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The Next GATT Round: Bilateralism versus Multilateralism?

by Gernot Klepper, Kiel*

A breakthrough towards the liberalization of trade in a world economy distorted by a multitude of trade barriers can only be achieved by bilateral or plurilateral negotiations, it is argued by some. The spread of bilateralism will lead to a fragmentation of world trade and the further distortion of the world economy, counter their opponents. Our author reviews some theoretical arguments in the light of historical situations similar to the present.

At the start of a new round of multilateral trade negotiations under the auspices of GATT pessimism is widespread. Countries increasingly ignore the GATT principle of nondiscrimination by signing bilateral trade treaties, while at the same time the importance of a multilateral international trading system is acknowledged. The multilateral approach has been defended among others by the GATT's "Wisemen's Group",¹ Aho/Aronson,² Baldwin,³ or Donges.⁴ Bilateral approaches have not found as many supporters among economists⁵ but have become reality in many parts of the world. Examples of regional liberalization are the EC with its free trade arrangements with the EFTA and the ACP-countries or, among developing countries, the ASEAN and the LAFTA. Recently the United States has moved towards bilateral agreements with the Caribbean Basin Initiative (CBI), the free trade arrangement with Israel, and the on-going negotiations with Canada. A group of 63 developing countries is now planning to implement a "Global System of Trade Preferences" among themselves which is supposed to go beyond the GATT system.⁶ Even more aggressive is the "reciprocity" approach⁷ which has been strongly supported by the AFL-CIO⁸ in the USA threatening trade

war if other countries do not concede reductions or removal of so-called unfair trade practices.

Whereas supporters of the multilateral approach argue that bilateral agreements will lead to a fragmentation of the world trading system and subsequently a distorted world economy, the bilateralists claim that in a world economy already distorted by multiple trade barriers ranging from tariffs to all kinds of non-tariff barriers (NTBs) only bilateral or plurilateral negotiations can bring a breakthrough towards liberalization. A tentative answer to what the most promising path towards trade liberalization might be can be found by evaluating theoretical arguments with the help of historical examples of situations similar

¹ GATT: Trade Policies for a better future – Proposals for action, Geneva, March 1985.

² Michael C. Aho, Jonathan David Aronson: Trade Talks – America Better Listen!, Council on Foreign Relations, 1985.

³ Robert E. Baldwin: Alternative Liberalization Strategies, Paper presented at the Kiel Conference on "Free Trade in the World Economy: Towards an Opening of Markets", 24-26 June 1986 Kiel.

⁴ Juergen B. Donges: The International Trading Order at the Crossroads, Working Paper No. 199, Kiel Institute of World Economics, Kiel 1984.

⁵ For an exception see Gary C. Hufbauer, Jeffrey J. Schott: Toward a Growth Round of Trade Talks, in: Economic Impact, 1986, pp. 14-21.

⁶ Frankfurter Allgemeine Zeitung of 14 July 1986: Dritte Welt will eigenes Handelsabkommen, p. 11.

⁷ See William R. Cline: 'Reciprocity': A New Approach to World Trade Policy? in: Policy Analysis in International Economics, Institute for International Economics, Washington D.C., Sept. 1982.

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to the present. In this article some of the theories on how best to achieve free trade are reviewed in the light of a few episodes from German trade history.

Germany's Trade and Tariff History

One can hardly conceive of any other area in economics where the conflict between economic insight and policy reality is more apparent than in trade policy. That free trade is a good thing, is an almost unanimously supported proposition among economists. Yet, no country – perhaps with the exception of Hongkong – follows the economists' advice. Many explanations for this divergence between theory and practice have been put forward, each of them adding to the understanding of the complexity of trade policy. However, recognizing the obstacles on the way towards a liberal international trading system does not by itself suggest ways of removing them. A look back in history shows that protection is nothing new. Therefore roads to liberalization should be analysed in a long-run perspective. Moreover, the ups and downs of protection in the last 200 years reveal important lessons. The episodes of moves towards and away from freer trade in history demonstrate the interplay of economic, political, institutional, and other factors determining the outcomes of international trading systems.

A brief look at German trade and tariff history shows that protection seems to be the norm and free trade the exception.⁹ There are two of these exceptional episodes in German trade policy. The first is the move to almost

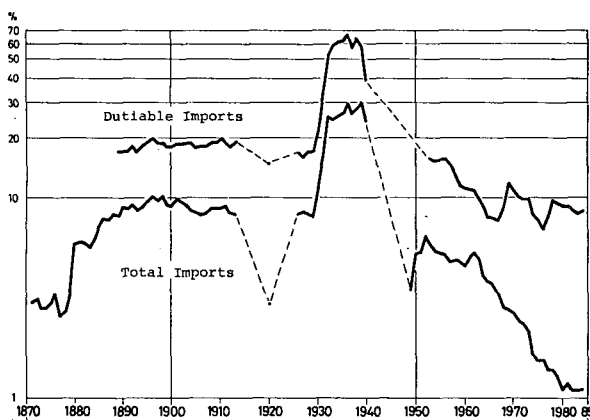
completely free trade upon the founding of the German Reich in 1871. This episode lasted only until 1879, however. The second is the return from the exorbitant tariff rates following the Great Depression to more normal tariffs after World War II. Figure 1 shows the free trade period in the 1870's and the subsequent rise to a remarkably stable level of protection thereafter. Average tariffs on dutiable imports stayed at just under 20 % from the 1880's until the 1930's. After World War II they fell to around 10 % and have remained there until the present. Because of the Common Market, intra-EC trade is not reflected in the tariffs on dutiable imports.¹⁰ The widening gap between tariffs on dutiable versus tariffs on total imports reflects the remarkable trade expansion inside the EC.

Actually, there is a third important episode in trade history which is not reflected in rapidly changing tariff rates. The oil-price shock of 1973 initiated a turbulent decade of changing relative world market prices together with a subsequent world-wide recession comparable only to the Great Depression. Yet, the reaction to this crisis was very different to that of the Great Depression when tariffs reached exorbitant levels. The spreading of the "New Protectionism" in the form of sector and country specific NTBs in that decade notwithstanding, the economic issues have apparently been more or less mastered within stable international institutions and within the national politico-economic framework without causing a breakdown of these institutions.

Figure 1 indicates a mixture of long periods of stable levels of protection and few sudden major changes. The first stable period lasted from the 1880's to the late 1920's – only interrupted by World War I and the postwar controls in Germany under the Treaty of Versailles – and the second, the period since the late 1950's, shows a slight downward trend¹¹ with some changes in the structure of protection reflecting the importance and effectiveness of domestic interest groups. The sudden changes in the level of protection on the other hand go hand in hand with dramatic changes in the international trading system. During stable times the politico-economic interpretation of protectionism seems to

Figure 1

Tariff Rates for Germany, 1871-1984^a



^a Tariffs on Petroleum are excluded after 1940.

Sources: Kaiserliches Statistisches Amt: Statistisches Jahrbuch für das deutsche Reich, various issues; Statistisches Reichsamt: Statistisches Jahrbuch für das deutsche Reich, various issues; Statistisches Bundesamt: Statistisches Jahrbuch für die Bundesrepublik Deutschland, various issues; Statistisches Bundesamt: Fachserie G, Außenhandel, Reihe 2, Ergänzungsheft, various issues.

⁸ American Federation of Labor – Congress of Industrial Organisations (AFL-CIO): Policies to Deal with Trade 'Realities', in: Economic Impact, 1986, pp. 36/37.

⁹ This is also more or less true for other countries. Great Britain in the 19th century probably was the exception for reasons discussed below.

¹⁰ The two jumps after 1965 and 1977, however, indirectly reflect the abolition of intra-EC tariffs in the EC of six and nine respectively, i.e. the peaks represent the EC trade barriers to the outside.

¹¹ With the inclusion of the so-called non-tariff barriers (NTBs) the downward trend may actually become reversed during the course of the seventies.

explain the structure of protection,¹² i.e. a system of interest groups interacting with the government determines trade policy. In contrast, the changes in the overall level of protection were influenced predominantly by international factors. This does not mean that international aspects were irrelevant in stable times. It suggests, rather, that a stable international situation acts as a constraint on interest group and government behaviour, whereas governments seeking changes in the international trading system are constrained by the power of their national interest groups.

The Task Ahead

The upcoming GATT round's agenda¹³ has a long list of critical issues, probably only a few of which will enter into the final negotiations. Considerable progress in sectors such as agriculture, textiles and services and in things such as subsidies, intellectual property, the GSP-system and, perhaps most important, the strengthening of the GATT itself would add up to a major change in the world trading system. Since previous GATT rounds have not addressed these issues in a satisfying way they can hardly serve as examples for designing strategies for the future. Yet, comparable evidence can be found by going further back in history. The three episodes of German tariff history mentioned above seem to give valuable insight into the difficulties ahead, but also indicate some avenues for progress.

Trade policy decisions depend not only on economic factors; political, ideological, and even military considerations influence them, too. Trade policy often enough becomes a substitute for classical foreign policy or even war, for which e.g. the history of economic sanctions gives abundant evidence.¹⁴ This complexity alone could serve as an explanation why economic reasoning has not led to free trade as the first best policy. In addition, trade policy has always been a major playground for interest groups, so that national policies may not follow an objective social or national welfare

function but a perceived welfare function induced by the interplay of interest groups, governments, bureaucracies, media, etc. Finally, in the international area such national goals and policies confront the independent strategic actions of other countries so that a strong game-theoretical aspect is added to the determination of trade policy measures and – beyond that – of the international trading system itself.

In bilateral or multilateral negotiations a country's situation can conveniently be described in terms of game theory. Each country faces the same international institution – be it an organisation like the UN, a treaty like GATT, or just the rules and conventions of classical diplomacy – which describes the limits and boundaries of possible actions and strategies. Within this framework national goals emerge as the result of the political process in each country. Due to the influence of special interest groups these goals often do not follow economic logic. Mercantilist positions in the trade policy history of most countries are evidence for such processes. The "New Mercantilism"¹⁵ still essentially boils down to the same logic: imports are a bad thing, exports a good thing. With such a perception of its national interest a country's trade policy runs into a decision dilemma which can be most easily illustrated by the so-called "prisoner's dilemma".

Trade Policy as a Prisoner's Dilemma

The "prisoner's dilemma" describes a situation in which – in our case – countries by following their selfish interests forgo mutual gains from cooperation, namely the gains from freer trade. The general problem can be represented in a simple matrix. There are only two countries, each having the option of choosing a policy of free trade (F) or of protectionism (P). The gains and losses of the countries are shown in the matrix with country A's payoff in the upper left-hand corner of each cell and country B's in the lower right-hand corner. The best outcome is achieved if both sides choose a policy of free trade. Yet, for each country there is only one rational choice, namely to choose protectionism regardless of

¹² Cf. Gernot Klepper, Frank D. Weiss, Doris Witteler: Protection in Germany – Toward Industrial Selectivity, paper presented at the Kiel Conference on "Free Trade in the World Economy: Towards an Opening of Markets", 24-26 June, 1986, Kiel; Doris Witteler: Tarifäre und nichttarifäre Handelshemmnisse in der Bundesrepublik Deutschland – Ausmaß und Ursachen, in: Die Weltwirtschaft, 1986, Heft 1, pp. 136-155, Tübingen; H.-H. Glismann, Frank D. Weiss: On the Political Economy of Protection in Germany, World Bank Staff Working Paper No. 429, Washington D.C., 1980.

¹³ See Michael C. Aho, Jonathan David Aronson, op. cit.; GATT, op. cit.

¹⁴ See Gary C. Hufbauer, Jeffrey J. Schott, op. cit.

¹⁵ Harry G. Johnson: Mercantilism: Past, Present, Future, in: Harry G. Johnson (ed.): The New Mercantilism, Oxford 1974.

Figure 2

		B's decision	
		F	P
A's decision	F	3 3	-1 5
	P	5 -1	1 1

what the choice of the other country is. As one can see from the matrix, it is better for A (B) to choose P over F, whether or not B (A) chooses P or F.

The dilemma is obvious: the greatest total gain is achieved if both countries choose F instead of P, but they have no incentive to do so. Consequently, the free trade option, although it is the optimum for both countries, will not materialize.

Trade Policy and Supergames

Yet the problem is not unsolvable. The incentive to choose protectionist policies must somehow be removed. Game theory provides several roads for achieving the so-called cooperative solution. One is the simple fact that such games in reality are played not once but repeatedly. In such "supergames" it may well be rational to choose free trade as long as the other country actually has done so in the past and is expected to do so in the future. Experiments have shown that strategies following four conditions are rather successful in this context:¹⁶ 1. Being "nice", i.e. cooperative, 2. "retaliatory", i.e. punish noncooperative behaviour right away, 3. "forgiving", i.e. do not punish too long, and 4. "clear", i.e. follow clear rules of behaviour.

In supergames players can build up reputations on which cooperative strategies can be selected. This is essentially the logic of the aggressive approach towards trade liberalization. The long periods of a relatively stable level of protection in the late 19th and early 20th centuries may have been the result of a mutual understanding that there would be no essential departure from the previous level of protection. This logic, however, can only explain the continuity in trade policy, but not the sudden changes.

Rapid increases in protection on an international scale can be attributed to a departure from the agreed policies by one country and subsequent retaliation on the part of the other countries. Whether this departure was initiated by dramatic internal political changes within a country, which then led to a different payoff matrix, or simply by the perceived expected gains from an – undetected and not retaliated against – optimal tariff policy can only be shown by historical analysis. The German tariff of 1879, e.g., was most likely attributable to the development of interest groups in the newly founded German Reich, together with a deep recession which gave the protectionists ample ammunition in their

claim that it was free trade that was causing the economic problems. The well researched situation during the Great Depression shows a breakdown of international cooperation together with the world-wide economic crisis.

Bilateralism at its Best and its Worst

Since in repeated prisoner's dilemma situations it is easy to fall back from cooperation to protection and mutual retaliation when the rules which have been constraining the incentives for a selfish policy break down, it is much more difficult to move from the non-cooperative equilibrium with protectionism toward the more cooperative behaviour of freer trade. In history, unilateral liberalization has not usually been practised for long by a country attempting to build a reputation as a free trader. In the 19th and early 20th centuries it was bilateral or plurilateral treaties that paved the way toward liberalization. The tariff reductions were granted under reciprocity or under a kind of conditional most-favoured-nation principle. A prime example is the liberalization in the mid 19th century. Great Britain was free trade oriented and started lowering trade barriers unilaterally. The first important trade treaty was the Cobden-Chevalier Treaty of 1860 between Britain and France,¹⁷ where Britain granted unconditional most-favoured-nation treatment whereas France did not. The economic effects of this treaty were felt immediately in the Zollverein, as German exporters to France came under competitive pressure from British goods. At the same time France had started negotiations with her neighbours on a bilateral basis which in only a matter of months led to bilateral treaties, including one with Germany. Clearly the selectivity of French trade policy together with a favourable internal situation in Germany led to liberalization. It is fair to say that if France had granted unconditional most-favoured-nation treatment freer trade would not have emerged at all or at least not as fast as it did.

Unfortunately this situation did not last very long. With the unification of Germany the ground was set for the national formation of the previously regionally dispersed industrial and agrarian interests. Important lobbies were founded in the 1870's which have shown surprising stability over the last 100 years or so. The "Centralverband Deutscher Industrieller" (CDI) continued to exist after World War I as the

¹⁶ For a brief review see: The Importance of Being Nice, Retaliatory, Forgiving and Clear, in: *The Economist*, 15. 11. 1985, pp. 89-93.

¹⁷ This treaty is itself a good example of the influence of the different factors influencing trade policy. It was Napoleon III's politico-military interests that made the treaty possible. Britain traded neutrality in the Austro-French conflict over Nice and Savoy for trade with France. Napoleon III overrode the domestic interest groups he had to deal with, which were against the treaty.

"Reichsverband der Deutschen Industrie" and, after World War II, became the "Bundesverband der Deutschen Industrie" (BDI) in 1952. The agrarian interests were unified in the "Verein der Steuer- und Wirtschaftsreformer" (1876) and, together with the "Verein Deutscher Eisen- und Stahlindustrieller" (1874), formed the iron-and-rye coalition which had enough influence in the Reichstag and the government to bring the free trade era to an end.

The bilateral treaties with all of Germany's major trading partners that brought a dramatic reduction in tariffs apparently did not restrain the politico-economic decision process inside the country from relapsing into protectionism. Of course, there still were protectionist countries like Russia and Austria which conveniently served as an argument for the installment of so-called "negotiating" tariffs. Here the argument of the multilateralists, that only an international institution, or at least a multilateral treaty, can force countries not to depart from the level of protection which has been agreed upon, seems to be supported.

Rise of Multilateralism

The level of protection established in the 1880's remained about constant until the Great Depression, despite major shifts in sectoral protection.¹⁸ The Great Depression itself ended in open trade wars by all countries. Already during World War II the USA and Great Britain developed schemes for an "International Trade Organisation" (ITO) in which they hoped to find an institution that could prevent the world from suffering another breakdown of the trading system. However, the political and economic interests inside the USA as well as in other countries were not willing to give up their freedom in trade policy matters to an international institution. Therefore the ITO never became a reality, but some important ideas were salvaged in the GATT, its cornerstone being the principle of nondiscrimination, i.e. the unconditional most-favoured-nation principle.

¹⁸ Not counting the period during World War I and the postwar period, when Germany had no sovereignty in trade matters.

The GATT's major weakness, however, is its lack of power. Since the GATT is only a treaty, the GATT Secretariat cannot act on its own; it can only serve as a negotiating table for the settling of disputes.

Despite this lack of power, the GATT provided the forum for a successful reduction of tariffs. The tariff rounds of Geneva (1947), Annecy (1949), Torquay (1950/51) and Geneva (1956), and the Dillon Round in 1961/62 brought US tariffs down to less than half their 1930 levels.¹⁹ In Germany tariff rates on dutiable imports fell to under 10 % in the mid-60's from more than 50 % in the mid-30's. The overall level of protection in Germany, measured on total imports, declined even more dramatically from over 25 % in 1932 to 4 % in 1965. As impressive as those numbers look, it is a comparison with the most unusual situation of the Great Depression. Compared to the average tariff rates in the late 19th and early 20th centuries the liberalization of trade was much less impressive, but the problem of returning from Great Depression and war-time trade relations to a functioning world trading system was successfully solved, although this was not solely the success of the GATT itself.

Need for a Hegemonic Power

The major force in establishing a liberal trading regime was the USA. As the dominating economic and military power after World War II her interests set the ground for the liberalization of the 1950's. In order to persuade other western countries, especially the European countries, which were maintaining restrictive trade controls, of the superiority of liberal trade, in the beginning the USA consciously made more tariff concessions than were offered in return by other countries.²⁰ Due to her influence most countries followed. In Germany foreign trade after 1945 was completely under the control of the Allies in the Joint Import Export Agency. The Allied High Commission had

¹⁹ See Robert E. Baldwin: The Changing Nature of U.S. Trade Policy since World War II, in: Robert E. Baldwin, Anne O. Krueger (eds.): The Structure and Evolution of Recent U.S. Trade Policy, University of Chicago Press, Chicago, pp. 5-27.

²⁰ Ibid.

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designated Germany as the leader in liberalizing intra-European trade and also supported her entering the GATT. In order to enter the tariff negotiation rounds Germany needed a new tariff code. The formulation of a rather protective tariff code, as supported by German industry and government²¹ was severely restricted and changed by the Allied High Commission.

Again the whole process of liberalization after World War II very much depended on the hegemony of the USA. At least in the early years the US administration had the international influence and the political support in Congress to take the role of leader and – most importantly – have other countries following for whatever reasons. However, the consecutive liberalization rounds became more and more difficult. Internal opposition in the USA against across-the-board liberalization weakened her leadership in the negotiations. In addition, the multilateral negotiations proceeded on a tariff line-by-line basis, a very time-consuming and complicated process which was finally given up in the Dillon Round. The Kennedy Round then brought about one more tariff reduction, this time on a linear basis. With the decline of American hegemony the GATT's role as an institution to negotiate trade liberalization faded.

This process has not stopped yet. The Tokyo Round was, despite some tariff cuts, a disappointment since more and more countries adopted policies which were not in accord with the GATT principles of "tariffs only" and nondiscrimination. There have been increases in discriminatory trade policies, in voluntary export restraints (VER's) and orderly marketing agreements (OMAs); subsidies have increasingly been used as trade policy measures. In addition the internal settlement procedures are hardly ever used; trade conflicts take place outside the institution which was designated to prevent or resolve such conflicts.

Multilateralism Preserving Status-quo

This account is contrasted by the fact that world trade has been flourishing, in fact it has been growing faster than world production since World War II. The world trading system has shown great stability over almost 40 years despite structural changes and an economic crisis comparable only to the Great Depression. After the oil-price shock the world economy had to face sharply changing relative prices and a subsequent world-wide recession. Yet no country completely broke with the international rules, and the GATT system remained

intact. It appears that the GATT system is rather successful in defending a liberal trading system, but has not made progress in attacking the remaining fields where trade is still controlled such as textiles, services, technology etc. or the new forms of protection generally headed under the term NTB's. Another look at the game theory presentation of the problem will illustrate why this might be so.

In the simple version of the repeated prisoner's dilemma presented above the incentives for moving from the noncooperative Nash-equilibrium in the lower right-hand corner of the payoff matrix with both countries pursuing protectionist policies to the Pareto-optimum of free trade policy, i.e. the upper left-hand corner, are entirely different from those for moving in the opposite direction. If both countries follow an already agreed-upon policy of free trade, there is no incentive to depart from this policy since the other country will retaliate in subsequent periods, such that the short-run gain of protection without retaliation, i.e. the payoff in the lower left-hand or upper right-hand corner, is less than the subsequent losses from a trade war. This situation might change, however, if one country perceives the short-term gains to be larger than the costs of potential retaliation. This could happen when domestic interest groups are influential enough to change the values attached to different policies, i.e. the perceived payoffs of different strategies.

If, on the other hand, both countries are following protectionist policies, there is no incentive for any of them to move towards a strategy of free trade. It would always run the risk of ending up in the worst possible situation of being exploited by the other country. Hence, for a move towards free trade something more is needed. It cannot be the reputation of a free trader which was alluded to as a stabilizing principle in supergames, since such a reputation has to be built up in the process itself. In most historical instances it was a dominating country that was able to employ political pressure or to have enough resources to compensate or "bribe" another country to follow her change in strategy. This was the case in the formation of the German Zollverein by Prussia, as well as in the Cobden-Chevalier Treaty, where Great Britain lowered its tariffs below its likely optimal tariff level,²² and the first GATT rounds with the USA making more concessions than her trading partners.²³ In all these cases a first step by a hegemonic

²¹ Ludwig Erhard: Deutschlands Rückkehr zum Weltmarkt, Düsseldorf 1954.

²² Donald N. McCloskey: Magnanimous Albion: Free Trade and British National Income, 1841-1881, in: Explorations in Economic History, Vol. 17, 1980, pp. 303-320.

²³ See Robert E. Baldwin: The Changing Nature . . . , op. cit.

power with the ability to make credible threats was needed to establish a new equilibrium.

This asymmetry between a move away from protection and a move towards protection becomes more distinct when not only bilateral but plurilateral or multilateral relations are considered. Once a number of countries have agreed on a liberal trade policy, the incentives for each member of the agreement depend on the number of countries involved. The gains from free trade increase with the number of countries. And the gains from protection against one country become relatively small. But most importantly, if the departure from free trade by one country is retaliated against by all other countries, the cost of protection to that country can become very large. Hence, the incentive for deviating from a liberal trade policy diminishes the more countries are involved in the agreement.

This illuminates the strength of the GATT system. If one country raises its trade barriers, it must do so against all members according to the unconditional most-favoured-nation principle and, at the same time, runs the risk of retaliation by all members and eventually the exclusion from the GATT. The incentives for moves away from the status quo to more protection are turned into disincentives. Even the depression and the need for structural adjustment after the oil-price shock did not seem to be worth the price of openly breaking with the GATT system. Of course, a considerable grey area remained and it was there that additional trade barriers were erected.

Multilateralism without Hegemony

Looking at the opposite side, i.e. moves towards more liberal trade policies, the problem becomes increasingly difficult as the number of countries involved increases. In the presence of a power with hegemony, initiating liberalization requires the ability of this country to find a feasible compromise for all countries involved. As in the bilateral case, success depends on its political influence, its resource availability for compensating potential losers, or its power to press for cooperative behaviour. The more countries are involved, the more hegemonic initiative and resources may be required. It is not only the fact that the number of countries matters, but with more countries trade negotiations have to take into account more diversity and more special national interests.

In contrast to this need for a strong hegemony in a multilateral institution such as GATT, the leading role of the USA has been declining steadily since the 1950's, and with this came the standstill in the liberalization of the world trading system. Without the USA pressing for

a successful negotiating round each country will try to maintain a free-rider position and wait for commitments by others before it will be willing to contribute to any compromise. The situation at the beginning of the preparations for the next GATT round is exactly this: nobody wants to move first. If the situation today resembles that of the game theory explanation illustrated here, there is not much hope for more than some cosmetic changes in the world trading system in this GATT round. The strength of the GATT in securing the status quo is at the same time its weakness since it makes it difficult to move to another, better status quo.

A Proposal for Amending GATT Principles

There is, however, no need for pessimism. Recent developments have already shown which way economic reality has forced governments to go. Bilateral and plurilateral liberalization – from the EC to the most recent developments mentioned at the beginning of this article – are evidence for the ability to proceed without the constraints of the most-favoured-nation principle and nondiscrimination. Since these developments take place outside GATT rules, they are a potential danger to the GATT system, but they are not necessarily a danger to the idea of a liberal trading system. In order to save the best of both worlds it might be worthwhile to think about amending the GATT principles in the following way:

- ☐ The unconditional most-favoured-nation principle remains intact for all existing tariffs and for any increase in tariffs or non-tariff measures.
- ☐ For lowering or removing tariff or non-tariff barriers countries are allowed to choose the conditional most-favoured-nation principle with free entry for any country willing to join.

With this construction the safeguards against a return to protection are maintained while countries willing to move towards free trade are given the opportunity to join a liberalization club²⁴ and to create incentives for other countries for joining their club inside the GATT framework.

There will be discrimination against some countries through different trade barriers but these will act as an incentive to enter liberalization clubs and will therefore eventually disappear. The free trade era of the 1870's may serve as an example for these incentives and as a lesson to maintain the rules safeguarding us from a return to protectionism.

²⁴ See Herbert Giersch: Perspectives on the World Economy, in: Weltwirtschaftliches Archiv, Vol. 121, No. 3, 1985, pp. 409-426.