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## BOOK REVIEWS

**TRADE POLICIES FOR A BETTER FUTURE: THE 'LEUTWILER REPORT', THE GATT AND THE URUGUAY ROUND.**  
Dordrecht, The Netherlands: Martinus Nijhoff Publishers, 1987.  
Pp. vii, 174. \$52.50.

*Reviewed by Professor Patrick Conway\**

*Trade Policies for a Better Future: the 'Leutwiler Report', the GATT and the Uruguay Round* is a collection of essays documenting the need for revision and clarification of the present rules governing international trade defined in the General Agreement on Tariffs and Trade (GATT). There are both economic and legal reasons for such revisions, and this volume presents them carefully in a prose nearly free of economic jargon. It is most useful for two sets of readers: those interested in the genesis and shaping of the Uruguay Round, and those looking for a non-technical introduction to the economic issues underlying the most recent calls for reform of the GATT.

This book contains three largely independent sections. The first section consists of a reprinting of the Leutwiler Report on the status of the GATT, preceded by an introductory note. The Leutwiler Report, published in 1985, was officially entitled *Trade Policies for a Better Future*.<sup>1</sup> The Director-General of the GATT commissioned this report from a group of seven respected officials as a long-term strategy analysis, and the group responded with an incisive and comprehensive catalogue of the successes and failings of the GATT as that agreement approached its fortieth year. The second section of the book is a series of essays on the present effectiveness of the GATT as a legal and economic agreement. The authors include Leutwiler panel members Drs. I.G. Patel, Guy Ladreit de Lacharrière, and GATT staff counselor Dr. Frieder Roessler. The third section provides a history of preparatory meetings for the Uruguay Round, the text of the Ministerial Declaration of Punta del Este that inaugurated

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<sup>1</sup> TRADE POLICIES FOR A BETTER FUTURE: PROPOSALS FOR ACTION, GATT Sales No. GATT/1985-1 (1985) [hereinafter LEUTWILER REPORT]. Dr. Fritz Leutwiler was chairman of the group commissioned by the Director-General of GATT.

that round, and a brief history of the GATT. Each section can be read separately with no substantive loss.

An introductory note by Arthur Dunkel, Director-General of the GATT, suggests a chronological thread to the contributions. The Leutwiler Report identified a number of problem areas in the operation of and compliance to the GATT in the early 1980s and concluded with 15 specific recommendations for GATT reform. The essays in the second section provide more technical economic and legal detail on these problem areas. The third section observes how the recommendations of the Leutwiler Report became components of the Declaration of Punta del Este and thus items for consideration in the Uruguay Round. Mr. Dunkel has collected these essays as ammunition for the Uruguay Round negotiations.

Not mentioned in the introduction was the disappointing product of the GATT ministerial meeting of November 1982. At that time, in the face of numerous challenges to and evasions of the GATT's regulations on trade barriers, the signatories were unable to reach a consensus about what had to be done.<sup>2</sup> The Leutwiler Report and its associated technical essays represent Mr. Dunkel's briefing papers for negotiators on the benefits from a new multilateral consensus.

I organize my remarks in three substantive sections as well. In the first I discuss the Leutwiler Report in greater detail and examine the extent to which the problem areas identified by this report and subsequently scheduled for discussion in the Uruguay Round have been recognized since the GATT's inception. In the second I combine a summary of the technical papers with a discussion of the tensions between the economic and legal goals of the GATT as a framework of international trade. In the final section I present a summary of the Punta del Este declaration and an idiosyncratic forecast of the reforms possible in the Uruguay Round.

### **I. The Leutwiler Report: Back to the Future**

Readers of this volume may be surprised at the absence of a detailed introduction to the GATT. The fascinating history of this agreement is relegated to an appendix, and discussion of the goals and provisions of the GATT are scattered throughout the essays. The agreement itself is a legal code that provides a framework for coordination and regulation of international trade policy by signatories. It sets out three principles to govern international trade. First, signatories cannot discriminate among themselves in setting trade policies: this is the principle of non-discrimination. All signatories become most-favored nations (MFN) and are accorded equal and

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<sup>2</sup> For a concise discussion of this meeting, see M. CAMPS & W. DIEBOLD, JR., *THE NEW MULTILATERALISM* 29-30 (1986).

most-favorable trade policy treatment by fellow signatories. Second, signatories also promise open markets for member imports. The GATT prohibits, subject to exceptions, all forms of protection except tariffs. Finally, the GATT promotes fair trade through the prohibition of export subsidies and the provision for anti-dumping and countervailing duties in response to subsidies by trading partners. Even more important than the legal code has been the role of the GATT as a forum for the coordination of discussions on trade liberalization. These negotiations have occurred in "Rounds," with the Kennedy and Tokyo Rounds preceding the present Uruguay Round. The GATT has been quite successful over the years in codifying and liberalizing international trade. An explosion in international trade has followed, as the Leutwiler Report notes.

In contrast to this impressive history, the members of the Leutwiler panel found that by 1984 the GATT and unencumbered international trade were threatened by a number of protectionist tides. The period 1973 to 1982 had been "[t]he decade of inflation, unemployment and stagnation" for major trading countries.<sup>3</sup> The free international trade called for under the GATT would have compelled domestic structural adjustment, as economic competition placed countries in unfamiliar niches in the international trading system. This adjustment was politically impossible during the period of economic stagnation from 1973 to 1982. Signatories of the GATT responded to the increased competition with discriminatory protective trade policy measures that either qualified as "exceptions" allowed under the GATT or bypassed the GATT entirely. Since 1982, however, there has been hope for the GATT; the worldwide economic upturn made structural adjustment less costly and a return to the non-discriminatory spirit of the GATT feasible.

The Leutwiler panel concluded that structural adjustment was inevitable given the changing international economy and that free trade was the least costly means, both economically and politically, to induce this economic adjustment. The protective policies introduced by signatory countries during the preceding decade, however, had weakened the free-trade environment embodied in the GATT. Reforms were necessary in three areas. The GATT's regulations covering non-tariff barriers, subsidies, and preferential trade arrangements needed clearer and more precise definition. The MFN treatment of the GATT should be extended to new areas including agriculture, textiles, and services. Trade restrictions defined outside the GATT, including orderly marketing arrangements and voluntary export restraints, should be eliminated or redefined within the GATT. In addition, the report called for better coordination of the GATT's activities with international financial arrangements and na-

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<sup>3</sup> LEUTWILER REPORT, *supra* note 1, at 5.

tional macroeconomic policies and a renewed effort to increase trade with developing countries.

The Leutwiler Report had a clear influence on the agenda of the Uruguay Round. It is also clear, however, that many of the problems identified in the report have haunted discussion of the GATT since its inception in 1947. The U.S. Senate Finance Committee wrote in 1970, for example, that "in a number of areas the GATT is deficient and discriminatory." The Committee deplored the exceptions to MFN status accorded to preferential trading arrangements, the GATT provisions for adjustments of taxes at national borders, the provision for quotas and other special trade measures in times of balance-of-payments difficulties, and the failure of GATT to provide a guide for agricultural trade.<sup>4</sup> In his influential 1970 volume on the organization and operation of the GATT, Kenneth Dam mentions these exceptions to MFN status as well as the exceptions for developing countries as major issues for reform or extension of the GATT.<sup>5</sup> The subsequent decade of inflation, unemployment, and stagnation has intensified these concerns as individual countries took advantage of exceptions in the GATT to raise trade barriers in the interest of balance-of-payments relief.

Given that the Leutwiler Report does not for the most part identify new reforms for the GATT, the success of the Uruguay Round in implementing its proposals depends upon its message falling upon receptive ears. There is a historical precedent for success. The GATT's initial gains in reducing trade barriers occurred in the 1950s and early 1960s. Still uppermost in negotiators' minds were the "beggar thy neighbor" excesses of protectionist policies in the world economy of the 1930s.<sup>6</sup> The negotiations led to falling trade barriers and a substantial and prolonged expansion of international trade ensued. The ten years of protectionism between 1973 and 1982 bear some similarities to the period from 1930 to 1939. Participants in the Uruguay Round may find that the present world economic upturn allows a reversal of the more recent trend to protectionism in much the same way as the economic upswing in the 1950s encouraged the reduction of trade barriers.

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<sup>4</sup> SENATE COMM. OF FINANCE, 91ST CONG., 2D SESS., STAFF ANALYSIS OF CERTAIN ISSUES RAISED BY THE GENERAL AGREEMENT ON TARIFFS AND TRADE 9-10 (Comm. Print 1970).

<sup>5</sup> K. DAM, *THE GATT: LAW AND INTERNATIONAL ORGANIZATION* 247-55 (1970).

<sup>6</sup> The term "beggar thy neighbor" is attributed to Joan Robinson, a British economist.

In the United States, these restrictive policies were manifested in the Smoot-Hawley tariff which raised already high U.S. tariffs and brought worldwide retaliation against the United States. Tariff Act of 1930, 19 U.S.C. §§ 1202 -1677 (1982 & Supp. IV 1986).

## II. The GATT at 40: Economic and Legal Aspects

The essays of the second section provide the technical underpinnings necessary to evaluate the Leutwiler Report. Dr. Roessler presents an overview of the scope, limits, and function of the GATT in his essay.<sup>7</sup> One important theme emerges through the wealth of detail—the GATT is limited as a legal basis for world trade, both because of the varying commitments of countries to the components of the GATT and because of the lack of guidelines for domestic macroeconomic policy or export restrictions. Dr. Roessler ends with an intriguing interpretation of the function of the GATT as a method to tie national governments' hands in the face of domestic protectionist pressures.

Dr. Patel's essay is a curious addition to this collection. He stresses the need for national economic adjustment in response to shifting international comparative advantage. In his view this adjustment is best realized through reliance on free trade. The resulting national dislocations should be addressed through retraining policies, demand management, and sponsorship of research and development spending. Lastly, however, Dr. Patel suggests that competent domestic policy is insufficient; there must also be access to foreign markets (an assurance of "fair trade," to use the politically fashionable term). The curiosity is not in these sensible conclusions, but in his lack of reference to the GATT at any point in the essay.

Dr. de Lacharrière contributes two essays. The first discusses the role of the GATT as a legal framework for international trade, while the second examines the procedures under the GATT for conflict resolution among contracting parties. The first essay takes the perspective that a universal international trade code would be desirable, and then examines the GATT against that principle. Not surprisingly, Dr. de Lacharrière finds the GATT wanting: there are too many non-signatories (and those that reserve the right to violate one or more codes of the agreement), there are too many exceptions made to its rule among signatories (common markets, developing countries), and the liberal practical interpretation of the codes has led to disregard of the law in certain areas (e.g., the Multi-Fiber Arrangement). Thus, despite the recent success in revising the GATT and extending it to new areas of traded goods, the relaxation of legal standards is such that "[t]he GATT therefore seems in danger of having moved from pragmatism to eclecticism or even agnosticism pure and simple."<sup>7</sup>

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<sup>7</sup> TRADE POLICIES FOR A BETTER FUTURE: THE 'LEUTWILER REPORT', THE GATT AND THE URUGUAY ROUND 114 (1987).

Despite this non-adherence, Dr. de Lacharri re concludes in his second essay that "any sanctions against a contracting party would be inadvisable"<sup>8</sup> since it would both de-liberalize trade and be largely ineffective. Rather, he urges that the machinery for dispute settlement be improved. The first step in this improvement is the better specification of the trading rules of GATT, for if there is agreement on rules then fewer disputes will occur. The second step is a regularization of the officials overseeing dispute settlement, either through explicit creation of a GATT tribunal or through a systematic reappointment of panel members to hear such disputes.

Comparing the subject matter and recommendations of the Patel essay with the others of this section provides a useful insight to the approach of economic and legal scholars to the issues of the GATT. Dr. Patel is most clearly concerned with structural economic adjustment in the world economy. He sees fair trade as one means for generating that adjustment and recognizes the need for harmonization of international trade, international finance, and macroeconomic policies. The GATT presumably serves to ensure that trade is "fair." The other authors take a legal perspective and examine the GATT as a trading environment and an end in itself.

The GATT has never been tremendously successful as a legal code, if success is measured by unquestioned adherence. As Harald Malmgren stated nearly two decades ago:

The problem of the effectiveness of the GATT is not really a problem of its provisions, nor of its flexibility. Rather, the difficulties of recent years arise out of a failure to enforce the provisions and out of a failure of the major countries to take up major issues in the GATT.<sup>9</sup>

Drs. Roessler and de Lacharri re provide corroboration of this statement for the 1980s. The GATT, nevertheless, has been tremendously successful as a channel for trade liberalization, as the evidence of the Negotiating Rounds indicates. Is there a contradiction here?

I think not. Dr. Patel notes the importance of fair trade to structural adjustment and economic recovery. Economists have recently recognized what negotiators have known all along: countries can be made better off acting in concert when the identical policy taken unilaterally can make the country worse off. Tariff reduction is a good example of this principle, and the GATT has provided the channel for concerted tariff reduction. Dr. Patel does not mention the obverse relationship, but economic recovery and growth do make the adjustment process to fair trade less painful to the domestic

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<sup>8</sup> *Id.* at 129.

<sup>9</sup> Malmgren, *The International Organizations in the Field of Trade and Investment*, in UNITED STATES INTERNATIONAL ECONOMIC POLICY IN AN INTERDEPENDENT WORLD 432 (Commission on Int'l Trade 1971).

economy. In the stagflationary economic environment of the 1970s, it was inevitable that domestic economies would balk at the adjustments called for by free trade. Exceptions to and subversion of the GATT were thus also inevitable.

The goal of the GATT in that instance should be to channel such protectionist pressures into the least disruptive form. A case in point is the relative importance attached to tariff and non-tariff barriers in the GATT code. As Kenneth Dam notes, the initial signatories meant for non-tariff barriers to be eliminated immediately and therefore did not make them an article for negotiation.<sup>10</sup> The end result, however, has been to channel protectionist pressure into these relatively inefficient means of restricting trade. It is revealing that the economists' advice for liberalizing an economy begins with the translation of quotas and other non-tariff barriers into equivalent tariffs and then the gradual elimination of those tariffs. The GATT's strictures work in precisely the opposite direction.

Economists, perhaps more than legal scholars, also stress the interdependence of the GATT with the other frameworks of international trade and payments. The original signatories framed the GATT as adjunct to the Bretton Woods agreement on international trade and financial coordination. That agreement set up both an international regime of fixed exchange rates and the International Monetary Fund (IMF) as a consultative and financing body for countries with balance-of-payments difficulties. The GATT was consistent with this system by allowing countries in difficulty to impose quantitative restrictions on trade while negotiating an appropriate revaluation of the fixed exchange rate to restore external balance. The original signatories to the GATT recognized that any agreement that did not permit trade policy responses to macroeconomic imbalances would soon be superseded or ignored.

The Bretton Woods regime of fixed exchange rates is now ancient history, replaced by a system of flexible exchange rates "managed" by domestic central banks. The GATT soldiers on, but to remain effective must admit these changes in environment. Most importantly, international trade in goods and services is now dwarfed by international trade in financial assets.<sup>11</sup> As the United States observed from 1981 to 1985, policies that attract foreign financial capital can lead to exchange rate appreciation and persistent deficits in goods and services trade. There is no international transactions imbalance, so economies do not automatically adjust to eliminate the

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<sup>10</sup> K. DAM, *supra* note 5, at 150.

<sup>11</sup> As Wilfred Ethier notes, the average daily transactions turnover on foreign exchange markets worldwide exceeds \$200 billion. This is twenty-five times as great as the average daily value of world exports of goods and services. W. ETHIER, *MODERN INTERNATIONAL ECONOMICS* 482 (1988).

deficits. The trade deficits lead to increased domestic pressure for trade restrictions.

When the GATT is placed within the context of this global explosion of international financial flows, it becomes clear that the tail is now wagging the dog. Imbalances in international financial flows cause compensatory movements in the exchange rate, and these movements lead to persistent trade imbalances. The imbalances in turn breed protectionist sentiment among residents of the deficit countries. An effective GATT must then be linked with an international framework that dissipates the impact of such destabilizing financial capital flows.

### **III. The Declaration of Punta del Este and the Prospects for Reform**

The Declaration of Punta del Este in September 1986 set the agenda for the Uruguay Round. The range of topics for discussion is dramatic: tariff reduction, non-tariff barrier reduction, a return to MFN treatment in textiles and clothing, trade liberalization in tropical products and natural-resource based products, and coverage under the GATT for trade in agricultural products and services.

We have become spoiled by the success of negotiations within the GATT during previous rounds and expect the Uruguay Round to produce similarly striking agreements for the liberalization of trade. The signing of agreements in these areas and adherence to them once signed, however, will depend upon two events quite distant from the negotiating table. If these two preconditions are not met, I suggest that reform will be painfully difficult in the Uruguay Round and will have little impact on international trade policy.

First, the world economic upturn must continue. It is politically much easier to reduce protectionism in a growing domestic economy, especially when the ability to export is widely seen as a stimulus to that growth. The costs of structural adjustment must be offset by the promise of participation in a growing world economy. Without growth, we will observe a recurrence of the protectionist pressures of the 1970s cited in the Leutwiler Report.

Second, major trading countries must better harmonize their macroeconomic policies. It is unrealistic to expect signatories of the GATT to adhere to its provisions in the face of severe trade deficits. As a replacement for the macroeconomic adjustment mechanisms provided by the Bretton Woods system, the major trading countries must reach agreement on monetary and fiscal policies. The goal of this agreement should be to minimize the volatility of financial capital flows, and thus stabilize the exchange rate and the relative price of traded goods around a sustainable macroeconomic and balance of payments equilibrium.

These preconditions are presaged in the Leutwiler Report. Its last recommendation states that:

The health and even the maintenance of the trading system, and the stability of the financial system, are linked to a satisfactory resolution of the world debt problem, adequate flows of development finance, better international coordination of macroeconomic policies, and greater consistency between trade and financial policies.<sup>12</sup>

This recommendation is one of the few that did not appear in the Declaration of Punta del Este, but must nevertheless be in each negotiator's mind as the Uruguay Round proceeds.

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<sup>12</sup> LEUTWILER REPORT, *supra* note 1, at 49.



**UNEQUAL TRADE: THE ECONOMICS OF DISCRIMINATORY  
TRADE POLICIES. Richard Pomfret. Oxford, Great Britain:  
Basil Blackwell, 1988. Pp. x, 277. \$39.95.**

*Reviewed by Dennis Thompson\**

Richard Pomfret's book, *Unequal Trade*, draws attention to the various and growing discriminatory international trade arrangements. These agreements have resulted in the erosion of the most-favored-nation (MFN) principle which is enshrined in Article I of the General Agreement on Tariffs and Trade (GATT).

In Part I Professor Pomfret traces the gradual emergence of the MFN clause in history. The MFN principle was very alive in the 19th Century. It received a great setback, however, in the restrictive trade policies of the 1930s, which led to disastrous consequences and eventually war.

Following World War II, many politicians credited restrictive trade policies with fueling the economic depression of the 1930s. An increased desire for more equal trading conditions led to the formation of the GATT in 1947. The GATT involved acceptance of MFN treatment by all the contracting parties. Even this acceptance, however, was subject to three major exceptions: a grandfather clause permitting continuation of existing preferential arrangements, the allowance of the formations of customs unions and free trade areas, and the troublesome Article XIX provision of safeguards against market disruptions.

Since GATT was first signed, a number of multilateral discriminatory arrangements have arisen. The most significant of these are the European Community (EC) and the European Free Trade Association (EFTA). The EC has now made preferential arrangements with the African, Caribbean, and Pacific States (ACP) under the Lomé agreements, with the EFTA countries, with the Mediterranean states, and with Comecon and OPEC. It has also participated in the Generalized System of Preferences (GSP) in favor of developing countries. In addition to these multilateral schemes, many bilateral

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agreements, in particular the voluntary export restraints, have eroded the MFN system.

The United States was the principal upholder of the MFN system for a long time, but during the present decade has ceased to be its champion.

Altogether MFN trade accounts for only half total world trade. Out of \$311 billion EC imports in 1985, only the imports coming from Australia, Canada, Japan, New Zealand, South Africa, Taiwan, and the United States, amounting to \$93 billion, were on a non-MFN basis. EFTA non-MFN imports, mainly from the EC, accounted for seventy-two percent of all EFTA imports. By contrast, in the same year only ten percent of U.S. imports were on a non-MFN basis. For Japan the figure was six percent.

In Part II Professor Pomfret examines the economic effects of such discrimination. He starts with Jacob Viner's work on trade creation and trade diversion. He then makes extensive inquiries into the various fields where trade creation and trade diversion aspects of discrimination operate to evaluate the net welfare gain in each case. Professor Pomfret concludes that discriminatory arrangements are always inferior to MFN trade and adopts the Johnson, Cooper, and Massell proposition that such arrangements cannot be explained by motives which are purely economic. He also believes that discriminatory agreements do not generally lead to the net welfare gains expected of them and produce only marginally beneficial effects.

It is important, however, to make a clear distinction between those preferential arrangements which are intended to be permanent and those which need only have a transient effect. The EC and probably the Lomé agreements have come to stay, while the EC's arrangements with the Mediterranean countries and the GSP need only have transient effects if further general tariff reductions occur. The EFTA countries eventually may join the European Community.

Finally, in Part III Professor Pomfret examines why geographically discriminatory arrangements exist. France, Germany, Italy, and the Benelux countries formed the EC and became known as the "Six," and were later joined by Britain, Spain, and others to become twelve. The formation of the EC was political and would have inevitably included a common market as part of the move towards European unity, as was the case of the federations that emerged in the United States and Canada. Common economic interests, however, have functionally kept the countries of the EC united.

The formation of the European common market had historical roots in the removal of tariff barriers after World War II. When the United States implemented the Marshall Plan, it required the European countries to remove their internal obstacles to trade as a condition of receiving relief. The removal of some obstacles to trade

under the Marshall plan paved the way for the formation of the Organization for European Economic Cooperation (OEEC), which was successful in achieving convertibility of currencies. Difficulties arose in reducing tariffs and quotas because the sovereign states in Western Europe were unwilling to agree to any measures which were not in what they perceived to be their immediate self-interest. One of the essential objectives in the establishment of the EC, therefore, was to create a mechanism whereby the member states could be induced to eliminate their internal tariffs and quotas. That mechanism took the form of a timetable for the removal of tariffs which formed part of the Rome Treaty.

The establishment of the EC itself created economic gains in the world trading system. In the negotiation of the Kennedy Round, for example, the Six were acting together. The four major powers—the United States, the EC, Britain, and Canada—were able to have their representatives bargaining together as the famous “bridge four.” Such cooperation made negotiations to remove tariffs easier and consequently benefited world trade.

Professor Pomfret correctly throws doubt on the gains to the developing countries, especially producers in newly industrializing countries and consumers, from the GSP. He recognizes, however, that political demands from developing countries for preferential trading arrangements to protect their infant industries had to be taken into consideration by developed countries. The GSP was the only substantial result to come from UNCTAD I. Because the Third World demanded the GSP as a concession, developed countries were not unreasonable in agreeing to it as a form of development assistance.

The author is correct in not seeing much prospect for a return to general MFN trading, but he despairs too greatly for the future. First, more serious barriers to trade exist than preferential tariffs. Second, the prospect that the preferences may be reduced or eliminated still remains. Although *Unequal Trade* was published in 1988, Professor Pomfret makes no mention in his book of the Uruguay Round in which tariff cuts are very much an issue. In June 1988 Australia, Canada, Hong Kong, Switzerland, and some other “neutrals” tabled a proposal suggesting a tariff cutting formula of general application. The United States has since proposed that all participants should make two commitments: first, to undertake to make a certain reduction in their average tariff levels over a given period separately and in a method of their own choosing, and second, on the full binding of all tariff schedules. If *Unequal Trade* assists in this process, the author will have been well rewarded.

