatment, and of lowering of trade barriers, became instead the rule. Indeed, in many cases (estimated at some 20% of global trade) the rules in a sense became irrelevant, since that trade is barter, or so-called counter-trade.

Much of the philosophical underpinning of the GATT gave way. "Industrial policy" became the slogan of the day. The thesis that trade policy should not determine more important issues—like employment in developed as well as developing countries—was a frequent thesis of international conferences. It was thought by many—the present speaker included—that the guidance by government bureaucrats implied by "industrial policy" was likely to have no better results; but that seemed old-fashioned and sentimental attachment by a few to policies now outgrown. And indeed, governmental policies gave emphasis to the new view, or to something like it. Governmental intervention, even by states professing continued adherence to GATT policies, became increasingly evident. The non-tariff interventions, as well as the frequent deviations from liberal trade policies, plus the increasing share of world trade outside of the GATT, all had an effect. And this too was accentuated by the temporary relief given to the developing countries by the "intermediation" of the private commercial banks, which undertook to recycle petro-dollars to the developing nations. That recycling, while giving momentary relief, gave rise to the enormous problems which are now recognized in the form of the "debt-crisis" of the developing world. Though there were many who pointed out early that the burden of interest alone on the then outstanding debt was overwhelming the ability of the developing countries to service that debt, and that these further loans, many at high rates of interest or floating rates, would be completely unserviceable, the loans continued to be made, without the early structural adjustments necessary for economic viability. The results soon became evident. Debtor nations had to cut back imports or subsidize exports, or both, simply to earn enough to service their external debt. And the consequent surge of protectionism, both open and somewhat disguised, with which we have now become accustomed, became itself a "Rule of the Game."

Little was done about this in a serious or timely fashion. What was done seemed reminiscent of the 1930's, with each country and each group seeking to protect its own interests, mainly at the expense of another country or group. To protect the farmers of at least some EEC countries, a complex system of price supports (the Common Agricultural Policy) was instituted (modeled to a certain extent on previous United States agricultural price supports, but even more distortive). Subsidies led to protective measures, such as countervailing duties, some justified, some not. To give United States exporters what the United States considered to be fair treatment (but other regarded, as did many in the United States, as unfair and even uneconomic), the Domestic International Sales Corporation (DISC), was established and maintained by the United States for years after the GATT found it to be an unfair trading practice.

There was a proliferation of special trading arrangements in what seemed to be almost complete disregard of MFN obligations. "Orderly marketing arrangements" and "voluntary export restraints," negotiated on a bilateral basis outside the GATT, became endemic. These were done without even the modest amount of control evidenced in the renegotiation, on a multilateral basis, of the Multi-Fiber arrangements. Devices outside nominal GATT controls were used, such as the French requirement that video equipment be cleared through the tiny customs facilities at Poitiers, a place previously notable for the medieval exploits of Charles Martel.

Complicating all of this was an all-too-frequent tendency to blame someone other than oneself for unsatisfactory economic performance. Transnational corporations, whose effects on international trade and the welfare of the developing countries are not always easy to measure, became, in the mid-1970's, an object of special concern and interminable debate and conferences. The UN Commission on Transnational Corporations, established in late 1974, became a sounding board for these complaints. Some issues clearly existed here, but they were clearly minor, and the remedy was largely irrelevant to the constrictions of growing protectionism. In the midst of all this, the Tokyo Round of trade negotiations, culminating in the Multilateral Trade Negotiations of 1982, achieved a series of codes, some of which had a dubious effect on the beleaguered MFN principle, some of which made minor contributions to the improvement in trade relations, and most of which went unratified by many countries. Talk emerged about mechanisms other than the GATT—perhaps a reinforced OECD, with strengthened rules looking toward more liberal trade practices among at least the developed market economies.

This is a grim picture. Its reality is illustrated in the debt crisis, perhaps especially that of Latin America which has, with Mexico, Brazil and Argentina, some of the major debtors. The statistics there are striking. Latin America owes, roughly, one-half of all the debt of the developing nations. Two-thirds of that is owed mainly to private commercial banks, not exclusively in the United States. That is a very impressive statistic, and depressing as well. Bear in mind that this debt was largely accumulated at a time of intensive attention, by public and private institutions, to financing the needs of the developing countries. It is to a substantial extent the result of the "intermediation" which had at one time been taken as a sign of how the private banking system could in fact rescue such countries from the consequences of the oil crisis. For 1983, the interest bill alone of the Latin American countries as a group took more than 35% of their export earnings. Total debt service, including such payments as were made to reduce the principal amount of debt, took 66% of export earnings. The total of such payments was in excess of $40 billion. One can compare those figures, even as adjusted in terms of constant dollars, to the $14 billion which was the then impressive amount which the United States put into the Marshall Plan, over a period of years.

At least one consequence has been the realization that this crisis has affected many outside of, as well as within, the developing countries.

First, of course, comes to mind the commercial banking system, which can hardly afford to see defaults by major debtor countries, and which is desperately struggling to keep loans in such a condition that they do not have to be considered by bank examiners to be in default — which would have serious effects on profit and loss statements. Another is the austerity regimes which have had to be adopted in the developing countries. Taking so much of export earnings for debt service deprives a country of funds for the costs even of adequate replacement, much less new investment or increased social benefits. The consequence, at least in some countries, has been debilitating political as well as economic effects; instability in several Latin American nations testifies to that. The Fund, with its prescriptions for conditions under which it would make funds available, which in turn are conditions for further lending by the commercial banks, has hardly enjoyed popularity (however unjust this feeling may be) in the developing countries. In an era when democracy has seemed to be finally on the rise in Latin America, this type of austerity puts it to a rough test.

Moreover, austerity has its consequences abroad, as well as at home. It is estimated that Latin American restrictive measures have resulted in the loss over three years of some 400,000 jobs in the United States. In this situation remedies are not easy to find. In Latin America this is particularly bitter since it emerged in full flower when the world was witnessing the emergence of what have been called the NIC's—the Newly Industrialized Countries—with their promise of development and generally higher living standards. Surely, one cannot blame only or even mainly the commercial banks, though these are sometimes accused of having thrust their loans on the innocent developing nations. Nor can one fault the IMF for being hard-hearted; it cannot throw more money (a supply of which is limited) into a sinking situation, or one in which long-term remedial measures are not being taken. Nor can one merely take the Micawberish attitude—that something will turn up, and that we can merely muddle through. The figures dissuade. Nor can a simple and easy solution be devised, certainly not by me.

IV. CONCLUSION

I suggest, however, that in order to get started back on the road to economic health one must do something about the debt overhead, which threatens default and weighs heavily on the prospects for social improvements and economic expansion. Somehow, Latin America and its creditors will have to devise a method of restructuring Latin American debt. One way of doing that, unacceptable to all but Mr. Castro, is simple default. But perhaps the debts of Latin America, or at least of those countries willing and able to take rigorous steps toward their own structural reform, could be consolidated into long-term instruments. Given additional resources, the Bank could take those instruments, and against them issue Bank obligations to the commerical banks. No one would very much like that, but it may be the only alternative to default, or at least to the arbitrary capping of interest payments, or to a continuing series of "roll-overs" on a cliff-hanging basis.

The possibility of an increased aid program also exists. It would be targeted toward desirable structural adjustment in the developing countries. Concessional aid does not enjoy good press in this era of huge deficits and unmet social claims at home. But bilateral aid has some advantages over the more popular multilateral institutional aid, like that of the IDA. It would be possible, at least by using the unpopular device of tied aid, to ensure that the contributions of donor/lending countries could result in increased exports and additional jobs in those countries. Moreover, inefficiencies of the sort normally connected with tied aid would be drastically reduced if there were a substantial number of contributors. Choices would then exist for the purchasing country, and it could buy where economics and not merely the availability of funds for purchase would dictate the choice.

One thing that should *not* be done is to abandon the present system and its principles. It has served quite well—with all of the difficulties—for some 40 years. It provides a framework and a forum for sensible, and sometimes calm discussion. An anecdote which I think is relevant comes from the early days when airplanes were a rarity, and from the then sensational country-fair stunt of wing-walking. Asked whether this sport was not terribly dangerous, a practitioner of the art said, "Not too much, if you obey the first law of wing-walking: never let go of the strut you are hanging onto until you have a firm grasp of the next one."

We must make progress. But we must not relinquish our firm grip on principles and institutions which have for so long served us well.